International Business Acquisitions

22. MALAYSIA

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22.1 Introductory Comments

The business laws of Malaysia, like the majority of its other laws, are based on what is generally known as the common law system. This is because Malaysia was administered by the British Government and inherited much of British law.

Although Malaysia is a federation of thirteen states, its business laws are largely federal laws; the business laws thus apply throughout the thirteen states and the Federal Territory of Kuala Lumpur, Putrajaya and Labuan. Hence, except for state laws such as the land law for Sarawak and Sabah which are applicable only to those states, a potential investor need not be unduly concerned about individual state laws.

22.2 Corporate Structures

The most common vehicle used for businesses is the company limited by shares incorporated under the Companies Act 1965. Other vehicles used are partnerships and sole proprietorships. Some businesses are conducted in the name of statutory corporations but these are generally government or quasi-government owned.

Companies limited by shares are separate legal entities following the common law principle of *Salomon v. Salomon* [1897] AC 22.

22.3 Letters of Intent and Heads of Agreement

Letters of intent and heads of agreements are used in Malaysia, but not frequently. The problem with letters of intent and heads of agreement is to what extent the parties intend the document to be binding on each other. By their very own terminology, they are not meant to be binding. But it is not uncommon for some clients to request binding provisions on exclusivity or confidentiality.

Letters of intent and heads of agreement are useful for those persons who do not have full authority to commit on behalf of the companies they represent or in a situation where one party wishes to secure his position for a certain period so that he may be able to carry out due diligence, or to allow the parties time to negotiate the definitive agreement. Those persons can return to the head office with something in writing for their board of directors to consider.

Some heads of agreement allow for due diligence to be conducted and, as such, are also useful because parties can stop the deal and not proceed with a binding agreement if the results of the due diligence are unsatisfactory.

Conditional agreements are commonly used in Malaysia because of the peculiarities of local conditions. Hence, many agreements are conditional upon various governmental approvals, board approval and shareholders' approval. There will be a clause requiring the parties to seek approval within a 'cut-off' date after which the agreement lapses.

22.4 Taxes Affecting the Structure and Calculation of the Price

Malaysia does not have a full-blown system of capital gains tax. The Real Property Gains Tax Act 1976 taxes gains arising from the sale of real property or from the sale of shares of real property companies (i.e., companies which have real properties as their substantial assets). There is a technical formula to determine what a real property company is.

The rate of tax on the gains from a disposal is on a graduated formula depending on the year of disposal. The rate decreases as the years go by. The Prime Minister of Malaysia announced a revision to the formula during the 2014 Budget speech in Parliament in October 2013. For gains on properties disposed of by citizens within the holding period of up to three years, the real property gains tax rate is increased to 30%, whereas for disposals within the holding period of up to four and five years, the rates are increased to 20% and 15% respectively. For disposals made in the sixth and subsequent years, no real property gains tax is imposed on citizens, whereas companies are taxed at 5%. As for non-citizens, real property gains tax is imposed at 30% on the gains from properties disposed of within the holding period of up to five years whilst for disposals in the sixth and subsequent years, real property gains tax is imposed at 5%. Clearly then, the Real Property Gains Tax Act 1976 was enacted to discourage land speculation.

Stamp duties are payable on instruments of transfer. In a sale of shares, the instrument of transfer is the share transfer form. In the case of an asset sale, the instrument of transfer is the National Land Code 1965 Form 14A for real property or, in the case of choses in action, the assignment itself. Stamp duties are generally levied on an ad valorem basis. The rates vary. For instance, duty on share transfer forms would be 0.3% of the total consideration or the value of the shares, whichever is higher, whereas the duty on land transfer instruments may be as high as 3%.

It was also announced in the 2014 Budget speech that a goods and services tax of 6% will be implemented from 1 April 2015 to replace sales tax and service tax. The Prime Minister of Malaysia has announced that the sale, purchase and rental of residential properties as well as selected financial services will be exempted from the goods and services tax. All stakeholders will be watching with interest how the goods and services tax will finally be implemented in Malaysia.

