

SHARIAH RFP MODULE 4: ZAKAT AND TAX PLANNING

1st Edition 2010

2nd Edition 2014

3rd Edition 2020

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ACKNOWLEDGEMENTS

The Malaysian Financial Planning Council (MFPC) gratefully acknowledges the numerous advice and feedback from Bank Negara Malaysia (BNM), Securities Commission Malaysia (SC), the Life Insurance Association of Malaysia (LIAM), The Malaysian Insurance Institute (MII), the National Association of Malaysian Life Insurance and Financial Advisors (NAMLIFA), life insurance companies, various organizations and individuals in developing the Shariah RFP programme.

SHARIAH RFP PROGRAMME

Module 4: Zakat and Tax Planning

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Chapter 1

Introduction to Malaysian Income Taxation

Chapter Outline:

- 16.1 Why study Taxation?
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Chapter Objectives:

Upon completion of this chapter you should have knowledge of:

- Defining the key concepts contained in the Scope of Charge
- Explaining the concept of Year of Assessment and the Basis Year associated with a particular year of assessment
- Differentiating Income from Capital Gains
- Defining the meaning of “Persons” as per ITA 1967
- Briefly explaining the concept of “Accruing in or Derived from Malaysia”.
- Identifying the four types of business that is not exempted by Para 28 Schedule 6, ITA 1967
- Classifying all the different types of income as per Section 4, ITA 1967
- Explaining the importance and significance of classifying the different types of income
- Explaining the concept of „Special Class of Income“ under Section 4A, ITA 1967
- Identifying the relevant persons who are responsible for paying taxes in normal circumstances and in special circumstances.
- Identifying the people responsible for doing all the acts and things required under the ITA 1967 in respect of companies and bodies of persons.

1.1 Why study Taxation?

Taxation affects almost every aspect of our life. Why is that? Taxation is a tax on our income or gains or goods and services, which we consume. It involves cash and therefore affects our disposable income. Money is in the middle of everything; it is the medium of exchange, a store of value and a unit of account. Therefore it affects everything and everyone. Knowing our tax system will allow us to pay our due taxes but at the same time allows us to pay no more than what is required by law. Tax planning is therefore an important module for financial planners as under our self-assessment tax system Malaysians are expected to do their own tax computations and it is the duty of a good financial planner to help the client with the client's tax compliance and look for ways under the tax system to improve the client's after-tax cash flow. The planner's job however is to educate the client and not become his tax agent. Tax agents are licensed by the Ministry of Finance to represent clients with the Inland Revenue Board.

Basic Questions an individual would ask

- Do I have to pay tax?
- When do I pay it?
- Where do I pay it?
- Who do I pay it to?
- How do I calculate the tax I have to pay?

1.2 What is the focus of this Tax Planning module?

Income taxation is the focus of this module. There are many other types of taxes. We conveniently classify them as Direct taxes and Indirect taxes. Indirect taxes refer to the tax on goods and services and taxes, which are administered by The Customs and Excise Department. It is not a tax on income but on imports, exports, manufacturing output and consumption of goods and services. It is usually based on an ad valorem (fixed percentage) rate and therefore involves little explanation or study. However, there are specialists who look for ways to save this tax based on an understanding of Customs and Excise regulations. This will not be within the scope of this module. Therefore the attention is on the provisions of the Income Tax Act (Act 53) 1967.

- The Income Tax Act 1967 will form the basis of tax computation.
- It will tell us when to pay our taxes and how much tax to pay.
- How tax is computed
- Tax rates
- Tax relief and tax credits
- Tax exemptions

Other Direct taxes under the supervision of the Inland Revenue Board will include The Stamp Duty Act, Petroleum Income Tax Act, and The Real Property Gains Tax Act (which has been repealed from 1st April 2007). However, the focus of this module is on The Income Tax Act 1967.

1.3 The starting point for studying Malaysian Income Taxation

Taxation - Scope of Charge

The first thing to note is the Scope of Charge under the Income Tax Act 1967 (hereinafter referred to as ITA 1967)

1.4 Scope of Charge

The most important section is **Section 3**, which outlines the scope of charge to income taxation. If you are not implicated or included within this section then you are outside the ambit of this tax Act.

Section 3, ITA 1967:

Subject and in accordance with this Act, a tax to be known as income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia.

Section 3B:

Notwithstanding Section 3, tax shall not be charged under this Act on income in respect of an offshore business activity carried on by an offshore company. (Offshore business activity and offshore company refer to activities in Labuan and companies registered in Labuan. At this point they are outside the scope of this study.)

It is very important to digest Section 3.

The key concepts contained in this section are as follows:

1.4.1 Income tax is paid for each year of assessment

A year of assessment is defined as „a calendar year“. Therefore tax is paid each calendar year. The basis year for each year of assessment (calendar year) is defined under Section 20. Section 20 states that “For the purposes of this Act, the calendar year coinciding with a year of assessment shall constitute the basis year for that year of assessment.” In other words the relevant basis year for a year of assessment is the same calendar year. The basis year for year of assessment 2007 is the calendar year 2007. This is the meaning of the term “current year assessment”

Before the year of assessment 2000 the basis year was the preceding calendar year. But since calendar year 2000, the basis year has changed to the current year of assessment. This produced one great difficulty. How do we compute tax on income yet to be earned or still unknown? The answer for employees has been solved since 1995; you pay tax as you earn (PAYE). For businesses you pay tax on estimated income. Hence the importance of estimation and for companies there is allowed a revision of income tax estimation in the 6th and 9th months of their financial year. One other concept associated with basis year is “basis period”.

For businesses they are allowed a basis period of 12 months ending in a basis year as the relevant period for taxation for a year of assessment. Hence companies can have their own financial year that does not have to end on 3rd of December each year. They can keep a 12-month accounting period as their basis period ending in a basis year for a year of assessment. Hence a company can have the accounting period 1st of July 2006 to 30th of June 2007 as the basis period in the basis year 2007 for the year of assessment 2007.

1.4.2 The tax is only upon income

Income is distinguished from capital gains. If I own an asset like shares or a building I can earn an income from it every year, like dividends or rent. This income is taxable each year. However, if I sell the asset I do not have the source of income anymore. The proceeds from that sale are capital in nature and therefore are not taxed. Only income is taxable. No matter how much profits or gains you made in that sale there is no tax. The income must be a regular source of revenue to the taxpayer. Dividends and rent, salary and business profits are regular sources of income or revenue to the taxpayer. We need to rely on case laws to get a clear idea of what constitutes income and capital. It is noteworthy that Malaysia never had a Capital Gains Tax and the only tax on capital gains was on real property gains. This tax has been repealed from 1st of April 2007. *Malaysia is now truly a capital gains haven.*

1.4.3 The income to be taxable must accrue in Malaysia or be derived from Malaysia

In other words income derived from outside Malaysia or not accrued in Malaysia is not taxable. There are specific provisions in the Act that describes when an income is derived from Malaysia. This has helped in deciding when an income is deemed derived from Malaysia.

- | |
|---|
| <ul style="list-style-type: none">a) Employment income – Section 13(2)b) Business income – Section 12 (1) and (2)c) Dividend income – Section 14d) Interest and royalty – Section 15e) Special class of income (Section 4A) – Section 15APensions, government and voluntary – Section 17 |
|---|

1.4.4 Received in Malaysia from outside Malaysia

Still within the scope of charge is income received in Malaysia from outside Malaysia. Although this phrase still exists within Section 3 it is rendered ineffectual by other provisions in the Act. There have been gazetted over time many provisions that touched on remittances. They sought to exempt certain categories of persons from tax on remittance. However, now the position on remittance income has been clarified within the Act itself. The following main categories of persons were exempted in stages prior to the amendment in Schedule 6.

- a) Non-resident persons
- b) Malaysian resident companies
- c) Unit trusts
- d) Resident individuals

Paragraph 28 of Schedule 6 states;

(Note: All income mentioned in the different paragraphs of Schedule 6 are exempt from tax)

<p><i>Para 28(1): Without prejudice to the provisions of Section 130, income of any person, other than a resident company carrying on the business of banking, insurance or sea or air transport, for the basis year for a year of assessment derived from sources outside Malaysia and received in Malaysia.</i></p>
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Based on Para 28 Schedule 6 all persons other than resident companies carrying on the business of banking, insurance or sea or air transport are exempt from tax on income received from outside Malaysia. This is a phenomenal change as now, except for resident companies involved in banking, insurance, sea or air transport business, Malaysians and non-resident persons are not taxed on foreign earned income remitted to Malaysia. This makes the Malaysian tax regime a *strictly territorial basis of taxation*, like Hong Kong; only Hong Kong has an even lower tax rate schedule.

1.4.5 The meaning of any person

The Act has specifically defined the meaning of a „person“.

- A person in the Act “includes a company, a body of persons and a corporation sole.”
- 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.
- A „body of persons“ means an unincorporated body of persons (not being a company), including a Hindu joint family but excluding a partnership.
- An individual is a natural person.

It is important to note that under Section 3 any person is taxable if they derive income from Malaysia. It is immaterial if they are citizens or non-citizens, resident or non-resident. And as defined a person includes artificial persons like a company or a body of persons like an association or society. So to be taxable in Malaysia it does not matter who or what you are as long as you have income derived from Malaysia.

A major point to note here is that a partnership is not a taxable entity. So Partners in a partnership are taxed as individuals having a business source like sole proprietors. Taxation of Partnerships is covered under Sections 55 to 59 in the ITA 1967.

1.4 Classes of Income

Income upon which tax is chargeable under the ITA 1967 is classified under six categories as per Section 4. A person can have more than one source of income and each source of income is classified as follows:

- S4(a)** Gains or profit from a **business**, for whatever period of time carried on
- S4(b)** Gains or profits from an **employment**
- S4(c)** **Dividends interest or discounts**
- S4(d)** **Rents, royalties or premiums**
- S4(e)** **Pensions, annuities** or other **periodical payments** not falling under any of the foregoing paragraphs
- S4(f)** Gains or profits not falling under any of the foregoing paragraphs

1.5 Special Class of Income

- Non-resident persons have a **special class of income** that is chargeable to tax.
S4A 'Special Class of Income' includes:
amounts paid in consideration of services rendered by the person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from such person;
amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;
rent or other payments made under any agreement or arrangement for the use of any **moveable property**

Such income of non-resident persons must be derived from Malaysia as described under Section 15A.

1.6 The tax to be charged

Income tax is computed on the basis of "Chargeable Income" of a person. There is a precise methodology to follow to compute the chargeable income of a person. The tax rates applicable to chargeable income are dependent on whether the person is resident or non-resident. Tax rates are specifically detailed under Schedule 1 of ITA 1967. The next important step is to determine the resident status of a person, which includes an individual or a company or body of persons. This will be the subject of the second chapter. Schedule 1 will be examined once the chapter on chargeable income is understood in Chapter 3.

1.7 Persons chargeable to tax

We have seen that tax is payable by all kinds of persons. A person includes the individual, the company, and a body of persons like trusts, associations, unions and societies. Therefore, there needs to be special provisions in the Act, to identify who is responsible for the payment of tax. This is covered in Part IV of the Income Tax Act 1967. It starts with Section 66, which states;

Section 66. Where under this Act the income of any person is assessable and chargeable to tax, that person shall, subject to this Part, be the person assessable and chargeable to tax in respect of that income.

If this were not the case an individual would be tempted to let his father or better still his Honorable Member of Parliament pay his taxes. Alas this cannot be the case and we have to be responsible for paying our own taxes. But special circumstances may exist that requires the specification of who shall pay the taxes.

Section 68: The Director General may if he thinks fit, by notice in writing appoint any person to be the agent of any other person for all or any of the purpose of this Act, and, where any person is so appointed for all those purposes, he shall be assessable and chargeable to tax on behalf of that other person.

1.7.1 Incapacitated persons

Section 69(1) Where a person lawfully having the direction, control, or management of any property or concern on behalf of an incapacitated person receives the gross income of that incapacitated person from all sources... shall be assessable and chargeable to tax in respect of that income.

Section 69(2) where there is no person assessable... the D-G will appoint an agent for the incapacitated person.

Section 69(3): Without prejudice to subsection (1) or (2), if an incapacitated person is a minor, the minor's parent or guardian shall be assessable and chargeable to tax on behalf of the minor.

Section 69(4): Nothing in this section shall prevent a minor being directly assessable and chargeable to tax.

1.7.2 Non-residents

Section 70(1): A person who is not resident for the basis year for a year of assessment shall be assessable and chargeable to tax for that year of assessment directly or in the name of any attorney, factor, agent, receiver or manager of his (whether or not these people are in receipt of any income of that non-resident person).

Section 70(2): where a partner in a partnership is not resident for the basis year for a year of assessment, his income ...shall be assessable ...to tax...in the name of:

- a) The partnership
- b) Any partner who is resident for that basis year
- c) Any agent of the partnership in Malaysia

1.7.3 Masters of ship and captains of aircraft

Section 71: The master of any ship and the captain of any aircraft...shall be deemed to be the agent of the person assessable and chargeable to tax under section 54 of the ITA 1967.

1.7.4 Hindu Joint families

Section 72: The income of a Hindu joint family shall be assessable and chargeable on the family's manager or *karta*

1.7.5 Trustees

The income of the trust body of a trust shall be assessable and chargeable to tax on the trust body...and so long as the trustees remain members of the trust body, they shall...jointly and severally be subject to all the liabilities of the trust body (as principal and representative)

1.7.6 Executors

Where an individual dies in the basis year for a year of assessment, his executors shall be assessable and chargeable to tax for that year of assessment, for the following year of assessment and for any previous year of assessment if necessary

1.7.7 Companies and bodies of persons

Section 75: ...the responsibility for doing all acts and things required to be done by or on behalf of a company or body of persons for the purposes of this Act including the payment of tax shall lie jointly and severally

- a) in the case of a company, with-
 - i. the manager or other principal officer in Malaysia
 - ii. the directors
 - iii. the secretary, and
 - iv. any person exercising the functions of any persons mentioned in the foregoing subparagraphs
- b) in the case of a body of persons, with
 - i. the manager
 - ii. the treasurer
 - iii. the secretary, and
 - iv. the members of its controlling authority

Section 75(2) **The liquidator of a company** which is being wound up shall not distribute any of the assets of the company to its shareholders unless he has made provision in full for the payment of taxes by the company.

1.7.8 Rulers and Ruling Chiefs

The income of a Ruler or Ruling Chief shall be assessable and chargeable to tax in the name of the person nominated by the Ruler or Ruling Chief for the purposes of this Act as the person executing the function of administrator of the private property of the Ruler or Ruling Chief.

1.8. Conclusion

This introduction sets the stage for the computation of income tax payable by a person. We are familiar with the term „person“. It is not just the individual. We have the job of identifying all the sources of income of a person. Each source is then classified into different types of income. The tax treatment for each class of income is different and therefore we need to classify income properly. We now need to establish the resident status of each person, as this would affect the tax rates applicable to that person and the derivation status of that income. We then need to understand the format for computing the chargeable income of a person before getting into the detailed calculation of gross income of each source of income. The Income Tax Act 1967 is very confusing and complicated. We need to take one step at a time to fully comprehend this very important text. The final picture will come together by the end of this module.

Self-Assessment Test

Q1 Explain briefly the Scope of Charge under the Income Tax Act 1967.

Q2 The following chargeable person has Malaysian source of income and foreign source of income for the basis year of 2007.

	Malaysian	Foreign	Remitted to Malaysia
	<u>Source</u> RM	<u>Source</u> RM	<u>In 2007</u>
a) Adrian (Non-Resident)	10,000	20,000	Remitted
b) Alex (Resident)	30,000	10,000	Remitted
c) Advance Sdn Bhd (Resident)	60,000	5,000	Remitted
d) Achievement Pte Ltd (Non-Resident)	40,000	40,000	Remitted
e) Anthony (Resident)	30,000	10,000	Not Remitted
f) Insurance Sdn Bhd (Resident)	900,000	100,000	Not Remitted

Required:

State whether the foreign source of income is chargeable to tax for Y/A 2007.

Q3 State the classes of income upon which income tax is chargeable. Why is this classification important?

Q4 Which of the following are **NOT** taxable under the ITA 1967?