22.5 Extent of Seller's Warranties and Indemnities

In line with international practice, it is now the norm for a due diligence to be carried out on the target to be acquired. This usually takes place upon the parties indicating seriousness in proceeding further with their negotiations. The parties may or may not have entered into a letter of intent at this stage. Sometimes, the buyer carrying out the investigation is required to enter into a confidentiality/non-disclosure agreement with the seller or the target company. The covenant would be that all information obtained during the course of the due diligence would be used only for the purpose of progressing the negotiations further and shall not in any case be disclosed to any party not involved in the negotiations. Care should also be taken to avoid a breach of insider trading laws when conducting due diligence on listed companies.

A due diligence exercise should not preclude a buyer from still seeking customary warranties and indemnities from the seller. Sometimes, a difficult seller may argue that since a due diligence investigation has been performed by the buyer's accountants and lawyers, the buyer should purchase the company or business on an 'as is where is' basis. This argument should not be accepted by the buyer because a due diligence does not necessarily disclose everything. In fact, if a cunning seller wishes to, he can quite easily hide whatever he wants to hide from the investigators. Therefore, it is always advisable for the buyer to obtain the appropriate warranties so that he has a remedy after completion but prior to the expiry of the warranty.

22.6 Liability for Pre-contractual Representations

When a formal written agreement is entered between the parties, it is difficult for one party to allege that there are other oral or written terms and conditions not contained in the written agreement. The courts will not necessarily reject a plea that there are other terms and conditions not in the written agreement, but the plaintiff will have an uphill climb to convince the courts to accept evidence not contained in the written agreement. Therefore, it is important for the parties to capture all their terms and conditions as exhaustively as possible in the written agreement. In most agreements these days, the parties will have an 'entire agreement' clause in order to exclude all other terms and conditions that are not in the agreement.

22.7 Liability for Pre-acquisition Trading and Contracts

In an asset sale, there is no liability for pre-acquisition contracts unless such contracts and the obligations thereunder are transferred/novated to the buyer. This is particularly so in the case of an acquisition of land. Malaysia adopts the Torrens system of land titles. Hence, in a purchase of land, if a search at the Land Registry reveals that there are no encumbrances or other interests registered against the land, the buyer can be said to purchase the land free from encumbrances notwithstanding, say, the seller having sold the land to another party. This is because the system of registration of title assures indefeasibility of title except where fraud, forgery or illegality is involved. As for purchase of equipment and machinery, again a buyer without notice of other claims would be able to obtain a clean title to the equipment or machinery. Sometimes, the buyer may wish to inherit some existing contract or liability; this may be achieved by novation or assignment. In the case of transferring of liability, the method is to go by novation of the liability whereby a third party assumes the liability of an earlier party with the consent of the party to whom the obligation is owed. In the case of a chose in action which is an asset and not a liability, the chose in action is transferred by way of an assignment and notice is served upon the party by whom the obligation is owed. Sometimes there may a clause restricting assignments. In such a case, the counterparty's consent must be obtained.

22.8 Pre-completion Risks

There is no common law principle which states that a party shall assume the risks of a business prior to completion. This is a matter of contract to be agreed between the contracting parties, and it is common to have negative and affirmative covenants pending completion to preserve as much as possible the state of affairs of the business. In the absence of express agreement, the courts must determine what the parties' intentions were. This is a difficult task as the decision will be based strictly on evidence. Generally, it can be argued that prior to completion, the seller assumes the risk of the business, particularly where only a deposit is paid upon signing the agreement. However, there may be situations where the buyer may wish to run the business prior to completion. In such an instance, the courts will probably transfer the risk to the buyer. In the case of a purchase of shares, the risk of the business rests with the company. Thus, the question of risks is addressed by the appropriate warranties in the sale and purchase agreement, for instance a warranty to say that the company's net tangible assets shall not be less than a certain amount on completion.

In Malaysia, it is common to have the agreement of sale conditional upon the approval of various governmental authorities. Depending on the types of approvals sought, the process can take a few months to complete. Hence, it is often necessary to control the direction or business of the company during this period of waiting for approvals. This can be achieved through pre-completion covenants and in some cases buyers could request the right to appoint observers to be placed in the company to monitor its activities pending completion. The issue of risks prior to completion is then most relevant.

22.9 Required Governmental Approvals

In the past, foreign investors wishing to invest in Malaysia through the acquisition or setting up of local companies and businesses were required to obtain various governmental approvals. This helped the Malaysian Government regulate the level of foreign participation and to ensure that Malaysians were not excluded from participating in local companies and businesses. However, in recent years, the Malaysian Government has announced a slew of liberalization measures, and various programmes and initiatives were launched in order to boost foreign investment in Malaysia. In April 2009, it was announced that there will be a removal of equity conditions for many services sub-sectors in the areas of health and social services, tourism services, transport services, business services, and computer and related services. Within the same month, the financial sector was liberalized when foreign equity limits were increased to 70% for investment banks, Islamic banks, insurance companies and takaful (insurance that is Shariah-compliant) operators even though the foreign equity limit for commercial banks remained at 30%. In June 2009, the Foreign Investment Committee, which was set up to ensure that local companies maintained a certain percentage of local shareholdings, was disbanded. In September 2010, the Malaysian Government launched the Economic Transformation Programme to promote economic growth.

One of the key sectors that attracts foreign investors is the manufacturing sector. Since June 2003, foreign investors have been allowed to hold 100% of the equity in all investments in new projects, as well as investments in expansion or diversification projects by existing companies, irrespective of the level of exports and without excluding any product or activity.

Nonetheless, this does not mean that the sale and purchase of companies and businesses in Malaysia are free from all governmental approvals. The type of governmental approvals required is dependent on the sector in which the company operates or the assets that are being acquired. These include:

(a) the approval of the Economic Planning Unit of the Prime Minister's Department for all property acquisitions (except for residential units) valued at Malaysian Ringgit (MYR) 20 million and more which would result in a dilution of Bumiputera interests or the interests of governmental agencies, whether through a direct acquisition or an indirect acquisition resulting in a change of control of the company which owns such property;
(b) the approval of either the Central Bank of Malaysia or the Minister of Finance for acquisitions and disposals of commercial banks, investment banks and insurance companies based on the Financial Services Act 2013 and the Islamic Financial Services Act 2013; and
(c) the equity and export conditions imposed on manufacturing companies prior to 17 June 2003 will be maintained, but companies can request that these conditions be removed and approval will be given based on the merits of each case.

22.10 Anti-trust and Competition Laws

The Competition Act 2010, which came into force on 1 January 2012, prohibits anti-competitive agreements and the abuse of a dominant position in the market. The Malaysia Competition Commission (MyCC) was set up to enforce the Competition Act 2010. The Competition Act 2010 applies to all those involved in commercial activities within and outside Malaysia except for anti-competitive practices regulated under the Communications and Multimedia Commission Act 1998 and the Energy Commission Act 2001 and those exempted or excluded. In relation to commercial activities outside Malaysia, it applies to any commercial activity transacted outside Malaysia which has an effect on competition in any market in Malaysia.

At present, there are no general merger control or notification rules in Malaysia which fall under the purview of MyCC. Nonetheless, in the context of an acquisition of a local company or business, anti-competitive concerns can still be relevant in the sense that the buyer may end up 'inheriting' anti-competitive agreements, conduct and practices of the local company or business. Buyers are advised to carry out a due diligence exercise before any acquisition so that any potential or actual anti-competitive concerns can be addressed prior to the transaction and appropriate warranties and indemnities provided for.

22.11 Required Offer Procedures

Under the Malaysian Code on Take-overs and Mergers 2010 (the '*Code*'), any person who acquires control of a public company whether listed or not is required to make a mandatory general offer for the remaining shares not owned by him. Control is defined in the Capital Markets and Services Act 2007 as the acquisition of more than 33% of the company's voting shares or voting rights. A person also triggers the obligation if he holds between 33% and 50% and acquires more than 2% of the voting shares or voting rights in any period of six months.

The offer price must not be less than the highest price paid by the acquirer in the last six months.

The Code also applies to 'downstream' companies where if there is an acquisition of the 'upstream' parent company, that acquisition gives rise to a change of control of the downstream company.

The Code represents a minefield of technicalities and a buyer who is likely to trigger the requirements under the Code is well advised to consult lawyers and investment bankers.

22.12 Continuation of Government Licences

In a share purchase, there should not be any concerns regarding the continuation of government licences because the licences remain with the target company that is operating the business. There may sometimes be change in control conditions within licences held by a company and in such an instance, the consent of the licensor should be made a condition precedent to closing or, alternatively, such condition should be removed or waived by the licensor as a condition precedent to closing, However, where the buyer is buying a business and assets, unless the licences are freely transferable, the buyer must ensure that he has obtained the licences necessary to operate the business and assets.