- a) Rental Income received by a resident company in Malaysia from Singapore
- b) Air Asia profits from its operations in Bangkok
- c) Maybank profits from its branch in Tokyo
- d) MISC oil tanker profits from operating in the African coast

Q5 Persons responsible for tax matters in a company are the following except

- a) Shareholders
- b) General Manager
- c) Directors of the company
- d) Company Secretary

Q6 The following income is referred to as '**Special Class of income**'

- a) Payments for technical advice to a British resident
- b) Payments for renting a boat from a Terengganu fisherman
- c) Payments to a Singapore company for services rendered in Singapore
- d) Payments for services rendered of a technical nature by a Malaysian expert

Suggested Answers

A1 Income of a person shall be chargeable to tax under:

- a) **Territorial Basis**
Every person (other than resident companies involved in the business of banking, insurance, sea and air transports) chargeable to tax shall only be taxed on income which is derived from Malaysia.
- b) **World Scope Basis**
A resident company carrying on the business of banking, insurance, sea and air transport is chargeable to tax on income derived from wherever in the world
- c) **Derived and Remittance Basis**
Other than the four specific types of businesses (banking, insurance, sea and air transport undertakings) all other persons receiving income from outside Malaysia are exempt from tax under Para 28 Schedule 6, ITA 1967

A2	<u>Chargeable Person</u>	<u>Remarks</u>
a)	Adrian	Only Malaysian source is chargeable. Foreign source remittance is tax exempt.
b)	Alex	Only Malaysian source is chargeable. Foreign source remittance is tax exempt.
c)	Advance Sdn Bhd	Foreign source remitted would not be chargeable to tax but instead would be credited to an exempt Account from which tax exempt dividends can be paid. Only Malaysian source is taxable.
d)	Achievement Pte	Only Malaysian source is chargeable. Foreign source Ltd remittance is tax exempt.
e)	Anthony	Only Malaysian source is chargeable to tax. Foreign source is not taxable.
f)	Insurance Sdn Bhd	Malaysian source and foreign source of insurance business of a resident person is charged on world income scope basis.

A3 For classification refer to lecture notes on classes of income. It is important to classify the different types of income as the ITA 1967 tax treatment for the various classes of income is very different.

Answers: 4- A, 5 - A, 6 - A

Chapter 2

Resident Status of Individuals and Other Persons

Chapter Outline:

- 2.0 Introduction
- 2.1 The need for determining resident status
- 2.2 Resident status of companies
- 2.3 Scope of Charge
 - 2.3.1 Section 7(1A)
 - 2.3.2 S7 (1)(a) – 182 Days test
 - 2.3.3 S7 (1)(b) – Less than 182 Days
 - 2.3.4 S7 (1)(c) - 90 Days and 90 Days or Resident in 3 out of 4 Preceding Years
 - 2.3.5 S7 (1)(d) – Not in the country rule
- 2.4 To determine the resident status of companies and bodies of persons
 - 2.4.1 “Management and Control”
- 2.5 Conclusion

Chapter Objectives:

Upon completion of this chapter, you should have knowledge of:

- Explain the importance of determining resident status of individuals and companies
- Explain the magnitude of Personal Relief, Rebates and Scale Rates of Tax to the tax payable by a person
- Differentiate the concept of taxability of income of a person with the amount of taxes payable by a person with respect to resident status.
- Identify the different Sections under Section 7 as regards establishing resident status of an individual.
- Explain the concept of „temporary absence“ under Section 7(1)(b)
- Work out the resident status of individuals for each year of assessment based on the physical stay using the different provisions under Section 7(1), ITA 1967
- Explain how the resident status of companies are determined
- Explain the concept of „management and control“ and the importance of the „board of directors“ meetings to establish resident status of companies.
- Explain how resident status affects derivation of income and taxability of income in Malaysia.

2.0 Introduction

This chapter aim to highlight the importance of Resident Status of Individuals and Other Persons in the context of tax. These aspects in taxation are needed for proper advising the client. Below are the details.

3

2.1. The need for determining resident status

To be tax resident means something.

There are several important reasons to qualify as a tax resident individual.

1. The first is the availability of „Personal Relief“ to deduct against Total Income in arriving at the Chargeable Income. Tax is computed on the Chargeable Income of a person. Personal Relief refers to the deduction for self, spouse and children expenses, medical, insurance and provident fund contributions. The details regarding Personal Relief will be covered in a later chapter.
2. The second is the tax rate that is applicable to a resident individual. Resident individuals are entitled to be taxed at the scale rates of tax. The scale rates of tax are gradual rates of tax that start at 0% and moves up in stages to the highest rate of 28%. (See appendix for the Schedule on individual rates of tax.) A non-resident individual will be taxed at a flat rate of 28%. This will make a big difference in terms of taxes paid. For example, tax on a Chargeable Income of RM 100,000 at scales rates will be RM 14,475; while tax at a flat rate will be RM 28,000. Of course once the Chargeable Income is above RM 100,000 the difference will be smaller. The marginal tax rate after RM 100,000 is 27%, which is very close to the flat rate of 28%.
3. There was a third important reason for establishing the resident status – to determine the taxability of remittance income. Prior to YA2004 resident individuals were taxable on remittance income. With the revision to Paragraph 28 Schedule 6 the scope of taxation has changed. Remittance income is now not taxable except for four types of businesses – banking, insurance, sea and air transport. (The taxation of sea and air transport undertakings is covered under Section 54 of ITA 1967). Therefore resident status consideration for the taxability of remittance income is no longer important.
4. A resident individual is entitled to a rebate of RM 350 for himself and another RM 350 for his spouse if his Chargeable Income is less than RM 35,000. This rebate, which is deducted from the tax payable, is only available to residents. Non-residents are not entitled to this rebate.
5. Taxation of interest income with Malaysian banks, finance companies and other approved deposit-taking companies or persons. Resident individuals are taxed at a favorable rate of 5% on interest income that is subject to tax. This is in the form of a withholding tax by the banks. They will retain the 5% and hand it over to the Inland Revenue Board. But interest income in the main is exempted under various exemption orders. However, when taxable the 5% applies to resident individuals. This is a very favorable tax rate applicable to interest income and to resident individuals. Paragraph 33 of Schedule 6 exempts non-residents from any tax on interest income from banks and finance companies. This is a common reciprocal arrangement between countries to encourage foreign deposits in each other's country.

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6. Income from Employment exercised in Malaysia for a period or periods of less than sixty days in a basis year is exempted from tax under Paragraph 21 of Schedule 6 if the person is a non-resident. This is an interesting provision for non-residents

2.2 Resident status of companies

It is also important to determine the resident status of companies.

These are the reasons why:

1. In order to determine whether the income is derived from Malaysia.
 - a. For example Dividends are derived from Malaysia if a Malaysian resident company distributes the dividends.
 - b. Derivation of certain employment income. Under Section 13(2) ITA 1967. Directors' fees are derived from Malaysia if a Malaysian resident company pays them. Even if the director is not resident in Malaysia he is taxable in Malaysia because he has a Malaysian derived employment income
If an individual is employed in a ship or aircraft operated by a person who is resident in Malaysia then the employment income is derived from Malaysia. However, Paragraph 34 of Schedule 6 exempts the income of an individual derived from exercising an employment on board a Malaysian ship.
2. For the application of Section 108. Under Section 108 a resident company is required to deduct tax at the corporate tax rate on dividends distributed unless the dividends are exempted. Therefore if a resident company declares and distributes a Gross Dividend of RM 1,000 it has to deduct tax of 28% from the dividend. The shareholder will only receive the net dividend of RM 720. RM 280 will be deemed deducted at source for tax purposes. Dividends distributed by a non-resident company will not be subjected to this tax. Dividends distributed by a non-resident company are not derived from Malaysia and therefore are not taxable. In a later chapter we will discover that tax deducted at source from dividends will be given back to the shareholder as a set-off from his own tax payable. This is called „Section 110 set-off“. With effect from YA 2008 dividends will not be taxable. Instead the shareholders will receive net dividends that have already suffered tax at the corporate tax rate. There will not be a Section 110 set-off.
3. Only resident companies involved in banking, insurance, shipping or air transport is subject to taxation on a world income scope. A non-resident bank or insurance company will not be subject to this world income scope. They will only pay tax on income derived from Malaysia.
4. Tax incentive under the Income Tax Act 1967, such as Reinvestment Tax Allowance under Schedule 7A are granted to resident companies only. The basis of tax incentives under the Promotion of Investments Act 1986 are based on promoted activities and promoted products. The Promotion of Investments Act 1986 is not within the scope of this study.
5. Withholding taxes are an important part of the Malaysian taxation scenario. Withholding means, when the Malaysian taxpayer makes a payment to a non-resident person, he is required to withhold an appropriate amount of tax before making the full payment to the non-resident person. This means only the net amount is paid to the non-resident and the tax portion is handed over to the Inland Revenue Board. Payments to non-resident persons for certain classes of income are subject to withholding taxes at different rates. For example interest, royalty or payment to non-resident public entertainers is subject to a flat rate of 15, 10 and 15 percent respectively. Special class

of income payments to non-residents for technical service or advice is subject to a final withholding tax of 10 percent.

Therefore it is very important to know how to determine the resident status of an individual or a company. In respect of individuals the ITA 1967 uses a quantitative test calculating the number of days an individual is in the country. For companies the focus is on whether the management and control of the company or body of persons is exercised in Malaysia. So let us now get to the details of calculating resident status.

2.3 Computing the tax residence of individuals

To qualify as a tax resident, an individual must satisfy the various tests under **Section 7 of the ITA 1967**. The Act takes into consideration the number of days the individual is physically present in Malaysia.

2.3.1 Section 7(1A) provides that an individual shall be deemed to be in Malaysia for a day if he is present in Malaysia for part or parts of that day. The day begins after mid-night.

2.3.2 S7 (1)(a) – 182 Days test

This is the main provision. It states that if, „he is in Malaysia in that basis year for a period or periods amounting in all to 182 days or more. He will be resident for that basis year.

ILLUSTRATION 1

Charlie was in Malaysia for the following periods: -

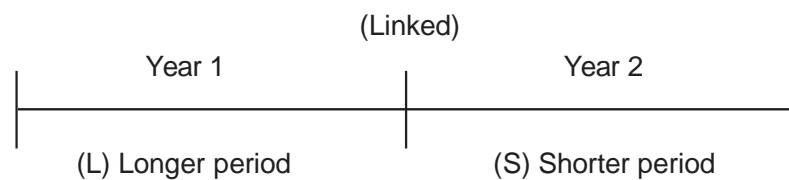
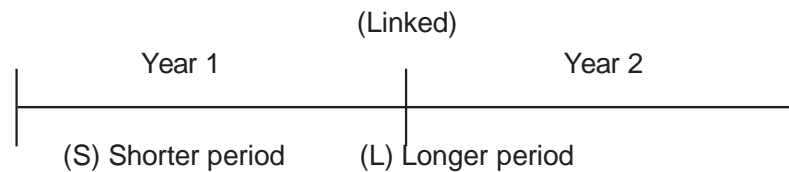
1-01-2001 to 31-07-2001	-	212 days
1-01-2002 to 30-04-2002	}	-
1-07-2002 to 31-10-2002		
		253 days

Charlie qualifies as a tax resident for Year of Assessment 2001 and Year of Assessment 2002 as the number of days in Malaysia amounted to 182 days or more in the relevant basis years.

It must be remembered that the basis year for a year of assessment is the same calendar year. Malaysia has adopted the current year assessment.

2.3.3 S7 (1)(b) - Less Than 182 Days

If he is unable to qualify under Section 7(1)(a), then he may qualify under Section 7(1)(b). To be a tax resident under Section 7(1)(b), he is in Malaysia in that basis year for a period of less than 182 days and that period is linked by or to another period of 182 or more consecutive days throughout which he is in Malaysia. The linking period applies to both the immediately preceding year and the immediately following year.

Diagrammatic presentation

S = Period of less than 182 days

L = Period of 182 or more consecutive days

The proviso to Section 7(1)(b) provides that certain temporary absences are allowed for ascertaining “the 182 or more consecutive days throughout which he is in Malaysia”. This is an important provision as it is difficult to sometimes make the 182 days consecutive stay.

The temporary absences must be for the following reasons:

- I) connected with his service in Malaysia and owing to service matters or attending conferences or seminars or studies;
- II) Owing to ill-health involving himself or a member of his immediate family; and
- III) In respect of social visits not exceeding 14 days in aggregate.

ILLUSTRATION 2

Christine was in Malaysia for the following periods:

1-12-2000 to 31-12-2000	-	31 days
1-01-2001 to 31-07-2001	-	212 days
1-01-2002 to 31-01-2002	-	31 days
1-01-2003 to 31-05-2003		
1-10-2003 to 31-12-2003	-	243 days
1-01-2004 to 31-01-2004	-	31 days

	31	212		31		151		92	31	
B/Y 2000		B/Y 2001		B/Y 2002		B/Y 2003			B/Y 2004	

B/Y = Basis Year

B/Y 2000	-	qualifies to be a resident as it satisfies the requirement under Section 7(1)(b).
B/Y 2001	-	the number of days in Malaysia in total amounting to 182 days or more qualifies for resident status under Section 7(1)(a).
B/Y 2002	-	fails to qualify as the period of less than 182 days is not connected to or joined by a period of 182 consecutive days.
B/Y 2003	-	qualifies as resident based on more than 182 days (Section 7(1)(a))
B/Y 2004	-	fails to qualify, as the linking period is less than 182 consecutive days

ILLUSTRATION 3

Charles was in Malaysia for the following periods:

1-07-2002 to 31-10-2002	-	123 days
11-11-2002 to 31-12-2002	-	51 days
1-01-2003 to 31-01-2003	-	31 days
		205 days

	123	?	51	3	
	Y/A 2002			Y/A 2003	
7(1)(a)	X			X	
7(1)(b)	X			✓	

The temporary period of absence from 1st of November 2002 to 10th of November 2002, a total of ten days, shall be accepted as temporary absence under the proviso of Section 7(1)(b). The taxpayer will have to inform Inland Revenue Board that the absence is for one of the three reasons allowed under Section 7(1)(b). There is a case law that even states that a vacation cannot be construed as a social visit. Social visits mean you are visiting someone in the other country. Charles thus qualifies as a tax resident for Year of Assessment 2003 as he is in Malaysia for 31 days and that period is linked by a period of 184 consecutive days (deemed).

For Year of Assessment 2002, Charles fails to qualify as the number of days in Malaysia in total amounted to only 174 days.

2.2.4 S7 (1)(c) – 90 Days and 90 days or Resident in 3 out of 4 Preceding Years

This section states that, „He is in Malaysia in that basis year for a period or periods amounting in all to 90 days or more, having been with respect to each of any three of four years of assessment immediately preceding the particular year of assessment, either

1. Resident in Malaysia or
2. In Malaysia for a period or periods amounting in all to 90 days or more.

ILLUSTRATION 4

Residential record of Christopher for basis years 2000 to 2004:

Year of Assessment	Period of Stay	No of Days	Resident Status
2000	1-04-2000 - 30-09-2000	183	S7 (1)(a)
2001	1-01-2001- 31-03-2001	90	NR
2002	1-01-2002 - 30-11-2002	335	S7 (1)(a)
2003	1-03-2003 - 31-10-2003	245	S7 (1)(a)
2004	1-07-2004 - 30-09-2004	92	S7 (1)(c)

Christopher is a non-resident for the basis Y/A 2001 as the period of stay does not qualify under any of the subsections in Section 7 of the Act.

However, he qualifies to be a tax resident for the basis year for the Y/A 2004 even though the period of stay is not linked to a period of 182 consecutive days. Under S7 (1)(c) the period of stay in Malaysia for the basis year for Y/A 2004 is more than 90 days and that he has been in Malaysia for 90 days or more or tax resident for 3 out of 4 preceding years of assessment

ILLUSTRATION 5

Chew has the following record of stay in Malaysia:

Year of Assessment	Period of Stay	No of Days	Resident Status
2000	1-07-2000 - 31-12-2000	184	R - S7 (1)(a)
2001	1-01-2001 - 31-01-2001	31	R- S7 (1)(b)
2002	1-01-2002 - 31-03-2002	91	NR
2003	1-03-2003 - 31-03-2003	31	NR
2004	1-07-2004 - 30-09-2004	92	R- S 7(1)(c)

Chew qualifies to be a tax resident for Y/A 2004 as he is in Malaysia for a period or periods of more than 90 days in YA2004 and he has been resident or was in Malaysia for 90 days or more in 3 out of the 4 years of assessment immediately preceding Y/A 2004.

2.2.5 S7 (1)(d) – Not in the country rule

This last rule is unusual in that an individual can still be regarded as a tax resident even if he is entirely absent from Malaysia for the whole of the calendar year in question. This arises when the individual has been a tax resident in Malaysia for the 3 immediately preceding years and is also a tax resident in the following year of assessment.

ILLUSTRATION 6

Residential record of Carol between years of assessment 2001 and 2005:

Year of Assessment	No of Days	Resident Status
2001	200	Yes, S7 (1)(a)
2002	190	Yes, S7 (1)(a)
2003	300	Yes, S7 (1)(a)
2004	-	Yes, S7 (1)(d)
2005	250	Yes, S7 (1)(a)

If Carol were in Malaysia for the above-stated periods, then for Y/A 2004 she would be considered a tax resident by virtue of S7 (1)(d).