Thus, the buyer must determine at the outset the licences that are required to operate the business and use the assets. One example is where the buyer is looking to invest in a manufacturing company. Under the Industrial Co-ordination Act 1975, manufacturing companies with shareholders' funds of MYR 2.5 million and above or engaging seventy-five or more full-time paid employees are to apply for a manufacturing licence issued by the Ministry of International Trade and Industry (MITI). It is common to find a term in the manufacturing licences granted prior to the liberalization measures announced by the Malaysian Government that the prior written approval of MITI is required for any transfer of shares to foreign investors.

22.13 Requirements for Transferring Shares

In a private company, shares are not freely transferable. Normally, there are pre-emption clauses in the articles of association or in the joint-venture or shareholders' agreement ensuring that existing shareholders are offered the shares of the selling shareholder before they are offered to strangers. The approval of the board of directors of the target company is also required for the transfer of shares. Where a regulator or licensor has imposed a restriction on the ownership of a certain percentage of the total share capital of a company to Bumiputeras, such Bumiputera shares should be transferred only to Bumiputeras unless there are valid reasons for those shares to be warehoused prior to the finding of another suitable Bumiputera partner.

22.14 Requirements for Transferring Land and Property Leases

Malaysia has adopted the Australian system of land law, the Torrens system. This means that title to land and real property depends strictly on the registration of the title with the Land Registry. Indefeasibility of title is practically guaranteed on registration. There are limited instances in which titles can be challenged. These would relate to fraud, forgery and illegality.

The system of title by registration offers good comfort to foreign investors when purchasing land with registered title as a search at the Land Registry confirms whether the seller is the landowner.

In many instances, foreigners purchase lands from state-owned entities. These entities are set up specifically by the various states to own and develop industrial lands. As a consequence, separate titles may not have been issued for the various pieces of land. This is not something to be unduly alarmed about as suitable representations and covenants can be sought from the state-owned entity in respect of the ownership of the land or the alienation and issue of the title.

22.15 Requirements for Transferring Intellectual Property

Malaysia has a system of registration of intellectual property as in the Trade Marks Act 1976, the Patents Act 1983, the Industrial Designs Act 1996 and the Geographical Indications Act 2000. Although the Copyright (Amendment) Act 2012 had introduced a scheme whereby notification of copyright in any work may be made to the Controller of Copyright by or on behalf of the author of the work, the owner of the copyright, an assignee of the copyright or a person to whom an interest in the copyright has been granted by licence, it remains the case that there is no system of registration for copyright in Malaysia since eligible works are automatically protected under the Copyright Act 1987. Malaysia is a signatory to the Paris and Berne Conventions as well as the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement.

The transfer of intellectual property rights takes place by way of assignment as in common law. Where the intellectual property right is registrable, the assignment may have to be registered at the relevant registry. The owner of an intellectual property can license it out for a fee.

22.16 Requirements for Transferring Business Contracts, Licences and Leases

The transfer of a business takes place in various steps. First, there is a sale and purchase agreement setting the various items of the business to be sold. The saleable items are the stock-in-trade, furniture and fittings, book debts, goodwill, patents and trademarks and any other assets as appearing in the balance sheet. Usually, the purchase of a business does not involve the automatic transfer of the bank loans like overdraft and trading facilities. Such liabilities can only be novated to the buyer with the bank's consent.

As discussed in section 7 above, contracts may be novated or assigned. Licences, on the other hand, are rarely transferable and the buyer of the business and assets will normally have to apply for a new licence. Registered leases can be transferred from the existing lessee to the buyer of the lease. In such cases, as the buyer will continue with the lease, the consent of the landowner / lessor should be sought before the lease is transferred.

22.17 Requirements for Transferring Other Assets

Individual assets capable of being physically delivered (e.g., stock-in-trade) can be transferred by way of delivery. Such transfers will not be subject to stamp duty as no instrument of transfer is required to effect such transfer. Book debts can be transferred by way of assignment with notice formally given to the debtor. Asset transfers involving instruments of transfer would incur ad valorem stamp duty ranging from 1% to 3%.

22.18 Encumbrances and Third-Party Interests

A company's assets may be subject to encumbrances or third-party interests. These can be created by agreement (e.g., a charge, mortgage or an option to purchase), by operation of law (e.g., an unpaid seller's lien) or by registration in a public registry (e.g., an encumbrance affecting title to real property). The assets employed in the business may also be subject to hire purchase or leasing agreements.

A buyer for good consideration of an asset generally takes good title to the property, save where it has notice of the prior interest or where the seller does not have title to the asset.

Where the asset purchased is real property, the buyer should conduct a search at the Land Registry, and interests such as caveats, charges or liens may be determined. As certain charges created by companies need to be registered with the Companies Commission of Malaysia (CCM), a buyer may conduct a search at the CCM to check the particulars of the charges that have been created in order to determine whether a charge has been created over the asset.

As there are other interests which may not be registered or ascertainable, it is essential that appropriate and extensive warranties be obtained from the seller.

22.19 Minimum Shareholder and Officer Requirements

Every company incorporated in Malaysia must have at least two directors, each of whom has his principal or only place of residence within Malaysia (Companies Act 1965, section 122(1)).

The number of shareholders must not be less than two. There can be only one shareholder if the sole shareholder is a company. A private company cannot have more than fifty shareholders, counting joint holders as one shareholder and not counting any employee of the company or of its subsidiaries (Companies Act 1965, section 15(1)).

22.20 Non-competition Clauses

In general, restraint of trade or non-competition covenants in share or asset purchase agreements are unenforceable (Contracts Act 1950, section 28). Under this section, any agreement whereby a person is restrained from exercising a lawful profession, trade or business is to that extent void. Such covenants are often included only as a deterrent.

There are three exceptions to this prohibition. First, where a person sells the goodwill of a business, he may agree to refrain from carrying on a similar business within specified local limits, provided that the limits are reasonable. Second, in a partnership, the partners may, upon or in anticipation of a dissolution, agree that some or all of them will not carry on a business similar to that partnership within local limits which must be reasonable. Third, the partners may agree that some or all of them will not carry on any business other than that of the partnership during the continuance of that partnership.

22.21 Environmental Considerations

Malaysia has a legal framework for the protection of the environment. Penalties are imposed on companies causing damage to the environment. Directors of such companies may also be personally liable. This is usually an area for concern where the business or company acquired is engaged in the business of manufacturing and waste is produced.

Warranties in relation to compliance with environmental laws and directives issued by the Department of Environment, environmental damage and liability should always be obtained to minimize the buyer's risks.

22.22 Employee Superannuation/Pension Plans

It is compulsory for employees and employers to contribute towards the Employees Provident Fund (EPF) established under the Employees Provident Fund Act 1991. The new employer must continue to pay the minimum rate of contribution or such higher rate paid to the employees prior to the acquisition.

Some companies establish a trust or retirement scheme in addition to the EPF. Where the acquisition involves a company within a group or where assets (including employees) are acquired, the employees may no longer be eligible under the scheme. As this may amount to a variation of the employees' terms of employment, provisions must be made for the seller to compensate the employees.

22.23 Employees' Rights

Employees' rights are primarily governed by the Employment Act 1955 or by contract, in the case of employees falling outside the scope of the 1955 Act. Employment relationships are also regulated by collective agreements, awards of the Industrial Court, common law and legislation (e.g., the Trade Unions Act 1959, the Industrial Relations Act 1967 and the Employees' Social Security Act 1969).

Employees may, pursuant to the Employment Act 1955 or the terms of any collective agreement, be entitled to termination and lay-off benefits. The Industrial Courts have powers to order reinstatement or compensation in lieu of reinstatement and back wages.

22.24 Compulsory Transfer of Employees

There is no statutory requirement for the compulsory transfer of employees. In an acquisition of a business, the buyer may choose to offer employment to selected employees and the seller would normally insist that the offer be on terms no less favourable. In most cases, the liability to pay termination and lay-off benefits rests with the seller.

In an acquisition of a company, the buyer should obtain an indemnity from the seller indemnifying the buyer from and against any outstanding claims or payments from employees, including termination claims.