TAX RESIDENCE OF INDIVIDUALS - SUMMARY

S 7 (1) (a)	182 days or more
S 7 (1) (b)	shorter period linked to longer period of 182 consecutive days with temporary allowances allowed as part of the consecutive period of stay.

- S 7 (1) (c) 90 days in the relevant basis year and either resident or 90 days in 3 out of 4 preceding years of assessment
- S 7 (d) not in the country or less than 90 days but the following year of assessment is resident and the three immediately proceeding years of assessment is resident.

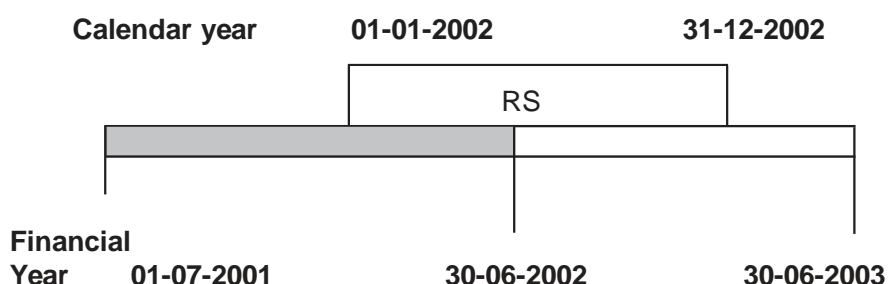
2.4 To determine the resident status of companies and bodies of persons

Section 8(1)(b) states that, a company or a body of persons carrying on a business or businesses is resident in Malaysia for the basis year for a year of assessment if at any time that basis year the management and control of its business or of any one of its businesses are exercised in Malaysia.

Section 8(1)(c) states that for any other company or bodies of persons, it will be resident if at any time during that basis year the management and control of its affairs are exercised in Malaysia.

Section 8 (2) states that once a company or body of persons is resident it shall be presumed until the contrary is proved that the company or body of persons is resident for every subsequent year of assessment.

Diagram 2.4



Basis period for a business source of income for Year of Assessment 2002 shall be from 01-07-2001 to 30-06-2002

RS: Residence status of a company does not follow the financial year-end of the company. It follows the basis year for a year of assessment, that is, for Year of Assessment 2002; it is from 01-01-2002 to 31-12-2002.

2.4.1 "Management and Control"

The expression "management and control" has not been defined under the Income Tax Act 1967. Certain case law decisions may be relied upon as to what actually constitutes "management and control".

As a general rule, the management and control of a company are normally exercised by its directors. Therefore, the place where the board of directors meet and hold their management meeting, would determine whether the management and control are exercised in Malaysia - *De Beers Consolidated Mines Ltd v Howe*

A foreign corporation carrying on trading activities in Malaysia may wish to be treated as a non-resident and can do so by ensuring that all its board meetings are held outside Malaysia. Where one of the board meetings of the company is held in Malaysia and the rest are held outside Malaysia, the company can be deemed to be a resident company because of the phrase, „at any time“. However once the management is held outside the country the company can claim itself to be non- resident.

In *American Thread Co V Joyce*, it was held that it is the directors' actions and not the shareholders' action, which usually indicate the residence status of the company.

The place where a company's central management and control are situated usually will be the place where the directors meet (that is where they hold their board meetings) to conduct the business of the company - *Koitaki Para Rubber Estates Ltd v FC of T*

The place of registration and the registered office of the company would not determine its residence status. In *Malayan Shipping Co. Ltd v FC of T*, it was held that a company incorporated in Singapore has been held to be resident in Australia for tax purposes because the company was completely managed and controlled by its Australian directors in Australia.

In *Egyptian Delta Land & Investment Co. Ltd v Todd*, it was held that a company incorporated in South Africa, which held its general meetings and kept its book of accounts there was held to be resident in the United Kingdom as the company was controlled by a majority of directors resident in London.

A company may have dual residence, that is, it may be considered to be tax resident in both countries. In *Swedish Central Railway Co Ltd v Thompson*, the court held that "a company incorporated in London to construct and operate a railway in Sweden was found to be resident in both the United Kingdom and Sweden for that purpose".

In *Bullock v Unit Construction Co Ltd*, it was held that a company might change its residence status, that is, a company may be tax resident in one year and non- resident in another year. In Malaysia, once a company is established to be tax resident for a basis year for a year of assessment, it shall be deemed to be tax resident for the subsequent basis year unless the company could prove otherwise to the satisfaction of the Director General.

2.5. Conclusion

The chapter has discussed different aspects of Resident Status of Individuals and Other Persons. Among the points discussed are: The need for determining resident status, Resident status of companies, Scope of Charge and To determine the resident status of companies and bodies of persons. These different aspects have been explained to provide a comprehensive knowledge on resident status of individuals and other person which are needed in the advise and the recommendations.

Self-Assessment

- Q1. A) An individual's tax liability is influenced by his tax residence status.

Outline the differences between a resident and a non-resident individual as regards their tax liability for Y/A 2007.

B) How is the residence status of a company carrying on a business in Malaysia determined for a particular year of assessment?

- Q2. Trevor first arrived in Malaysia on November 1, 2003 and left Malaysia permanently on August 1, 2007. His pattern of stay was as follows:-

01.11.2003	-	31.12.2003	61 days in Malaysia
01.01.2004	-	10.07.2004	192 days in Malaysia
02.09.2004	-	11.10.2004	40 days in Malaysia
03.04.2005	-	05.10.2005	186 days in Malaysia
03.04.2006	-	15.07.2006	104 days in Malaysia
18.01.2007	-	31.01.2007	14 days in Malaysia
01.02.2007	-	07.02.2007	7 days" social visit to Singapore
08.02.2007	-	30.06.2007	143 days in Malaysia
01.07.2007	-	14.07.2007	14 days business trip to Taiwan
15.07.2007	-	01.08.2007	18 days in Malaysia

Required:-

Determine his tax residence status for the Years of Assessment 2003 to

- Q3. Oxford Ltd, a non-resident company closes its account on 30th June each year. On 1 September 2007 the board of directors held their meeting in Malaysia (for the first time) for certain policy decisions.

Henry, a resident of Malaysia and Charles, a non-resident each received the following dividends from Oxford Ltd.:-

<u>Date</u>	<u>RM</u>
18 th May 2007	48,000 gross
18 th December 2007	50,000 gross

Required:-

- (a) Explain the tax implications of the 1 September 2007 board meeting of Oxford Ltd in respect of its dividend payments.
- (b) State how the meeting will affect Henry and Charles's Malaysian tax liability.

- Q4. Wayne, an Australian national, arrived in Malaysia on 11 March 2003 and left Malaysia permanently on 30 September 2008. Details of his stay in Malaysia are as follows:-

<u>Year</u>	<u>Date</u>	<u>Days</u>
2003	11 March to 6 September	180
2004	1 July to 31 December	184
2005	1 January to 5 January	5
2006	3 June to 21 August	80
	1 September to 10 October	40
2007	1 April to 10 April	10
2008	21 March to 19 May	60
	1 June to 29 September	121
	Leaves Malaysia permanently on 30 th September at noon.	

Wayne remitted to Malaysia foreign income of RM 10,000 in 2005 and RM 30,000 in 2007.

Required:-

- (a) State the resident status of Wayne for each of the years he was in Malaysia and identify the relevant section under which he qualifies?
- (b) State with reasons whether or not the foreign income remitted to Malaysia is subject to Malaysia income tax.
- (c) State the circumstances in which temporary absence from Malaysia would be accepted as part of the period of at least 182 consecutive days for purposes of determining the residence status of an individual.

Suggested Answers

- A1. a) The differences between a resident and a non-resident individual for tax purposes are as follows:-

	Resident individual	Non-Resident individual
i) Scope of charge	Income derived in Malaysia	Income derived in Malaysia
ii) Personal relief	Relief available	No relief allowed
iii) Tax rates	Subject to income tax at the graduated rates of 0% to 28%, Flat rate of 28% and Different withholding rates for other income	Subject to income tax
iv) Interest income derived from deposits with Licensed banks in Malaysia	Taxable or exempt	Exempt
v) Employment income from short-term employment of 60 days or less	Taxable	Exempted

- b) A company carrying on a business in Malaysia is resident in Malaysia for basis year for a year of assessment if at any time during that basis year management and control of its business is exercised in Malaysia.

A2.	Year of Assessment	Period	No of days in Malaysia	Residence status
	2003	01.11.2003 - 31.12.2003	61	S.7 (1)(b)
	2004	01.01.2004 - 10.07.2004	192	S.7 (1)(a)
		02.09.2004 – 11.10.2004	40 } 232	
	2005	03.04.2005 – 05.10.2005	186	S.7 (1)(a)
	2006	03.04.2006 – 15.07.2006	104	S.7 (1)(c)
	2007	18.01.2007 – 31.01.2007	14 }	S.7 (1)(c)
		08.02.2007 – 30.06.2007	143 } 175	
		15.07.2007 – 01.08.2007	18 }	

- A3. (a) As the meeting of directors was for making policy decisions, Oxford Ltd is regarded as being tax resident when the management and control was exercised in Malaysia.

As resident, the company will have to comply with Section 108 of the Income Tax Act 1967 with regard to the dividends distributed to them after the date of the meeting. This means that the company will have to deduct income tax at the company tax rate of 27% and pay only the net amount of dividends to the shareholders.

- (b) Both foreign and local investors will be charged to Malaysian tax in respect of the dividends distributed after the date of the meeting as dividends distributed by a resident company are deemed to be derived from Malaysia.

The dividends will be charged to tax at gross and Section 110 set off will be given for the tax deducted at source. Resident individuals will be subject to scale rates of tax and this means that some individuals may receive a tax credit if their tax rate is lower than the corporate tax rate whereas non-resident individuals will be taxed at a flat rate of 28%, and thus will not receive any tax credit.

A4.	(a)	Year	Residence Status	Section
		2003	Non-resident	-
		2004	Resident	7(1)(a)
		2005	Resident	7(1)(b)
		2006	Resident	7(1)(c)
		2007	Resident	7(1)(d)
		2008	Resident	7(1)(a)
		Year	Reasons	
		2004	He stayed in Malaysia for at least 182 days in the basis year	
		2005	The period of five days in the basis year was linked by a period of at least 182 consecutive days in the preceding basis year.	
		2006	He was in Malaysia for at least 90 days in the basis year and in any three out of four immediately preceding basis years he was either resident or in Malaysia for at least 90 days	
		2007	Resident in the following basis year (2008) and resident for the three immediately preceding basis years (2004 to 2006)	
		2008	In Malaysia for at least 182 days. Part of a day is regarded as one day.	

- (b) Remittance of foreign income to Malaysia is tax exempt, effective from Y/A 2004.
- (c) The circumstances under which temporary absences are allowed for Section 7(1)(b) purposes are as follows:
- Service matters, attending conferences/seminars or study abroad;
 - Ill-health involving himself or a member of his immediate family;
 - Social visits not exceeding fourteen days in the aggregate;

The 2003 Budget amended the proviso of Section 7(1) (b) where an individual need not be in Malaysia on 31 December and 1 January of the following year.

Chapter 3

Computation of Chargeable Income

Chapter Outline:

- 3.1 Introduction
- 3.2 Chargeable income of a Person
- 3.3 Exclusion
- 3.4 Computing the chargeable Income
 - 3.4.1 Gross Income
 - 3.4.2 Adjusted Income
 - 3.4.3 Statutory Income
 - 3.4.4 Aggregate Income
 - 3.4.5 Total Income (Section 44)
- 3.4. Conclusion

Chapter Objectives:

Upon completion of this chapter, you should have knowledge of:

- Know the structure for computing Chargeable Income
- Explain the acronym GASAT- (Gross. Adjusted. Statutory. Aggregate. Total. Chargeable)
- Explain the concept of Gross, Adjusted and Statutory Income
- Know where and against which income brought forward business losses are deducted
- Know where and against which income current year business losses and donations are deducted
- Know at which point Personal Relief is deducted
- Know all the Personal Relief currently available to resident individuals
- Use the tax rate schedule and calculate the tax based on Chargeable Income
- Know the rebates available to resident individuals
- Explain the different tax rates applicable to resident and non-resident individuals, companies, small-scale companies and other persons

3.1 Introduction

We have covered the scope of taxation and the residence status of a person. We understand that the tax rates and derivation of some income depends on the residence status. Now we need to turn our attention to how the tax is computed for a person. **Tax is based on a person's Chargeable Income.**

Computing Chargeable Income

- There is a precise methodology to compute the chargeable income of a person.
- It does not matter if he/she has numerous sources of income or different types of income. They follow a certain order.

Some preliminaries:

Who is the taxpayer? What year of assessment is this? What are his sources of income? For each source we have to first compute the statutory income

3.2 Chargeable income of a Person

The **Chargeable Income of a person**, upon which tax is chargeable for a year of assessment, shall be ascertained in accordance with **Section 5 of ITA 1967** as follows:

- a) first, **the basis period for each of his sources** of income for that year of assessment shall be ascertained.
- b) next, his **Gross Income from each source** for the basis period for that year of assessment, shall be ascertained
- c) next, his **Adjusted Income from each source** for the basis period for that year of assessment. shall be ascertained
- d) next, his **Statutory Income from each source** for that year of assessment. shall be ascertained
- e) next, his **Aggregate Income and Total Income** for that year of assessment. shall be ascertained
- f) next his **Chargeable Income for that year of assessment**, shall be ascertained

3.3 Exclusion

The proviso to Section 5 states that, ...in ascertaining the chargeable income of an individual resident in Malaysia, there shall be **excluded the income consisting of interest accruing in or derived from Malaysia** and received from persons referred to under Section 109C (e.g. a bank or finance company) in respect of interest paid or credited to that individual. It will be noted that such interest will be taxed at 5% and deducted at source. **Interest income received by companies is not included** in the above and will be taxed as a separate source at the prevailing corporate tax rate.

Explanations of the various descriptions of income for computing the Chargeable Income. For each source we have to compute the gross income, adjusted income and the statutory income. Only then do we aggregate and calculate the total and Chargeable Income.

3.4 Computing the chargeable Income

3.3.1 Gross Income

This is the most important category. There are specific provisions in the ITA 1967 that outlines what constitutes Gross Income for business, employment, dividends, interest, rent, royalties, pension and other classification of incomes outlined in Section 4. For each class of income we have to explore the various sections to identify Gross Income. This would be handled when we study each class of income separately in later chapters.

3.3.2 Adjusted Income

The adjusted income from each source of income for the basis period for a year of assessment is the Gross Income from each source reduced by expenditure wholly and exclusively incurred in the production of that gross income. Expenditure, which qualifies for deduction, must be revenue in nature. In addition, it should be expenditure, which is not specifically disallowed under Section 39 of the ITA 1967. A basic example of disallowed expenditure would be domestic, private and capital expenditures. The full list of disallowed expenses will be studied under the business taxation chapter.

The predominant section in this regard is **Section 33**, which is a very long provision that states that for an expense or outgoing to be allowed against Gross Income it must be wholly and exclusively incurred in the production of income, by that person for that source in that basis period. Besides looking at the various sections in the ITA we also need to explore case laws to look at various meanings of allowable expenses as determined by the courts. There will be many pages allocated to studying allowable expenses and outgoings in the chapters related to each class of income.

The adjusted income of a source is arrived as follows:

Net Income (Accounting Income)	<u>NI</u>
Add: Non-Deductible Expenditure	
(Example: Capital Expenditure)	<u>NDE</u>
Adjusted Income	<u>AI</u>

It is perhaps good to look at a few illustrations.

ILLUSTRATION 1

ABC Sdn Bhd provides you with the following computation for the year ended 31 December 2006.

	<u>RM</u>
Gross Profit before tax	100,000
Expenditure	
Revenue (Tax Deductible)	40,000
Capital in nature	18,000
Net Profit	<u>42,000</u>

However, the above computation will be adjusted as follows:

The adjusted income for Y/A 2006 can be calculated as follows:

	<u>RM</u>
Gross Income (Net Profit)	42,000
Add: Non-Deductible	
Expenditure	18,000
Adjusted Income	<u>60,000</u>

In a situation where the amount of tax-deductible expenditure exceeds the gross income, the difference will constitute an **adjusted loss**. Where there is an adjusted loss from a business source in that year of assessment, a deduction will be given in arriving at the Total Income of the person. This deduction is only allowed in the case of business losses. Losses incurred in a non-business source will not be entitled to any deduction. For example if there is a rental loss there is no deduction against other income, as in a business loss situation.

ILLUSTRATION 2

(Assumed Data)

	Business source of Income	Rental source of Income
	RM	RM
Gross Income	70,000	30,000
Tax Deductible Expenditure	90,000	40,000
Adjusted Loss	(20,000)	(10,000)
Adjusted Income	NIL	NIL
Loss relief that can be given	(20,000)	NIL

3.3.3 Statutory Income

This is a description of income, which is peculiar to income taxation only. The key issue here is about allowance for capital expenditure. Section 39 specifically disallows capital expenditure in arriving at the Adjusted Income of the person. In normal accounting, capital expenditure is depreciated over the economic life of the asset or following some accounting rules. The ITA however does not allow capital expenditure and specifically disallows depreciation as it is regarded as a provision only. A provision is not an expense incurred in the production of income. Therefore, unless specifically allowed by the ITA, all provisions are added back to net profit. However this is not fair to businesses. Therefore under the ITA 1967, under Schedule 3, capital allowances are allowed for qualifying capital expenditure. Only a business source is entitled to capital allowances. The capital allowances are separately calculated and allowed against Adjusted Income in arriving at Statutory Income. That is the story behind capital allowances and Statutory Income. However this topic gives endless problems to new students. There will be a special chapter covering capital allowances. It is required that for each source you have to compute the Statutory Income. However, capital allowances are only relevant for a business source. This would mean that for all non-business sources the Adjusted Income is the Statutory Income. For a business source however, the capital allowances are computed and deducted from the Adjusted Income to arrive at Statutory Income.

At this stage the student should understand that for a business source there is Gross Income, Adjusted Income and then Statutory Income. The study of capital allowances is left to a later stage, as it is a very detailed study that involves various assets. The rules regarding qualifying expenditure, the capital allowance rates applicable in the initial year and the following years, and what happens when the asset is sold require a detailed study.

3.3.4 Aggregate Income

The aggregate income of a person for a year of assessment shall consist of: -

- a) The **aggregate of his statutory income from business, reduced** by the amount of **brought forward business loss**
- b) The aggregate of his other sources of income; and
- c) Any additions falling to be made under Schedule 4 or 4A.

As the word suggests Aggregate Income is the addition of all his statutory incomes. However, if there are any business losses brought forward from previous years they are first set-off from the Aggregate statutory incomes from all his business sources. The net aggregate statutory incomes from business are then added to the other non-business sources to give the Aggregate Income.

Example:

Statutory Income:-

Business I	A
Business II	B
Partnership business	C
Aggregate of Statutory Business Income	D
Business loss b/f - S.43 (2)	(E)
Net Aggregate Statutory Business Income	F
Employment	G
Dividen	H
d Rental	I J

Schedule 4 (Recovered abortive prospecting expenditure. K

Aggregate Income

L

The amount of business loss brought forward of "E" is used to reduce the aggregate amount of business income of "D". It is not restricted to the same business source only. It includes the aggregate of all his statutory income from business sources. Any excess loss will be carried forward to reduce "Aggregate Statutory Business Income" in subsequent years of assessment. Distinction must be made between brought forward losses and current year or basis year losses. Brought forward losses are losses of previous years that have not been absorbed by Aggregate Income of the previous years? Current year or basis year business loss is of the current accounting period loss and is allowed against the Aggregate Income of the current year. In other words current year business loss is allowed against all incomes, the aggregate of business and non-business incomes, whereas brought forward losses are only set-off against the aggregate of statutory business income of the current year.

ILLUSTRATION

	RM
Statutory Business Income	40,000
Business Loss B/F	(50,000)
Dividend Income (Gross)	30,000

The aggregate income for that year of assessment shall be:-

Statutory Income	Business	40,000
	S.43 (2) loss B/F	(50,000)
	Amount utilised	40,000
	Net Aggregate Statutory Business Income = Nil	
	(Unabsorbed loss C/F RM 10,000)	
Net Statutory Business Income		NIL
Dividend		30,000
Aggregate Income		<u>30,000</u>

The amount of unutilised business loss brought forward of RM 10,000 shall be carried forward to reduce the aggregate statutory business income of subsequent years of assessment. It will not be utilised against the aggregate of non-business income, for example, the dividend income of RM 30,000.

We will explore in detail the methodology for calculating Chargeable Income at a later stage in this module, especially when we study the Inland Revenue Board Public Ruling on this.

3.3.5 Total Income (Section 44)

The total income of a person shall consist of the amount of his aggregate income for the year of assessment reduced by deductions allowed under Section 44 in the following order: -

- a) **Adjusted loss from a business source for the basis period;**
- b) **Abortive prospecting expenses** under Schedule 4;
- c) Certain **pre-operating expenses** incurred in respect of an approved business venture outside Malaysia under Schedule 4B.
- d) Section 44(6) - **Approved donations**
 - i **Gift of money or donation** to Government, State Government, local authority or approved institutions. However, for companies cash contributions to approved institutions is restricted to 5% of its aggregate income.
 - ii Section 44(6A) - **gift of artefact, manuscript or painting** to government. Value as determined by the Dept. of Museums and Antiques or the National Archives
 - iii Section 44(8) - **Gift of money for provision of library facilities** to public libraries / libraries of schools & institutions of higher education. Maximum RM 20,000
 - iv. Section 44(9) - **gift of money or contribution in kind for the provision of facilities in public places for the benefit of disabled persons.** Restricted to individuals and the value is to be determined by the relevant authorities
 - v Section 44(10) - **gift of money or medical equipment to healthcare facilities.** Restricted to individuals and the cost or value as certified by the Ministry of Health but **cannot exceed RM 20,000**
 - vi Section 44(11) - **gift of painting to the National Art Gallery** or any State art gallery
- e) **Group Relief** for companies (Section 44A)

There have been major changes in the application of Section 44. Losses can only be allowed if **the principal share ownership remains unchanged or at least 50% unchanged.** (Section 44 (5A), (5B), (5C) and (5D) of ITA 1967)

Group Relief for companies has been consolidated and it would require the student to spend more time to understand its full implications. A brief summary will be presented in the chapter on company taxation.

ILLUSTRATION

(Assumed Data)

	RM
Business I	
Adjusted Loss	(30,000)
Schedule 3 Capital Allowance	8,000
Rental	40,000
Approved donation	5,000

The **total income** of a person for that year of assessment shall be: -

	RM
Statutory Business Income	NIL
Schedule 3 Allowances (8,000 c/f to next year)	
Rental	<u>40,000</u>
AGGREGATE INCOME	<u>40,000</u>
S.44 (2) loss - Adjusted loss from Business source (current year)	(30,000)
S.44 (6) - Approved Donation	(5,000)
TOTAL INCOME	5,000

ILLUSTRATION

Assume that the rental income in Illustration 7 is RM 20,000 instead of RM 40,000.
The **total income** of that person shall be:-

	RM
Business Income (as above)	Nil
Rental	20,000
AGGREGATE INCOME	20,000
S.44 (2) loss (current year loss)	<u>(30,000)</u>
Total Income	Nil
Unabsorbed loss C/F to next year	10,000
Approved Donation C/F	NIL

The amount of approved donation of RM 5,000, which is not utilised to reduce the Aggregate Income, will not be allowed to be carried forward. However, the unabsorbed loss of RM 10,000 will be carried forward to reduce the Aggregate Statutory Business Income for subsequent years of assessment.

Summary of computation of Chargeable Income**Source : Business income from sole proprietorship****Gross Income** (Start with Net Profit)

Less: Allowable expenses, Double deductions, Special deductions

Add: Not allowable expenses (based on the provisions of the Act)

Adjusted Income

Add: Balancing Charge

Less: Capital Allowances,
Balancing Allowances

Statutory Income of business source**Add: Statutory Income of other business sources**

Less: Previous year business losses, reinvestment allowances

Add: Recoveries

Add: Other non-business statutory incomes

(Employment, dividend, rent, pension)

Aggregate Income**From Aggregate Income:**

Less: Current year business losses

Less: Trust annuity

Less: Approved donations (restricted to 5% of Aggregate income for companies)

Total income

Less: Personal relief for resident individuals

Chargeable income

Apply tax rates to arrive at tax payable

Deduct:

Tax rebates

Dividend set-off

Double tax relief

Tax payable

Chapter 3 - Summary

This chapter needs to be re-visited many times. In the study of Malaysian taxation the methodology for calculating Chargeable Income must be memorised and understood. This is the skeleton upon which we add the flesh. We need to identify a person's various sources of income and classify them as between business and non-business sources.

With business sources we go from Gross Income to Adjusted Income and then to Statutory Income, by allowing Capital Allowances. We then deduct any business loss that is brought forward from the previous year against the aggregate of all business sources for the year. We then add the other sources of income, which are non-business like rent, dividends and employment to the net aggregate of business income. This is called the Aggregate Income. From this Aggregate Income we deduct any current year business loss and donations, with a few other items as per Section 44. This gives us the Total Income. From the Total Income we deduct the Personal Relief available to all resident individuals. This will give us the Chargeable Income. We then apply the tax rates on this Chargeable Income.

From the tax calculated as per Schedule 1 we allow some rebates as stated in the ITA. There will also be a set-off for tax suffered on dividends. We will study this implication when we study company taxation. For some businesses there will be double tax relief if tax has been suffered in two countries. Today this applies to mainly sea and air transport undertakings and to banking and insurance companies.

We will study in detail later how to compute the Gross Income of the various sources of income, the adjusted income process, the computation of Capital Allowances for businesses, the various personal reliefs available, the application of tax rates, rebates and tax relief.

We will now study the tax rates applicable to Chargeable Income of the various persons under Schedule one, followed by a quick review of Personal Relief.

Tax Rates

Schedule 1 – Rates of Tax for Resident Individuals

Chargeable Income (RM)	Tax Rates (%)	Tax Payable	Cumulative Tax (RM)
1 to 2,500	0	0	
2,501 to 5,000		25	25
5,001 to 20,000	3	450	475
20,001 to 35,000	7	1,050	1,525
35,001 to 50,000	13	1,950	3,475
50,001 to 70,000	19	3,800	7,275
70,001 to 100,000	24	7,200	14,475
100,001 to 250,000	27	40,500	54,975
Above 250,000	28		

Corporations and trusts pay tax at the current corporate tax rate of 27% for YA 2007. Non-resident individuals pay tax at a flat rate of 28%.

Small and medium scale companies with paid-up capital of 2.5 million and below pay tax at the rate of 20% on the first RM 500,000 Chargeable Income. Thereafter, they pay tax at the current corporate tax rate of 27%.

The corporate tax rates have been reduced to 27% in calendar year 2007 and will reduce further to 26% in year 2008 and to 25% in YA 2009.

How do we use the tax schedule?

If we are to calculate the tax payable for a Chargeable Income of RM 65,000, we will do the following:

- We will go to column one and see in which tax bracket RM 65,000 falls in. In this case it is the sixth bracket, which says 50,001 to 70,000.
- We then go to the fifth bracket and column 4 and take the cumulative tax payable. This is the tax payable up to Chargeable Income of 50,000. In this case it is RM 3,475
- We then take the difference of 65,000 and 50,000 and apply the tax rate for the sixth bracket found in the second column. In this case it is 19%. Therefore we take 19% of RM 15,000 which gives us RM 2,850
- The tax payable will be the addition of the two figures 3,475 and 2,850, which gives us RM 6,325. This is the tax payable for a Chargeable Income of RM 65,000.

Go ahead; compute the tax payable for a Chargeable Income of RM 150,000. The answer is RM 27,975.

Schedule 1 has various other parts which states the tax rates applicable for different persons and types of income.

Small-scale company – 20% on the first RM 500,000 Chargeable Income and the prevailing corporate tax rate thereafter.

Co-operative societies have their own tax rate structure.

Non-resident persons who derive interest income, derived from Malaysia which are not exempted, will be taxed a withholding tax of 15%. They will pay a withholding tax of 10% on royalty derived from Malaysia. And the withholding tax rate on payments to non-resident public entertainers is 15%. The withholding tax rate on Special Class of income is 10%.

You are advised to look at Schedule 1 for the full range of tax rates applicable.

Personal Relief		
Self		8,000
Medical expenses for parents (max)		5,000
Medical expenses for taxpayer, spouse and children on serious diseases(including RM500 for medical examination expenses)		5,000
Disabled person	Taxpayer	6,000
	Spouse	3,500
Supporting equipment for disabled member of family		5,000
Wife – has no total income or elects for combined assessment		3,000
Children – all - per child		1,000
Local college 4 * 1,000		4,000
Overseas education 4 * 1,000		4,000
Life insurance premiums and EPF contributions		6,000
Insurance premiums for education or medical benefit		3,000
EPF annuity or insurance scheme		1,000
Fees for acquiring technical, vocational, industrial, Scientific or technological skills,		
Accounting, law and Islamic studies		5,000
Purchase of books, journals, magazines for family		1,000

Note

Personal Relief is often and regularly amended in the Budget. Therefore it is necessary to keep up with the changes to the ITA during the Budget announcement by the Finance Minister in September or October each year.

The rebate of RM 500 that is given for the purchase of personal computer will be amended to a Personal Relief of RM 3,000 every three years, from Year of Assessment 2007 onwards.

The relief for books and magazines has been increased to RM 1,000 from Year of Assessment 2007

The accounting profession prepares a publication every year on the recent budget changes and some other pertinent information, which is a useful booklet to have.

Tax Rebates

Tax Rebates are given as a direct set-off against taxes payable. They are therefore different from Personal Relief, which is a deduction from Total Income. Rebates directly reduce taxes. There are three common rebates.

1. **A Basic Rebate of RM 350 each to taxpayer and wife if the Chargeable Income of the taxpayer is less than RM 35,000.**
2. **Rebate for *zakat* and *fitrah* or any other Islamic religious dues which is obligatory, paid in the year, evidenced by receipt by appropriate religious authority.**
3. **Rebate of RM 500 to an individual for the purchase of personal computer once in five years. This rebate has now been converted into a Personal Relief for computers of RM 3,000 once every three years. For higher tax bracket taxpayers this would be a better benefit.**

With these basic issues handled we are now ready to walk into the details of Malaysian taxation. We will now examine the various sources of income.

3.4. Conclusion

The chapter has discussed different aspects of Computation of Chargeable Income. Among the points discussed are: Chargeable income of a Person, Exclusion and Computing the chargeable Income which includes Gross Income, Adjusted Income, Statutory Income, Aggregate Income and Total Income (Section 44). The different aspects have been discussed have explained to provide a comprehensive knowledge on computation of chargeable income.

Self Assessment Test

Q1 Danny has the following adjusted income/loss year ended 31 December.

	2006	2007
	RM	RM
Sole-Proprietorship		
Adjusted Income	12,000	20,000
Capital Allowances	3,000	2,000
	2006	2007
	RM	RM
Partnership		
Adjusted Loss	(20,000)	(1,000)
Balancing Charge	-	5,000
Capital Allowances	2,000	1,000
Rent		
Adjusted Income/(loss)	(2,500)	500
Dividend	5,000	4,500

Donations made to approved institutions in 2006 and 2007 were RM 1,000 and RM 2,000 respectively.

Required:

Compute the Chargeable Income for the years of assessment 2006 and 2007. Assume that the amount of Personal Relief available for both years of assessment to be RM 8,000.

Q2 What are the tax rates applicable to small scale companies and what is the tax payable by Company XYZ which has a paid-up capital of 2 million and a Chargeable Income of RM 800,000.

Suggested Answers

A1

Danny Computation of Chargeable Income

		Y/A 2006		Y/A 2007
		RM	RM	RM
Statutory Income				
BUSINESS				
Adjusted Income		12,000		20,000
Capital Allowances		<u>(3,000)</u>		<u>(2,000)</u>
		9,000		18,000
PARTNERSHIP				
Adjusted Income	NIL		NIL	
Balancing Charge	-		5,000	
Capital Allowance – b/f			(2,000)	
Capital Allowance	<u>2,000C/F</u>	NIL	<u>(1,000)</u>	2,000
Aggregate Statutory				
Business Income		9,000		20,000
S.43 (2) - Business loss B/F		-		<u>(6,000)</u>
Net Aggregate				
Statutory Business Income		9,000		14,000
RENTAL		NIL		500
DIVIDEND		<u>5,000</u>		<u>4,500</u>
Aggregate Income		14,000		19,000
S.44 (2) loss - current year				
business loss	20,000			
Utilised	<u>14,000</u>	(14,000)		(1,000)
Carried forward		<u>6,000</u>		
S.44 (6) - Approved Donation		-		<u>(2,000)</u>
Total Income		NIL		16,000
Personal Relief		<u>8,000</u>		<u>8,000</u>
Chargeable Income		<u>NIL</u>		<u>11,000</u>

A2 Tax rate applicable to small scale companies, which have a paid-up capital of less than 2.5 million, is 20% on the first RM 500,000 Chargeable Income and the balance is taxable at the basic corporate tax rate of the relevant year. For YA 2007 it is 27%. Therefore, the tax payable by Company XYZ is $20\% \times 500,000 + 27\% \text{ of } 300,000 = 100,000 + 81,000 = 181,000$.



**LEMBAGA HASIL DALAM NEGERI
INLAND REVENUE BOARD**

PUBLIC RULING

**COMPUTATION OF TOTAL INCOME
FOR INDIVIDUAL**

Translation from the original Bahasa Malaysia text.