22.25 Tax Deductibility of Acquisition Expenses

Where the buyer is not taxable in Malaysia, the deductibility of its acquisition expenses is determined in accordance with the laws of its home country.

Acquisition expenses are deductible from the income of a Malaysian taxpayer only and to the extent that the expense was incurred in the production of income. Expenses incurred in connection with the acquisition of a capital asset are not deductible.

22.26 Levies on Acquisition Agreements and Collateral Documents

Stamp duty is payable on the instruments conveying the assets and shares. Stamp duty of 0.3% of the purchase consideration or the value of the shares, whichever is higher, is payable on the transfer of Malaysian shares, whereas ad valorem stamp duty ranging from 1% to 3% is payable on an asset purchase agreement.

Transfers of shares listed on Bursa Malaysia Securities Berhad, the stock exchange, are done using contract notes. The stamp duty payable by both buyer and seller is 0.1% up to a maximum of MYR 200, and a clearing fee of 0.03% of the transaction value is payable by both buyer and seller, up to a maximum of MYR 1,000 per contract.

22.27 Financing Rules and Restrictions

A Malaysian company obtaining credit facilities from a non-resident requires permission from the Central Bank of Malaysia if such credit facilities exceed the prescribed thresholds (presently, the equivalent of MYR 100 million in aggregate for resident companies and the equivalent of MYR 10 million in aggregate for resident individuals).

Each financial institution has its own rules for lending, but they are generally quite similar to rules practised internationally by other banks. If a project is commercially viable, many banks would willingly finance it.

The target company is not permitted to finance, or provide any form of financial assistance in connection with, the purchase of its own shares, and as such, the buyer must look for its own funding. This is not an issue in an asset purchase.

22.28 Exchange Control and Repatriation of Profits

There is no restriction on a non-resident investor repatriating funds out of Malaysia arising from the proceeds of sale of assets, or from the profits, dividends or any other income arising from investments in Malaysia. Repatriation, however, must be made in a foreign currency.

The requirements in relation to exchange control are subject to changes and amendments by virtue of exchange control circulars, notices and guidelines issued from time to time by the Central Bank of Malaysia.

22.29 Group of Companies

For income tax purposes, group companies are generally not taxed as a group. Each individual group member is treated in law as a separate legal entity. It is always a moot point whether the courts would lift the corporate veils of group companies to regard them as one single entity. Generally, the courts have approached this matter cautiously, following the common law closely. However, it is envisaged that if a holding company persistently trades by way of a pattern of using 'MYR 2' companies

(companies with only a nominal capital base that are unlikely to meet their obligations to creditors), the courts may be inclined to lift corporate veils.

There is currently only limited group relief available in Malaysia introduced by the Finance Act 2005 with effect from the year of assessment 2006. The group relief is provided to all locally incorporated resident companies under the Income Tax Act 1967 and allows 70% of a company's current year losses to be offset against the income of other companies in the same group. The relief only applies to companies with a paid-up capital exceeding MYR 2.5 million, and companies within a group must have, amongst others, a minimum of 70% ownership between them.

22.30 Responsibility for Liabilities of an Acquired Subsidiary

The liabilities of an acquired subsidiary stay with the subsidiary in line with the concept of a separate legal entity. In some instances, the previous holding company or shareholder could have executed corporate guarantees for the subsidiary. Care should be taken by the sellers of these subsidiaries to have these guarantees released prior to or on completion of the sale.

22.31 Governing Law of the Contract

As the Malaysian system of law is the common law system, most foreign investors are quite content to have their contracts governed by Malaysian law as they are familiar with the concepts.

Occasionally, foreign laws can be agreed between the contracting parties as the governing law of the agreement. The Malaysian courts do recognize the parties' choice of foreign laws, if the choice is not made *mala fide* or to avoid the operation of Malaysian law or public policy.

22.32 Dispute Resolution Options

Parties may choose to either litigate, mediate or refer disputes to arbitration. If parties choose the latter, in Malaysia, there is an arbitration centre called 'The Kuala Lumpur Regional Centre for Arbitration' (KLRCA). The KLRCA was set up under the auspices of the Asian–African Legal Consultative Organisation and has its own rules for arbitration which were adopted from the UNCITRAL Arbitration Rules with certain modifications. Arbitration is usually used when the dispute is very technical, and experts are called in to resolve the dispute.