PUBLIC RULING NO. 1/2005

DATE OF ISSUE: 5 FEBRUARY 2005



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DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

**Director General of Inland Revenue,
Malaysia**

1. This Ruling explains how total income in respect of an individual is computed.
2. The related provisions of the Income Tax Act, 1967 (ITA) for the computation of total income are sections 5, 42, 43 and 44.
3. The words used in this Ruling have the following meanings:
 - 3.1 “Residual expenditure” for a year of assessment in relation to a plant, machinery and industrial building purchased/constructed and used in/for the purposes of the business, is the cost of that asset after deducting all the initial, annual and notional allowances given on that asset.
 - 3.2 “Capital allowance” for a year of assessment in relation to plant, machinery or industrial building purchased/constructed and used in/for the purposes of the business, is the deduction in the form of initial allowance and/or annual allowance which is given on the cost of that asset in substitution for depreciation which is not allowable in computing the adjusted income of the business.
 - 3.3 “Initial allowance” for a year of assessment in relation to a plant, machinery and industrial building purchased/constructed and used in/for the purposes of the business, is the allowance given on the cost of that asset in the first year it is purchased/constructed and used in/for the purpose of the business and is computed as follows:
 - plant and machinery - 20% on the cost of the plant and machinery or at the rate prescribed by the Minister of Finance; and
 - industrial building- 10% on the cost of that building.

“Annual allowance” for a year of assessment in relation to a plant, machinery and industrial building purchased/constructed and used in/for the purposes of the business, is the annual deduction on the cost of that asset which is computed as follows:

 - in respect of plant and machinery -

a. Motor vehicles and heavy machinery	20% on cost
b. Plant and machinery	14% on cost
c. Others (such as office equipment, furniture & fittings)	10% on cost
 - in respect of industrial building -

a. building constructed/ purchased	3% on cost
b. building which is purchased	3% on cost; or permitted fraction if that fraction is higher than 3% on cost

“Notional allowance” for a year of assessment in relation to plant, machinery and industrial building purchased/constructed and used in/for the purposes of the business, is the annual allowance which is computed on that asset but not allowed as a deduction from the business income due to the reason that it is not claimed or the asset is not used in the business.

“Balancing allowance” is the deficit that arises where the sale price of a plant, machinery or industrial building which is purchased/constructed and used in/for the purposes of the business is lower than the residual expenditure of that asset.

“Balancing charge” is the excess that arises where the sale price of a plant, machinery or industrial building which is purchased/constructed and used in/for the purposes of the business exceeds the residual expenditure of that asset. However, the amount of the balancing charge should not exceed the total capital allowances allowed.

“Permitted fraction” is the computation of the allowance on an industrial building which is purchased based on the following formula:

$$\frac{1}{(A + 50) - B + 1} \times \text{Cost of building}$$

Where:

A= year of assessment in which the building is constructed

B= year of assessment in which the building is sold

“Year of assessment” means calendar year.

Source of income” means source of income chargeable to tax consisting of:

- a. gains or profits from a business;
- b. gains or profits from an employment;
- c. dividends, interest or discounts;
- d. rents, royalties or premiums;
- e. pensions, annuities or other periodical payments; and
- f. gains or profits not falling under a. to e.

4. Determination of total income

4.1 In ascertaining the total income of an individual for a year of assessment, Section 5 of the ITA has stated clearly that -

- a. First, the basis period for each of his sources for a year of assessment shall be ascertained; and

- b. next, the following stages of income as specified below must be computed for each source of income in sequence as follows:
 - i. Gross income;
 - ii. Adjusted income;
 - iii. Statutory income;
 - iv. Aggregate income; and
 - v. Total income

4.2 The chargeable income stage and the manner in which income tax is computed for an individual will be discussed in another separate Public Ruling.

5. The flowchart format of computation of total income in relation to an individual is as in APPENDIX A.

6. Determination of basis period

For an individual, the basis period for a year of assessment in relation to each of his sources of income is year ending 31 December.

7. Computation of gross income

Section 22 of the ITA explains that for an individual, the gross income of that individual from a source for a basis period for a year of assessment is ascertained in accordance with the provisions of the ITA specifically provided for that source.

Components of gross income from a business source for a basis period for a year of assessment include:

- a. Receipts in cash for goods sold or services rendered;
- b. Debts arising in respect of goods sold and services rendered;
- c. Receipts in kind;
- d. Recovery of trading debts written off as bad debts; and
- e. Insurance recovery for loss of business profits.

In respect of employment income, the components of gross income are as follows:

a. Paragraph 13(1)(a) ITA

Wages, salary, remuneration, leave pay, fee, commission, bonus, gratuity, perquisite or allowance (whether in money or otherwise) in respect of having or exercising the employment;

b. Paragraph 13(1)(b) ITA

Value of benefit in kind (not convertible into money) provided for the employee by the employer, but excluding -

- Medical/dental treatment benefit;
- Child care benefit;
- Local leave passages not exceeding 3 times in a year and one overseas leave passage limited to a maximum of RM3,000 in a year;
- Benefits used by the employee solely in connection with the performance of his duties, such as uniform.

c. Paragraph 13(1)(c) ITA

Value of living accommodation in Malaysia provided for the employee by or on behalf of the employer rent free or otherwise;

d. Paragraph 13(1)(d) ITA

Amount received by the employee, whether before or after his employment ceases, from an unapproved pension/provident fund; and

e. Paragraph 13(1)(e) ITA

Amount received by the employee, whether before or after his employment ceases, by way of compensation for loss of the employment.

- 7.4 In respect of other non-business sources of income such as dividends, interest, rents, royalties, pensions/annuities and other income, gross income from each of the sources above is the amount consisting of any sums received or deemed to have been received for that basis period in relation to that source.

8. Computation of adjusted income/loss

Adjusted income of an individual from a source of income for a basis period for a year of assessment is the gross income from that source less all deductible expenses incurred in the production of income as provided for under the general and specific provisions of the ITA for that source.

Adjusted loss from a source of income for a basis period for a year of assessment will arise when the expenses deductible against that source exceed its gross income. However, the ITA provides that only adjusted loss from a business source in the basis year is given a deduction from all other sources of income. Adjusted loss arising from non-business sources is not deductible against any other sources of income and is thus forfeited.

The computation of adjusted income/loss in respect of a business source is as follows:

	RM	
Gross income from business		XX
Less: Allowable expenditure		
General provision -subsection 33(1) ITA		
• Expenses wholly and exclusively incurred in the production of gross income from the business	XX	
Specific provision- sections 34, 34A and 34B ITA		
• Specific expenditure deductible - section 34 ITA	XX	
• Approved research expenditure - section 34A ITA	XX	
• Contribution to an approved research institute or payment for the use of services of an approved research institute/company - Section 34B ITA	XX	XX
Adjusted income/loss from business		XX

Among the expenses which qualify for deduction under the general provision of subsection 33(1) of the ITA for a business source are as follows:-

- Wages and salary for staff.
- Interest payments arising from loans/overdraft taken and used solely for business purposes or spent on the purchase of assets used in the business.
- Rent payable on land or buildings occupied for purposes of the business.
- Repairs to premises, plant and machinery, furniture or fixtures used in the business.
- Insurance premiums paid in respect of policies insuring against indemnity or damage to or loss of business assets. However, where the businessman buys a life policy on himself or on any member of his family, the premiums are not allowable and are not deductible against the gross business income.
- Legal and other professional fees incurred in respect of the business for example where the services of a lawyer are engaged to enforce a trading contract or to recover trading debts.

Among the expenses deductible in the computation of adjusted income/loss under the specific provisions of section 34 of the ITA are as follows:

- a. Specific provisions for doubtful trade debts which are estimated to be irrecoverable (general provision for doubtful debts or non-trading bad debts written off are not deductible).
 - b. Irrecoverable bad debts written-off.
 - c. Contributions to EPF, pension scheme or provident fund approved by the Director General, subject to a maximum of 19% of the employee's remuneration.
 - d. Expenses incurred on the provision of any equipment to assist disabled employees in the performance of their duties.
 - e. Expenses incurred in respect of translation into or publication in the national language of books approved by the Dewan Bahasa dan Pustaka.
 - f. Expenses not exceeding RM100,000 incurred on the provision of library facilities and contributions to public libraries, schools and institutions of higher education.
 - g. Expenses incurred on the provision and maintenance of a child care centre for the benefit of the employees.
 - h. Expenses incurred on the provision of services, public amenities and contributions to a charity or community project pertaining to education, health, housing, infrastructure, information and communication technology, approved by the Minister of Finance.
 - i. Contributions to establishing and managing a musical or cultural group approved by the Minister of Finance.
 - j. Expenses not exceeding RM300,000 incurred for sponsoring any local or foreign arts or cultural activity approved by the Ministry of Arts, Culture and Heritage provided that the amount of expenditure incurred in sponsoring foreign arts or cultural activities shall not exceed RM200,000.
 - k. Expenses incurred on the provision of practical training related to the business of the person to a resident individual who is not an employee of that person.
- 8.3.3 Adjusted loss from a business source for a basis period for a year of assessment arises when the expenses deductible against the business source exceed its gross income. This adjusted loss can be deducted from all other sources of income that is at the aggregate income stage.

In respect of an employment source, the computation of adjusted income is as follows:

	RM	
Gross income from employment - paragraphs 13(1)(a) to (e) ITA		XX
Less: Allowable expenditure		
General provision - subsection 33(1) ITA		
Expenses wholly and exclusively incurred in the production of gross income from employment	XX	
Specific provision -sections 38 & 38A ITA		
Payment for rent of premises, furniture, public rates, insurance premiums on living accommodation provided by the employer to employees	XX	
Entertainment expenses (limited to the entertainment allowance received)	<u>XX</u>	<u>XX</u>
Adjusted income from employment		<u>XX</u>

Expenses allowable in computing adjusted income from an employment source are expenses incurred in the performance of work, such as:

- Travelling expenses which are incurred by the individual in the course of exercising his duties as an employee.
- Annual subscriptions paid to professional bodies where membership to such bodies is relevant to the performance of duties.
- Entertainment expenses which are incurred by the individual in entertaining existing clients on behalf of the employer, however, limited to the amount of entertainment allowance paid by the employer.

In respect of other sources of non-business income (such as dividends, interest, rents, royalties, premiums and others), the computation of adjusted income/loss from each source of income is as follows:

	RM	
Gross income		XX
Less: Allowable expenditure		
General provision - subsection 33(1) ITA		
Expenses wholly and exclusively incurred in the production of gross income from that source		<u>XX</u>
Adjusted income/loss		<u>XX</u>

For these sources of income, where there is adjusted loss for a basis period for a year of assessment, this loss is not deductible against any other source of income and it is thus forfeited.

In computing the adjusted income for each source of income, there are several expenses prohibited by section 39 of the ITA. Examples of such expenses are:

- a. Domestic or private expenses for example wages paid to a domestic-helper, cost of travelling from home to place of business and drawings from business for private use.
- b. Capital withdrawn or any sum used or intended to be used as capital for example payments for purchase of fixed assets or private assets such as private residence, cars and shares.
- c. Any expenditure incurred in the provision of a benefit or amenity to an employee consisting of leave passages to local or overseas destinations.
- d. In the case of business source only, 50% of any expenses incurred on entertainment including entertainment allowances paid to employees.
- e. Depreciation of fixed assets.
- f. Rentals of non-commercial motor vehicles in excess of RM50,000. In cases where the vehicle is new (not reconditioned) and has not been used for any purpose prior to the rental and the cost of the vehicle does not exceed RM150,000, then rentals in excess of RM100,000 are disallowed.

Records and documents relating to all claims of expenditure incurred in the computation of adjusted income for each source of income should be retained for a period of seven (7) years from the end of the year of assessment in which the Income Tax Form is furnished as proof in cases which are audited.

9. Computation of statutory income

Statutory income for a year of assessment should be computed in respect of each source of income (Section 42 of the ITA).

Statutory income from a business source for a basis period for a year of assessment is computed as follows:

	RM	
Adjusted income from business		XX
Add: Balancing charge		<u>XX</u>
		XX
Less: Balancing allowance	XX	
Capital allowance	<u>XX</u>	<u>XX</u>
Statutory income		<u>XX</u>

Example 1

Encik A has a business source of income and information in respect of the business for year ended 31.12.2004 is as follows:

	RM
Adjusted income from business	100,000
Balancing charge	15,000
Capital allowance	20,000

Statutory income from business for the year of assessment 2004 is:

	RM
<i>Adjusted income from business</i>	<i>100,000</i>
<i>Add: Balancing charge</i>	<i><u>15,000</u></i>
	<i>115,000</i>
<i>Less: Capital allowance</i>	<i><u>20,000</u></i>
<i>Statutory income</i>	<i><u>95,000</u></i>

Statutory income from business for a basis period for a year of assessment can still arise even though there is adjusted loss in respect of a business source, if its balancing charge exceeds its capital allowance.

Example 2

Encik B has a business source and information in respect of the business for the year ended 31.12.2004 is as follows:

	RM
Adjusted loss from business	(50,000)
Balancing charge	10,000
Capital allowance	5,000

Statutory income from business for the year of assessment 2004 is:

		RM
Adjusted income from business	(loss 50,000)	NIL
Add: Balancing charge		<u>10,000</u>
		10,000
Less: Capital allowance		<u>5,000</u>
Statutory income		<u>5,000</u>

Note:

The loss of RM50,000 is loss incurred for the basis year. According to subsection 44(1) of the ITA, this loss can be deducted from the aggregate income for the basis period (1.1.2004-31.12.2004) for year of assessment 2004 by Encik B in computing his total income.

- 9.4 In computing the statutory income from a business source, where there is capital allowance which cannot be absorbed by the adjusted income from business, the unabsorbed capital allowance will be carried forward and allowed in computing the statutory income from business from the same source for the following year of assessment.

Example 3

Encik C has income from the following sources for the years ended 31.12.2004 and 31.12.2005.

	Year ended	
	31.12.2004	31.12.2005
	Year of assessment	
	2004 - RM	2005 - RM
Business:		
Adjusted income	3,000	10,000
Capital allowance for the year of assessment	4,700	5,000
Rents:		
Adjusted income	24,000	28,000

**COMPUTATION OF TOTAL INCOME
FOR INDIVIDUAL**

**Public Ruling No. 1/2005
Date of Issue : 5 February 2005**

Statutory income from each source for the years of assessment 2004 and 2005 is computed as follows:

	Year of assessment	
	2004 - RM	2005 - RM
Business:		
Adjusted income	3,000	10,000
Less:		
Capital allowance	4,700	Y/A2005 5,000
		b/f from
Restricted to	<u>3,000</u>	Y/A2004 <u>1,700</u>
Capital allowance c/f to Y/A2005 1,700 ¹		
	<u>3,000</u>	<u>6,700</u>
Statutory income	<u>Nil</u>	<u>3,300</u>
Rents:		
Adjusted /statutory income	<u>24,000</u>	<u>28,000</u>

Note:

¹ The capital allowance of RM1,700 which cannot be allowed against the business source will be carried forward to year of assessment 2005 and will only be allowed to be deducted from the same business source.

Statutory income from each non-business source for a basis period for a year of assessment is the total amount of income from that source after deducting any expenses which are deductible in accordance to the ITA. In other words, the statutory income from a non-business source is the adjusted income of that source for the basis period for that year of assessment. Therefore,

$$\text{Adjusted income from a non-business source} = \text{Statutory income from a non-business source}$$

Example 4

Encik D is a senior manager in Syarikat ABC Sdn Bhd. in Kuala Lumpur. He has employment income for year ended 31.12.2004 as follows:

	RM
Salary	120,000
Travelling allowance	24,000
Entertainment allowance	<u>12,000</u>
	<u>156,000</u>

Encik D made the following claims-

- a. Expended the full sum of RM24,000 of the travelling allowance provided to him by the employer for visiting factories of the company to ensure the smooth operations of the factories.
- b. Expended RM13,000 for the purpose of entertaining existing clients of the company.

Statutory income from employment for the year of assessment 2004 is:

	RM
Salary	120,000
Travelling allowance	24,000
Entertainment allowance	<u>12,000</u>
	156,000
<i>Less: Expenses - subsection 33(1) & 38A ITA</i>	
Travelling	24,000
Entertainment (limited to the entertainment allowance)	<u>12,000</u> <u>36,000</u>
<i>Adjusted/statutory income from employment</i>	<u>120,000</u>

Note:

- i. *Entertainment expenses incurred by Encik D in entertaining existing clients of the company are allowable as a deduction under subsection 33(1) of the ITA provided the entertainment is carried out in the performance of his duties. However, according to section 38A of the ITA, the amount of entertainment expenses that can be allowed is limited to the amount of allowance received.*
- ii. *Travelling expenses incurred by Encik D are allowed under subsection 33(1) of the ITA provided the amount is expended in the course of discharging his employment duties and certified by the employer. Private travelling expenses such as travelling between his residence and place of employment is not admissible.*

Example 5

Encik E, a project manager in a project management company, has the following information regarding his income from the following sources for the year ended 31.12.2004:

Employment:	RM
Salary	84,000
Travelling allowance	12,000
Entertainment allowance	6,000

Rents:

Gross income	24,000
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Dividends:

Gross income	1,000
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Encik E made claims on expenses as follows:

In respect of employment income:

- i. RM12,000 for visiting construction project sites; and
- ii. RM7,200 for entertaining the company's customers.

In respect of rental income:

- i. RM6,000 on housing loan interest; and
- ii. RM1,200 on house assessment and quit rent.

In respect of dividend income:

- i. RM1,500 on loan interest taken to purchase the shares.

Statutory income for each source for the year of assessment 2004 is:

Employment:	RM	
Gross income (84,000 + 12,000 + 6,000)		102,000
Less: Allowable expenditure - subsection 33(1) & section 38A		
Travelling	12,000	
Entertainment (limited to allowance received)	<u>6,000</u>	<u>18,000</u>
Adjusted/statutory income from employment		<u>84,000</u>

Rents:

Gross income	24,000
Less: Allowable expenditure - subsection 33(1) ITA	
Loan interest	6,000
House assessment and quit rent	<u>1,200</u>
Adjusted/statutory income from rents	<u>16,800</u>

Dividends:

Gross income	1,000
Less: Allowable expenditure- subsection 33(1) ITA	
Loan interest	<u>1,500</u>
Adjusted loss	<u>(500)</u>
❖ statutory income from dividends	<u>NIL</u>

Note:

Adjusted loss (RM500) from the dividend source cannot be allowed against any other source of income and is therefore forfeited.

10. Computation of aggregate income

10.1 The computation of aggregate income is determined under section 43 of the ITA. The aggregate income of an individual for a year of assessment is computed as follows:

- a. Firstly, compute the aggregate of the statutory income from all business sources for a year of assessment;
- b. Secondly, deduct the business loss brought forward from previous years which has not been deducted against any source of income; and
- c. Thirdly, add to the sum arrived at with the following items received for the same year of assessment:
 - i. statutory income from each non-business source (employment, dividends, interest, discounts, rents, royalties, premiums, pensions, annuities and other income) that is derived;
 - ii. amount received in respect of qualifying prospecting expenditure under Schedule 4 of the ITA; and
 - iii. amount received in respect of qualifying farm expenditure under Schedule 4A of the ITA.

Example 6

Encik F has income from the following sources for the year ended 31.12.2004:

	RM	
Adjusted income from business		55,000
Capital allowance	10,000	
Balancing charge	2,500	
Adjusted income from employment		36,000
Adjusted income from rents		2,400

The computation of aggregate income for the year of assessment 2004 is as follows:

	RM
<i>Adjusted income from business</i>	<i>55,000</i>
<i>Add: Balancing charge</i>	<i><u>2,500</u></i>
	<i>57,500</i>
<i>Less: Capital allowance</i>	<i><u>10,000</u></i>
<i>Statutory income from business</i>	<i>47,500</i>
<i>Statutory income from employment</i>	<i>36,000</i>
<i>Statutory income from rents</i>	<i><u>2,400</u></i>
<i>Aggregate income</i>	<i><u><u>85,900</u></u></i>

Example 7

Encik G has income from the following sources for the year ended 31.12.2004:

	RM
Adjusted income from business I	40,000
Capital allowance	8,000
Balancing charge	10,000
Adjusted loss from business II	(7,500)
Capital allowance	5,000
Balancing allowance	2,300
Balancing charge	3,000
Employment - adjusted income	12,000
Rents: adjusted loss	(2,400)

Encik G also has business loss brought forward from the year of assessment 2003 amounting to RM5,500.

The computation of aggregate income for the year of assessment 2004 is as follows:

	RM
<i>Adjusted income</i>	<i>40,000</i>
<i>Add : Balancing charge</i>	<i><u>10,000</u></i>
	<i>50,000</i>
<i>Less : Capital allowance</i>	<i><u>8,000</u></i>
<i>Statutory income from business I</i>	<i>42,000</i>
<i>Adjusted income (loss 7,500) ¹</i>	<i>NIL</i>
<i>Add : Balancing charge</i>	<i><u>3,000</u></i>
	<i>3,000</i>
<i>Less : Capital allowance 5,000</i>	
<i>Balancing allowance <u>2,300</u></i>	
<i>7,300 restricted to</i>	<i><u>3,000</u></i>
<i>Capital allowance c/f to year of assessment 2005= 4,300</i>	
<i>Statutory income from business II</i>	<i><u>NIL</u></i>
<i>Aggregate statutory income from businesses</i>	<i>42,000</i>
<i>Less:</i>	
<i>Loss b/f from an earlier year of assessment (subsection 43(2) ITA)</i>	<i><u>5,500</u></i>
<i>Income from business sources</i>	<i>36,500</i>
<i>Statutory income from employment</i>	<i>12,000</i>
<i>Statutory income from rents ²</i>	<i><u>NIL</u></i>
<i>Aggregate income</i>	<i><u>48,500</u></i>

Note:

¹ The loss of RM7,500 is loss incurred for the basis year. This loss can be deducted in computing Encik G's total income.

² Rental loss of RM2,400 is not deductible.

11. Computation of total income

The manner in which total income is computed is explained under section 44 of the ITA. Total income of an individual for a year of assessment is his aggregate income for that year of assessment less certain deductions given following the order as stated in paragraphs 11.2 to 11.4 of this Public Ruling.

First deduction: Adjusted loss from business for a basis year (subsection 44(2) ITA)

Adjusted loss from a business source or sources for a basis year appropriate to that year of assessment is the first deduction to be allowed against the aggregate income in computing the total income for a year of assessment for an individual. Where the adjusted loss cannot be allowed wholly against the aggregate income from all sources, the balance of the loss that cannot be allowed is carried forward to the following year and can only be deducted from the aggregate of the statutory income from business sources.

Example 8

Encik H has income from the following sources for the years ended 31.12.2004 and 31.12.2005:

	Year ending	
	31.12.2004	31.12.2005
	RM	RM
Business I:		
Adjusted loss	(10,000)	(5,000)
Balancing charge	5,000	Nil
Capital allowance	4,000	1,000
Business II:		
Adjusted income	5,000	8,000
Capital allowance	7,000	2,000
Dividends - Adjusted income	2,000	1,000
Rents - Adjusted income	4,000	6,000

**COMPUTATION OF TOTAL INCOME
FOR INDIVIDUAL**

**Public Ruling No. 1/2005
Date of Issue : 5 February 2005**

Total income for the years of assessment 2004 and 2005 is computed as follows:

	Year of assessment	
	2004	2005
Business I		
Adjusted income (loss 10,000)	Nil	(loss 5,000) Nil
Add: Balancing charge	<u>5,000</u>	
	5,000	
Less: Capital allowance	<u>4,000</u>	<u>Nil</u> ¹
Statutory income from business 1	1,000	Nil
Business II		
Adjusted income	5,000	8,000
Less: Capital allowance 7,000	2,000	
Restricted to <u>5,000</u>	<u>5,000</u>	
Capital allowance c/f 2,000		
Capital allowance b/f	<u>2,000</u>	<u>4,000</u>
Statutory income from business II	<u>Nil</u>	<u>4,000</u>
Aggregate statutory income from businesses	1,000	4,000
Less: Loss b/f	<u>Nil</u>	<u>3,000</u>
Income from business sources	1,000	1,000
Add:		
Statutory income from dividends	2,000	1,000
Statutory income from rents	<u>4,000</u>	<u>6,000</u>
Aggregate income	7,000	8,000
Less:		
Basis year loss - subsection 44(2)ITA 10,000		<u>5,000</u>
Restricted to <u>7,000</u>	<u>7,000</u>	
Loss c/f	3,000	
Total income	<u>Nil</u>	<u>3,000</u>

Note:

¹ Capital allowance of RM1,000 not allowed is carried forward to the following year to be deducted from the adjusted income from the same business source.

Second deduction: deduction for qualifying prospecting expenditure (Schedule 4 ITA) and deduction for qualifying farm expenditure (Schedule 4A ITA)

In computing the total income of an individual for a year of assessment, qualifying prospecting expenditure to winning access to deposits of minerals and qualifying farm expenditure are deducted from the aggregate income after allowing a deduction for the basis year loss under subsection 44(2) of the ITA.

Third deduction: gifts or contributions (subsections 44(6) to 44(11) ITA)

This third category consists of gifts or contributions made in the basis year in the form of cash, in kind, equipment, artefact, manuscript or painting.

Gifts of money

- i. Gift of money made in the basis year for a year of assessment to -
 - the Federal Government;
 - the State Government;
 - Local Authorities; or
 - an institution or organization approved by the Director General on the application of the institution or organization concerned. The Director General will publish the name of the institution or organization in the Government Gazette after the application is approved.

An individual who makes a cash donation to any of the bodies stated above is eligible to be given a deduction equal to the amount of donation made.

- ii. Gift of money not exceeding RM20,000 to build or equip public libraries and libraries of schools and institutions of higher education, provided a claim for the same expense is not made under paragraph 34(6)(g) of the ITA in computing the adjusted income from business.
- iii. Cash contributions to the cost of treatment for serious diseases for individuals, made through a fund or trust account established for helping individuals.

Gifts of artefact, manuscript or painting

- i. Gift of artefact, manuscript or painting made to the Federal Government or State Government, where an amount equal to

the value of the gift as determined by the Department of Museum and Antiquities or the National Archives is given a deduction in computing the total income - subsection 44(6A) ITA.

- ii. Gift of painting made to the National Art Gallery or State Art Gallery where an amount equal to the value of the painting as determined by the respective Art Galleries is given a deduction in computing the total income - subsection 44(11) ITA.

Contribution for the benefit of disabled persons

Gift of money or contribution in kind (the value of which is determined by the relevant local authority) made in the basis year for the provision of facilities in public places for the benefit of disabled persons qualifies for a deduction - subsection 44(9) ITA.

Contribution to healthcare center

Gift of money or gift of medical equipment (the value of which is determined by the Ministry of Health) made in the basis year to a healthcare center approved by the Ministry of Health. However, the allowable deduction is restricted to a maximum of RM20,000 - subsection 44(10) ITA.

Proof of payment

Receipts in respect of gifts or contributions made should be kept in safe custody for a period of seven (7) years from the end of the year of assessment in which the Income Tax Form is furnished for audit purposes.

Manner in which deductions are allowed

In the computation of total income, deductions on gifts, donations or contributions are allowed only if there is aggregate income after the deduction of basis year loss under subsection 44(2) of the ITA, the deduction of expenses under Schedule 4 and 4A of the ITA. Where there is no aggregate income after allowing for the deduction of basis year loss under subsection 44(2) of the ITA, expenditure under Schedule 4 and 4A of the ITA, the donations or the balance of the donations that cannot be deducted are forfeited and not allowed to be carried forward.

Example 9

Using the information available in Example 8, if Encik H donates to an institution approved by the Director General as follows:

- RM1,000 in the year ended 31.12.2004; and
- RM6,000 in the year ended 31.12.2005.

Total income for the years of assessment 2004 and 2005 is computed as follows:

	Year of assessment	
	2004 - RM	2005 - RM
Aggregate income	7,000	8,000
Less:		
Basis year loss - subsection 44(2) ITA restricted to	<u>7,000</u>	<u>5,000</u>
	Nil	3,000
Donation -subsection 44(6) ITA	<u>Nil</u>	<u>3,000</u>
Total Income	<u>Nil</u>	<u>Nil</u>

Note:

- i. *Donation of RM1,000 for the year of assessment 2004 cannot be deducted and is forfeited due to the reason that there is no excess income after allowing a deduction for the basis year loss under subsection 44(2) of the ITA.*
- ii. *Donation of RM6,000 for the year of assessment 2005 is only given a deduction up to RM3,000 that is up to the amount of excess income after allowing a deduction for the basis year loss under subsection 44(2) of the ITA.*

12. This Ruling shall be effective for the year of assessment 2004 and subsequent years of assessment.

**Director General
of Inland Revenue**

COMPUTATION OF TOTAL INCOME FOR INDIVIDUAL

Business I		Business II		Employment		Other non-business sources- interest, dividends, rents, etc.	
Gross Income	X	Gross Income	X	Gross income	X ¹	Gross Income	X
Less: Expenditure		Less: Expenditure		Less: Expenditure		Less: Expenditure	
• General - subsection 33(1)	X	• General - subsection 33(1)	X	• General - subsection 33(1)	X	• General - subsection 33(1)	
• Specific - Section 34	X	• Specific - Section 34	X	• Specific - Sections 38 & 38A	X X X		
• Research - Sections 34A & 34B	X	• Research - Sections 34A & 34B	X				
Adjusted Income	X	Adjusted Income	X	Adjusted Income	X ²	Adjusted Income	X ²
Add: Balancing Charge	X	Add: Balancing Charge	X				
	X		X				
Less: Balancing Allowance	X	Less: Balancing Allowance	X				
Capital Allowance	X	Capital Allowance	X				
Statutory Income	X	Statutory Income	X	Statutory Income	X ²	Statutory Income	X ²

Chapter 4

Employment Income

Chapter Outline

4.0 Introduction

- 4.1 Employment is defined in Section 2 of the ITA
- 4.2 Section 13: General provisions as to Employment Income
- 4.3 Derivation of Employment Income
- 4.4 Section 25: Basis periods to which Gross Income from an employment is related
 - 4.4.1 Summary of Section 25 – basis periods under employment
- 4.5 Understanding the provisions of Section 13 (1) (a) to (e)
- 4.6 A Comprehensive Example for computing Gross Income under Section 13(1) (c)
- 4.7 Comprehensive Example 1
- 4.8. Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- Explain the 5 categories of Gross Income from Employment
- Define Section 13(1)(a) Gross Income
- Explain the meaning of 'perquisites' in Section 13(1) (a)
- State the exempt benefits-in-kind under Section 13(1) (b)
- Explain how to compute the value of benefits-in-kind using the Inland Revenue Board Valuation of benefits schedule as presented in their Public Rulings
- Explain the tax computation for living accommodation under Section 13(1) (c) and Section 32
- Explain the tax treatment for Directors of controlled companies
- Explain Section 13(1) (d)
- Explain Section 13(1) (e)
- State the exemptions available under each category as per Schedule 6, which is described in more detail in Chapter 6.
- Understand the tax treatment of Gratuities
- Understand the tax computation of a comprehensive case of a person with the various categories of Employment Income

4.1 Introduction

This source of income is probably the most common class of income encountered by planners. The law is stated under Section 13 of the ITA 1967.

4.2 Employment is defined in Section 2 of the ITA as:

“Employment means –

- (a) Employment in which the relationship of master and servant subsists;
- (b) Any appointment or office, whether public or not and whether or not that relationship subsists, for which remuneration is payable;

“Employee”, in relation to an employment, means –

- (a) Where the relationship of master and servant subsists, the servant;
- (b) Where that relationship does not subsist, the holder of the appointment or office, which constitutes the employment;

“Employer”, in relation to an employment, means –

- (a) Where the relationship of master and servant subsists, the master;
- (b) Where that relationship does not subsist, the person who pays or is responsible for paying any remuneration to the employee who has the employment, notwithstanding that person and the employee may be the same person acting in different capacities;

Section 13(1) identifies 5 different types of Gross Income from Employment. To further understand these provisions we need to study the Public Rulings issued by the IRB.

4.3 Section 13. General provisions as to Employment Income

Gross Income of an employee in respect of gains or profits from an employment includes -

- (a) Any wages, salary remuneration, leave pay, fee, commission, bonus, gratuity, perquisite or allowance (whether in money or otherwise) **in respect of having or exercising the employment;**
- (b) An amount equal to the value of use or enjoyment by the employee of **any benefit or amenity** (not being a benefit or amenity convertible into money) provided for the employee by or on behalf of his employer, **excluding** –
 - (i) A benefit or amenity consisting of medical or dental treatment or a benefit for childcare;
 - (ii) A benefit or amenity consisting of –

(A) Leave passages for travel within Malaysia not exceeding three times in any calendar year; or

(B) One leave passage for travel between Malaysia and any place outside Malaysia in any calendar year, limited to a maximum of three thousand ringgit;

Provided that the benefit or amenity enjoyed under this subparagraph is confined only to the employee and members of his immediate family;

(iii) A benefit or amenity used by the employees solely in connection with the performance of his duties; and

(iv) A benefit or amenity falling under paragraph (c);

(c) An amount in respect of the use or enjoyment by the employee of living accommodation in Malaysia (including living accommodation in premises occupied by his employer) provided for the employee by or on behalf of the employer rent free otherwise;

(d) So much of any amount (other than a pension, annuity or periodical payment falling under Section 4(e)) received by the employee, whether before or after his employment ceases, from a pension or provident fund, scheme or society not approved for the purpose of this Act as would not have been so received if his employer had not made contributions in respect of the employee to the fund, scheme or society or its trustees; and

(e) Any amount received by the employee, whether before or after his employment ceases, by way of compensation for loss of the employment, including any amount in respect of –

(i) A covenant entered into by the employee restricting his right after leaving the employment to engage in employment of a similar kind; or

(ii) Any agreement or arrangement having the like effect.

4.4 Derivation of Employment Income

Section 13(2) Gross income in respect of gains or profits from an employment –

(a) For any period during which the employment is exercised in Malaysia;

(b) For any period of leave attributable to the exercise of the employment in Malaysia;

(c) For any period during which the employee performs outside Malaysia duties incidental to the exercise of the employment in Malaysia;

(d) For any period during which a person is a director of a company and that company is resident in Malaysia for the basis year for a year of assessment and within that basis year that period or part of that period falls; or

- (e) For any period during which the employment is exercised aboard a ship or aircraft used in a business operated by a person who is resident in Malaysia for the basis year for a year of assessment and within that basis year that period or part of that period falls,

Shall be deemed to be derived from Malaysia.

Section 13 (3) Gross income in respect of gains or profits from an employment in the public services or the service of a statutory authority –

- (a) For any period during which the employment is exercised outside Malaysia; or
- (b) For any period of leave attributable to the exercise of the employment outside Malaysia,

shall be deemed to be derived from Malaysia if the employee is a citizen.

Section 13(4) For the purposes of subsection (1) a benefit, amenity or living accommodation provided for an employee as therein mentioned shall be deemed to be used or **enjoyed by the employee if it is used or enjoyed by his spouse, family, servants, dependants or guests.**

4.5 **Section 25: Basis periods to which Gross Income from an employment is related**

- (1) Where Gross Income from an employment –
 - (a) Is not receivable in respect of any particular period; and
 - (b) First becomes receivable in the relevant period;
It shall when received be treated as gross income of the relevant person for the relevant period.
- (2) Subject to Section 3 and subsection (5), where gross income from an employment is receivable in respect of the whole of the relevant period (or, except in a case to which subsection (4) applies, in respect of any part of the relevant period), it shall when received be treated as gross income of the relevant person for the relevant period.
- (3) Subject to Section 3 and subsection (5), where Gross Income falls to be treated under subsection (1) or (2) as Gross Income for the relevant period, then, if its receipt first becomes known to the Director General on a day more than five years after the end of the relevant period, it shall whenever necessary be treated as Gross Income of the relevant person for the basis period for the year of assessment which began five years before the beginning of the year of assessment which includes that day.
- (4) Subject to Section 3 and subsection (5), where Gross Income from an employment is receivable in respect of a period (in this subsection referred to as the overlapping period) which overlaps the relevant period, that Gross Income when received shall be apportioned between the part of the overlapping period which overlaps

the relevant period and the remaining part or parts of the overlapping period (the apportionment, unless the Director General having regard to the facts of any particular case otherwise directs,) being made in the proportion that the number of days of the overlapping period that fall into the relevant period bears to the total number of days of the overlapping period) and so much of that gross income as is apportioned to the overlapping part of the overlapping period shall be treated as Gross Income of the relevant person from the employment for the relevant period

Provided that –

- (a) **Where the employment ceases** in the basis period for a year of assessment and, at or about the time of the cessation of the employment, Gross Income from the employment becomes receivable as a lump sum by way of gratuity, deferred pay or otherwise but excluding any amount which by virtue of Section 13 (1) (d) or (e) is included in his Gross Income from the employment, then, for the purposes of this subsection –
 - (i) That sum, notwithstanding subsection (1), shall be treated as accruing evenly over and receivable in respect of an accrual period consisting of the period of the employment (including, where the employment was employment by a company, any particular period during which the relevant person was employed by another company in the same group, being a group of which that first mentioned company was a member at the time of the cessation of the employment) or, if the period of employment (including any such particular period) commenced more than five years before the commencement of that basis period, an accrual period consisting of that basis period and the basis periods for the five years of assessment immediately preceding that year;
 - (ii) So much of that sum as by virtue of subparagraph (i) is treated as accruing evenly over and receivable in respect of any such particular period during which the relevant person was employed by any such other company shall be deemed to be income from the source consisting of his employment by that other company and not from the source consisting of his employment by that first mentioned company; and
 - (iii) that accrual period shall be treated as the overlapping period
- (5) Where Gross Income from an employment first becomes receivable in the relevant period and is in respect of –
 - (a) **a period which commences after the end of the relevant period;** or
 - (b) a period which overlaps the relevant period and which partly elapsed after the end of the relevant period,

Subsections (2) to (4) shall not apply and that gross income shall when received be treated as Gross Income of the relevant person for the relevant period:

(6) Notwithstanding the foregoing subsections, where the Director General is satisfied that –

(a) **An employee has left or will be leaving Malaysia in the basis year** for the year of assessment to which the relevant period relates (that year of assessment being in this subsection referred to as the relevant year) and will not be resident for the basis year for the following year of assessment;

(b) **No pension derived from Malaysia** will be receivable by the employee for the basis period for that following year; and

(c) Gross income from the employee's **employment will cease** to be derived from Malaysia on the expiration of a period of leave following the employee's departure from Malaysia,

Any gross income from the employment which but for this subsection would by virtue of any of the foregoing subsection be receivable for the basis period for the year of assessment following the relevant year shall be treated as receivable for the relevant period unless the employee in making his return of income for the relevant year (or within such period after the making of that return as the Director General may allow) makes a written request to the Director General that this subsection shall not apply in relation to his Gross Income from the employment.

4.4.1 Summary of Section 25 - basis periods under employment

The legal tax language used can be quite arduous on simple folks. But tax has a precise application. Therefore to answer difficult questions as to application one has to read the legal provision. Planners do not have to memorise the law, they just have to know where to look.

Section 25 relates to employment income and basis periods. This has important implications when it comes to tax planning as in deferment of income.

The first **subsection (1)** is about where to put income, which has no specific period. In this case you put it in the basis period it is received.

Subsection (2) states that you relate employment income to the relevant period that it is receivable. For example if bonus is for a specific earlier period you tax the income in that specific period. You relate income to the period it is receivable. This is the main provision. The rest of the provisions are for exceptions to the rule.

Subsection (3) is interesting. It protects the IRB from losing income received more than five years from the current basis year. The D-G is entitled to treat the income as receivable five years from the year he gets to know about the income. The Malaysian tax laws have reduced the period of raising tax on income to six years from its previous 12 years. But

this subsection allows the D-G to capture any employment income receivable for earlier periods, if he comes to know of it.

Subsection (4) has very common application as it relates to lump sums received from employment, especially gratuity. It states that lump sums that are taxable, (most retirement gratuities are exempt), are spread back between the current basis period and five preceding years of assessment, if he commenced employment with the same group more than five years from the beginning of the current basis period. This is good because resident individuals are taxed on a scale rate of taxation and therefore, they avoid the lump sum pushing them to a higher tax bracket. By spreading back they remain in the lower tax brackets. The complication here is that, if the period of employment is less than five years from the beginning of the current basis year then the spread back is based on a time basis, apportioned according to the number of days in each relevant period to the whole of the period.

Students have difficulty calculating the five years from the beginning of the current basis period and to determine whether the gratuity is spread back over the current period and five years or on a time basis. To add to the complication they have to determine if the gratuity is exempted under Schedule 6. Practice makes perfect.

Subsection (5) is about receiving income ahead for a period, which follows or overlaps the current period. It states that income received ahead in a year of assessment will be taxed in that year, even though it is for the following years. Section 25(2) distinguished.

Subsection (6) relates to income received in a year of assessment in respect of the following year but gives the taxpayer the option to choose between having it taxed in the current year or in the following year if certain conditions apply. The conditions are:

- (i) He will be leaving Malaysia permanently
- (ii) He is non-resident the following year
- (iii) He has no more pension receivable in the following year
- (iv) His employment income has ceased.

The taxpayer will most probably not make residence in the following year. Therefore if he wants to enjoy the benefits of being taxed as a resident he will choose to tax his leave pay in the year it is received and not in the following year. But he has the option.

It is hoped these explanations have managed to cut through the legal parlance or nomenclature. Some examples will help.

Example1.

Employment Income of Mr Wong for RM 10,000 first receivable for the year ended 31 December 2006 is received on 1 November 2007.

The RM 10,000 received in 2007 shall be declared in 2007 but treated as Gross Income for Year of Assessment 2006 according to Section 25(2). Additional Assessment for Year of Assessment 2006 would be necessary.

Example2:

Gross employment income for the year ended 31 December 2000 first became known on 30 September 2007 and to raise assessment for the basis year 2000 in 2007 would contravene the 6 years rule of Section 9(1).

It would therefore be necessary to include the income for 2000 as an income for the Year of Assessment 2002 i.e. the fifth year of assessment before year of assessment of receipt. (Section 25(3))

Example3:

If employment income receivable for the period 1 July 2006 to 31 December 2007, of RM 18,000 is received in 2007, the income received for the 18-month period shall be apportioned and forms the income of the basis periods as follows:

(Section 25(2))

Year of Assessment 2006 (Year ended 31 December 2006)

$$6/18 \times \text{RM } 18,000 = \text{RM } 6,000$$

Year of Assessment 2007 (Year ended 31 December 2007)

$$12/18 \times \text{RM } 18,000 = \text{RM } 12,000$$

Example4:

If Mr Lim went on leave in November 2006 and received leave pay of RM 10,000 for the 3 months ended 28 February 2007, the whole leave pay of RM 10,000 shall be included as Gross Income for Year of Assessment 2006. (Section 25(5) - overlapping period moving into the next period. Ignores Section 25(2) and (4)).

Example5:

Harris left Malaysia on 30 November 2006 with no intention of returning to Malaysia, has leave pay until 30 June 2007 and will not receive any pension or other employment income from Malaysia.

Details of his remuneration are:

Salary till 30 November 2006	RM 20,000
Leave pay: 1 December 2006 to 31 December 2006	RM 5,000
1 January 2007 to 30 June 2007	RM 20,000

The gross employment income for Year of Assessment 2006 would be RM 45,000 by virtue of Section 25(5).

However, Harris can elect in writing under Section 25(6) to have the income (the leave pay for the 6 months ended 30 June 2007) taxed in the Year of Assessment 2007. It ignores Section 25(5). The four conditions of leaving Malaysia, being non-resident, having no pension income and employment ceasing the following year must be satisfied.

4.5 Understanding the provisions of Section 13 (1) (a) to (e).

Gross income from employment has many interesting facets. Understanding the different subsections is important. Let us explore some of the issues.

4.5.1 Section 13 (1) (a) relates to cash income received. Every conceivable cash income or allowances has been identified. It also includes perquisites or perks for short. The simplest way of understanding perquisite is to look at it as a cash benefit or a benefit that is convertible into cash. For example share options are a benefit that is convertible into cash. Tips of waiters and taxi drivers are cash benefits from having or exercising the employment. Private expenses of the employee that are borne by the employer are examples of cash benefits. Perquisites must be distinguished from benefits in kind (BIK). BIK is not convertible into cash as it belongs to the employer or is the proprietary interest of the employer. The Public Rulings on this subject is attached as an appendix for greater understanding of the tax treatment. Identifying Section 13(1)(a) income is very important in the calculation of Section 13(1)(c) – value of living accommodation benefit. One must successfully separate BIK from perquisites to get Section 13(1)(c) right.

4.5.2 Section 13(1)(b) relates to benefits in kind. It is often difficult to value in monetary terms the value of a benefit provided to an employee. Public Rulings by IRB has lent a hand to understand this difficult area. IRB has in some cases provided a convenient method for valuing a benefit, called the 'Prescribed Value' method. It has also identified some formulas to determine the value of private use of assets. The relevant Public Rulings are attached in the appendix for useful reference. A confusing benefit is Leave Passage. Three local passages and one trip to a place outside Malaysia up to the value of RM 3,000 is a tax-exempt benefit. However, that expense is not an allowable deduction to the employer. Companies will think twice before incorporating a leave passage into an employment contract because of this 'add back' provision under Section 39. A further section to note is Section 32(1).

Section 32. Special provision applicable to Gross Income from an employment

(1) Where in the relevant period there has been the use or enjoyment by the relevant person of any benefit or amenity of the kind to which Section 13 (1) (b) applies, the amount in respect thereof to be included in his gross income from the employment for the relevant period shall be an amount equal to the value of that use or enjoyment as ascertained by whatever method is just and reasonable in the circumstances

4.5.3 **Section 13(1)(c)** is another complicated area of employment tax. This section must be studied along with Section 32 of the ITA.

Section 32(2) Where in the relevant period there has been the use or enjoyment by the relevant person of living accommodation of the kind to which Section 13 (1) (c) applies, then, subject to subsection (3), the amount in respect thereof to be included in his gross income from the employment for the relevant period shall be –

(a) An amount equal to the defined value of the living accommodation for the relevant period or an amount equal to thirty per cent of the gross income which by virtue of

Section 13 (1) (a) and Section 25 or 28 falls to be included in his Gross Income from the employment for the relevant period, whichever is the less; or

(b) Where the living accommodation is provided in –

- (i) a hotel, hostel or similar premises;
- (ii) any premises on a plantation or in a forest; or
- (iii) any premises which, although in a rateable area, are not subject to public rates,

an amount equal to three per cent of the Gross Income which by virtue of Section 13 (1) (a) and Section 25 or 28 falls to be included in his Gross Income from the employment for the relevant period.

Section 32(3) further states:

Notwithstanding subsection (2), where in the relevant period there has been the use and enjoyment by the relevant person of living accommodation of the kind to which Section 13 4 (c) applies, then –

- (a) Where the relevant person's employer is a company and the relevant person at any time during the relevant period is a director of the company (not being a service director) while the company is a controlled company, then, whether or not he is a director at the time of the use and enjoyment, the amount to be included in his gross income for the relevant period shall be the defined value of the accommodation for the relevant period, or if the accommodation is wholly or partly shared with other employees, such proportion of the defined value as is just and reasonable;
- (b) Where the living accommodation is provided for only a part of the relevant period, the amount to be included in his gross income for the relevant period under subsection (2) or this subsection shall be reduced in such a proportion, if any, as is just and reasonable having regard to all the circumstances;
- (c) Where the living accommodation (except in a case to which paragraph (a) or subsection 2 (b) applies) is provided in such circumstances that –
 - (i) it is to be wholly or partly shared with other employees;
 - (ii) the relevant person is required by the employer to reside therein; or
 - (iii) the relevant person is required or expected by the employer to use it for the advancement of the employer's interests by the provision of hospitality or otherwise and, in order that it may be so used, it is larger or more valuable accommodation than the relevant person would otherwise need,

The amount to be included in his Gross Income for the relevant period under subsection 5 (a) shall be so much of the defined value of the accommodation for the relevant period as is just and reasonable or thirty per cent of the Gross Income which by virtue of Section 13 (1) (a) and Section 25 or 28 falls to be included in his Gross Income from the employment for the relevant period, whichever is the less (that amount being reduced in any case to which paragraph (b) applies in such a proportion, if any, as is just and reasonable having regard to all the circumstances).

Defined value is defined in Section 18 as follows:

“Defined value”, in relation to living accommodation provided for an employee by or on behalf of his employer, means –

- (a) Where the accommodation is not affected by any written law providing for the restriction or control of rents and the person so providing the accommodation holds the accommodation on lease the rent which is or would have been paid if the accommodation is or had been unfurnished and the lessor and lessee were independent persons dealing at arm's length;
- (b) in any other case, the rateable value or, in the absence of a rateable value, the economic rent;

“Economic rent”, in relation to any premises or part of any premises, means the rent at which those premises or that part might reasonably be expected to be let if

- (a) The lessor covenanted to pay the cost of fire insurance, public rates and work of repair and maintenance (being work which would normally be included in a covenant to repair and maintain if such a covenant were entered into by a lessor dealing at arm's length); and

“Rateable value”, in relation to premises, means the annual value as determined for rating purposes by the local rating authority, if any;

Examples for computing Section 13(1) (c) income

Hong received the following income from his employer for the year ended 31 December 2007.

a)	Salary	RM 40,000
b)	Bonus	RM 7,000
c)	Travelling Allowance	RM 3,000

The employer provided Hong with a servant and gardener benefit during the year ended 31 December 2007.

a)	Wages for servant	RM 5,600
b)	Wages for gardener	RM 4,000

The defined value for the house in which Hong was staying for the year ended 31 December 2007 was RM 18,000.

Compute the Gross Income from employment for Hong for the Year of Assessment 2007

HONG
Income Tax Computation
Year of Assessment 2007

Gross Income Employment	RM	RM
Section 13(1)(a)		
Salary	40,000	
Travelling Allowance	3,000	
Bonus	7,000	
	-----	50,000
Section 13(1) (b)		
Servant	4,800	
Gardener	3,600	
Furniture (note 4)	NIL	
	-----	8,400
Section 13(1)(c) (notes 1 to 3)		
House defined value or	18,000*	
30% of S13 (1)(a), whichever is		
Lower i.e. 30% of RM 50,000	15,000	
	-----	<u>15,000</u>
Gross Income		<u>73,400</u>

4.6 A Comprehensive Example for computing Gross Income under Section 13(1)(c)

Maniam is a technical manager in a manufacturing company operating in Klang and earned the following remuneration for the year ended 31 December 2007:

	RM
Salary	72,000
Bonus	2,000
Entertainment Allowance	3,000
Traveling Allowance	3,000

During the year, the company paid RM 1,200 for medical treatment received by Maniam. In addition, he was provided with unfurnished accommodation. The rent paid by the employer was RM 19,200 for the year.

Calculate the assessable value of living accommodation for the basis year 2007 under each of the following circumstances:

- The accommodation was provided for the whole year;
- The accommodation was provided only 6 months in the year;
- The accommodation was shared with another employee for the whole year; and
- The accommodation was too large for his needs and he was required to use it to advance the interest of the employer. It was agreed by the Inland Revenue Board that he was entitled to a 1/3 rebate on the define value.

Answer:

(a) Gross Income from employment under Section 13(1)(a) would be made up of:

	RM
Salary	72,000
Bonus	12,000
Entertainment Allowance	3,000
Traveling Allowance	3,000
	<u>90,000</u>

Value of living accommodation is:

Defined value	19,200
30% of Section 13(1)(a) income	27,000

Therefore, the value is the lower amount i.e. RM 19,200.

(b) Defined value	19,200
30% of Section 13(1)(a) income	27,000
The lower amount is RM 19,200	
Value of living accommodation is $6/12 \times \text{RM } 19,200 =$	<u>RM9,600</u>

(c) Defined value (RM 19,200 / 2)	9,600
30% of Section 13(1)(a) income	27,000
Value of living accommodation, Whichever is the lower amount	<u>9,600</u>

(d) Value of living accommodation will be:	
Defined value	19,200
Less: 1/3 rebate	(6,400)
	<u>12,800</u>
30% of Section 13(1)(a) income	27,000
Thus, value of living accommodation, Whichever is the lower	<u>12,800</u>

Provision of hotel / hostel

Example

Sunny received a salary of RM 4,000 per month for the period 1.1.2007 – 31.12.2007. For the month of January 2007, he is provided with accommodation in Excelsior Hotel, Ipoh. The employer settled the hotel bill equivalent to RM 200 per day for the room occupied.

Calculate the value of accommodation of Section 13(1)(c)

Answer:

Section 13(1)(a)	RM 4,000 x 12	=	RM 48,000
	3% of RM 48,000	=	RM 1,440

Since accommodation is only provided for one month, the value of benefit under Section 13(1)(c) for Sunny is $\text{RM } 1,440 \times 1/12 = \text{RM } 120$.

4.6.1 Section 13(1)(d) is quite straightforward. It is the distribution of funds from an unapproved provident fund to an employee either before or after his employment ceases. Such funds are created from the contributions of the employer. Funds have to be approved by the D-G. The contributions of the employee are not taken into account, as employee contributions are after-tax. The income earned in the fund and distributed is also taxable on the employee.

4.6.2 Section 13(1)(e) is another important subsection. It deals with compensation for loss of employment. This is quite common as during downturns or boom-bust economic cycles there will be plenty of cases of retrenchment, voluntary separations from service and people losing their jobs. There is an exemption from tax for compensation under Paragraph 15 of Schedule 6. The exemption is RM 6,000 for each completed year of service.

There is a need to distinguish compensation from a loss of employment with gratuity. Gratuity is a gratuitous payment for services rendered. It looks at past services, whereas compensation is for loss of future income. There is also a provision under compensation that allows for payment received for a covenant not to compete. People are sometimes asked to leave or forced to leave and asked not to compete for a certain short period of time.

Example

Sheldon is forced to stop working in 2007 due to his ill health and received the following from his employer for the year ended 31 December 2007. He started work two and a half years ago.

a)	Salary	RM 100,000
b)	Compensation for loss of employment	RM 28,000

Sheldon approached you regarding his tax position for the Year of Assessment 2007.

Sheldon Income Tax Computation Year of Assessment 2007

Gross Income		RM	RM
Employment (Section 13(1)(a))			100,000
Section 13(1)(e)	Compensation for loss of employment	28,000	
	Less: Exemption under Para 15(1)(a)		
	Of Schedule 6 (refer to notes below)	12,000	16,000
	Gross Income		<u>116,000</u>

Notes:

Compensation for loss of employment during the basis year by an employee or consideration for any covenant entered into by the employee restricting his right to take up employment of the same or similar kind is exempt:

- a) if the Director-General is satisfied that the payment is made on account of loss of employment due to ill-health;
- b) in the case of payment in relation to a period of employment with the same employer or with companies in the same group. Exemption in such cases is limited to RM 6,000 per year multiplied by the number of completed years of service with that employer or group of companies.

The above exemption does not apply to a director of a controlled company who is not a full-time service director. Controlled company directors are not perceived as employees in a master-servant relationship. Service directors on the other hand hold less than 5% ownership in the company and thus are treated more as employees.

4.7 Comprehensive Example 1

Hah Chiang was a director (not a service director) of a controlled company in Kota Kinabalu since January 1, 2003. Due to some misunderstanding between him and the other directors, he left the company on January 31, 2007. Details of his remuneration for the year ended December 31, 2006 were as follows:

	RM
(i) Salary 01-01-2006 to 31-10-2006	7,000 p.m.
(ii) Leave pay 01-11-2006 to 31-01-2007 paid on 30-12-2006	7,000 p.m.
(iii) Bonus (for 2005 was paid on 23-01-2006)	8,000
(iv) Travelling Allowance [up to 31-10-2006] (Travelling expenses wholly and exclusively incurred for the Company's business amounted to RM 8,000)	600 p.m.
(v) Entertainment Allowance [up to 31-10-2006] (Actual amount expended for entertaining and servicing existing clients amounted to RM 9,000)	600 p.m.
(vi) Gratuity received on 15-01-2007	245,000
(vii) Hah Chiang also received the following employment benefits up to October 31, 2006	
(a) The use of a company car costing RM 105,000, which was purchased in year 2000, a driver and a gardener up to 30/9/06	
(b) Fully furnished accommodation (inclusive of furniture at RM300 p.m.) paid by the company, at RM 3,500 p.m. up to 31/10/06.	

Hah Chiang paid a rental of RM 1,200 p.m. to the company for the use of this accommodation benefit.

Required:

Compute his Adjusted/Statutory Income from Employment for Y/A 2006.

Answer:**Gross Income from Employment**

	RM
Section 13(1)(a)	
Salary	70,000
Leave Pay	14,000
Leave Pay [S25 (5) applies]	7,000
Bonus [S25 (2)] - constitute income for Y/A 2005	Nil
Travelling Allowance	6,000
Entertainment Allowance	6,000
Gratuity (Note 1)	<u>61,250</u>
	164,250
Section 13(1)(b)	
Car (RM 5,000 / 2) x 3/4	1,875
Fuel (1,500 * ¾)	1,125
Driver (600 * 9)	5,400
Gardener (3,600 * 3/4)	2,700
Furnishings (280 * 10)	<u>2,800</u>
	13,900
Section 13(1)(c) (Note 2)	<u>32,000</u>
Gross Employment Income	210,150
Less: Travelling Expenses	(8,000)
Entertainment Expenses [S38A](Note 3)	(6,000)
Rental	<u>(12,000)</u>
Adjusted Income/Statutory Income	<u>184,150</u>

Notes:

- 1) It is not very clear if the amount received as gratuity is in fact a compensation for loss of employment. A director of a controlled company will not be entitled to any exemption in respect of compensation received. However if the payment is regarded as gratuity there will be a spread back on a time basis if the employment is for a period of less than five years from the beginning of the current basis period, which is the current case. An issue will be how long is his employment? Does one take his period of leave? Under Section 25(5) his leave pay is included as gross income for YA2006. In this regard his employment period will be considered up to 31.12.2006. This would be the most appropriate treatment. Section 25(6) will not apply, as he lives in Malaysia and will be most probably resident in the following year.

To compute the amount of taxable gratuity, use the following formula: -
 Nos. of Months of employment for Y/A 2006 basis period x Gratuity
 /Total No of Months of Employment

$$12/48 * \text{RM } 245,000 = \text{RM } 61,250$$

- 2) The basis of comparing the lower of 30% of S13 (1)(a) or the defined value does not apply to a non-service director of a controlled company. Only the defined value is taken. The defined value is: Rent of 3,500 less furniture portion of 300 = 3,200 times 10 months = 32,000.

- 3) Under Section 38A the amount of entertainment expenditure allowed is limited to actual entertainment allowances given. This does not apply to travelling expenses.

Comprehensive Example 2

Encik Hanafiah was retrenched on June 30, 2007 from Company A where he had worked for 10 1/2 years. His employment income for the 6 months amounted to RM 40,000. In addition, he received RM 50,000 as compensation for loss of office. Immediately thereafter, Encik Hanafiah commenced employment with Company B on July 1, for which he was given the following remuneration and benefits:

- i) Basic salary of RM 5,000 per month;
- ii) Bonus of RM 7,000 in December 2007;
- iii) Fully furnished bungalow, the rental for which is RM 2,500 per month for the unfurnished accommodation and RM500 per month for the furnishings;
- iv) 6 year-old car costing RM 60,000 when new;
- v) Employer's contribution to the EPF of 15%;
- vi) Overseas leave passage of RM 10,000.

Required:

Compute the Statutory Income from employment for Y/A 2007

Company B

	RM	RM
Section 13(1)(a)		
Salary (5,000 * 6)	30,000	
Bonus	7,000	37,000
Section 13(1)(b)		
Furnishings (RM 280 x 6)	1,680	
Leave passage (10,000 less 3,000)	7,000	
Car provided		
	Annual Value	Fuel
Per Annum	2,400	900
Half Year of benefit	1,200	450
Car more than 5 yrs old	600	450
	1,050	9,730
Section 13(1)(c)		
30% of RM 37,000 ;(Section 13(1)(a)	11,100	
OR		
RM 2,500 x 6 months	15,000	11,100
Whichever is lower?		

Company A

Employment Income		40,000
Compensation	50,000	
Exemption (RM 6,000 X 10) (Restricted)	50,000	Nil
Adjusted Income/Statutory Income from Employment		<u>97,830</u>

4.8. Conclusion

The chapter has discussed different aspects of Employment Income. Among the points discussed are: Employment is defined in Section 2 of the ITA, Section 13: General provisions as to Employment Income, Derivation of Employment Income, Section 25: Basis periods to which Gross Income from an employment is related, Understanding the provisions of Section 13 (1) (a) to (e), A Comprehensive Example for computing Gross Income under Section 13(1). The different aspects have been explained to provide a comprehensive knowledge on employment income.

Self Assessment

Q1 Encik Halim, aged 48 years is a full-time director of a company from which he receives a salary of RM 15,000 per month. He also received 3 1/2 months' bonus and a commission of RM 17,500 during the year ended December 31, 2007. Other benefits extended to him include: -

- i) A company car and chauffeur. The car, which is 6 years old, originally costs RM 95,000. Both the chauffeur's monthly salary of RM 650 and annual fuel cost of RM 4,000 were borne by the company.
- ii) An annual leave passage to Langkawi costing RM 12,500 for Encik Halim and members of his immediate family.
- iii) An unfurnished bungalow for which the company pays a monthly rental of RM 7,250.
- iv) A mobile phone
- v) Employer's contribution to the EPF of 16 per cent.

Required:

Compute the Statutory Income from employment for Y/A 2007.

Q2 What are the conditions for the following income to be exempted from tax?

- a) Gratuity
- b) Compensation for loss of employment

Suggested Answers

A1**Halim**

RM

Section 13(1)(a)

Salary	180,000
Bonus	52,500
Commission	17,500
	250,000

Section 13(1)(b)

Car	Annual Value	Fuel	
Per Annum	3,600	1,200	
Car more than 5 years	1,800	1,200	3,000
Furnishings (assume)	NIL		
Driver (RM 600 x 12)			7,200
Mobile phone			600
Leave passage			Exempted

Section 13(1)(c)

30% of RM 250,000	75,000	
OR		
RM 7,250 x 12	87,000	75,000
Whichever is lower?		
Adjusted/Statutory Income from employment	335,800	

- A2** a) Gratuity received by an individual is exempted from tax if:
- i) The Director-General is satisfied that the retirement was due to ill-health, or
 - ii) The retirement takes place on or after reaching the age of 55 or on reaching the compulsory age of retirement from employment specified under any written law and in either case the employment has spanned at least 10 years with the same employer or with companies in the same group.
 - iii) Sums received by way of gratuity or by way of payment in lieu of leave paid out of public funds on retirement or sums received by way of gratuity paid out of public funds on termination of a contract of employment (less employer's contribution to EPF, if any, and interest thereon)
- b) Compensation for loss of employment during the basis year is exempted:
- i) if the Director-General is satisfied that the payment is made on account of loss of employment due to ill-health.
 - ii) in the case of payment made in relation to a period of employment with the same employer or with companies with the same group. Exemption in such cases is limited to RM 6,000 per year multiplied by the number of completed years of service with that employer or group of companies.

The above exemption does not apply to a director of a controlled company who is not a full-time service director.



**LEMBAGA HASIL DALAM NEGERI
INLAND REVENUE BOARD**

PUBLIC RULING

PERQUISITES FROM EMPLOYMENT

Translation from the original Bahasa Malaysia text.

PUBLIC RULING NO. 1/2006

DATE OF ISSUE: 17 January 2006



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**INLAND REVENUE BOARD
MALAYSIA**

PERQUISITES FROM EMPLOYMENT

**Public Ruling No. 1/2006
Date of Issue : 17 January 2006**

DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

**Director General of Inland Revenue,
Malaysia**



1. This Ruling explains:
 - i. the distinction between perquisites and benefits-in-kind (BIK);
 - ii. the meaning of perquisites in relation to an employment;
 - iii. types of perquisites and the tax treatment;
 - iv. the employer's responsibilities upon the granting of perquisites to the employee; and
 - v. the employee's responsibilities on receiving such perquisites.
2. The provisions of the Income Tax Act, 1967 (ITA) related to this Public Ruling are sections 2, 4(b), 7, 13, 25, 77, 82, 82A, 83, 112, 113, 119A, 120 and Schedule 6.
3. The words used in this Ruling have the following meanings:
 - 3.1 "Resident", in relation to an employee, is an employee resident in Malaysia for a basis year for a year of assessment by virtue of section 7 of the ITA.
 - 3.2 "Document" means -
 - a. statement of income and expenditure; and
 - b. invoices, vouchers, receipts and such other documents as are necessary to verify the particulars in a return.
 - 3.3 "Individual" means a natural person.
 - 3.4 "Employer", in relation to an employment, means -
 - a. where the relationship of master and servant subsists, the master;
 - b. where the relationship does not subsist, the person who pays or is responsible for paying any remuneration to the employee who has the employment, notwithstanding that that person and the employee may be the same person acting in different capacities.
 - 3.5 "Market value", in relation to any thing, means the price which that thing would fetch if sold in a transaction between independent persons dealing at arm's length.
 - 3.6 "Employee", in relation to an employment, means -
 - a. where the relationship of master and servant subsists, the servant;
 - b. where that relationship does not subsist, the holder of the appointment or office which constitutes the employment.
 - 3.7 "Reimbursement", in relation to any perquisite received by the employee, means an expense incurred by the employee which is subsequently reimbursed by the employer.



- 3.8 "Employment" means -
- a. employment in which the relationship of master and servant subsists;
 - b. any appointment of office, whether public or not and whether or not that relationship subsists, for which remuneration is payable.
- 3.9 "Perquisites", in relation to an employment, means benefits in cash or in kind that are convertible into money received by an employee from the employer or third parties in respect of having or exercising the employment.
- 3.10 "Records" include -
- a. books of account recording receipts and payments or income and expenditure;
 - b. invoices, vouchers, receipts and such other documents as in the opinion of the Director General are necessary to verify the entries in any books of account; and
 - c. any other records as may be specified by the Director General under statutory order.
- 3.11 "Basis year", in relation to a year of assessment for an employment source, is the basis period for that year of assessment.
- 3.12 "Year of assessment" means the calendar year.
- 3.13 "Basis period", in relation to gross income from employment, is as ascertained by section 25 of the ITA.
- 3.14 "Not resident", for a basis year for a year of assessment in relation to an employee, means an employee other than a resident employee.

4. The distinction between perquisites and benefits-in-kind (BIK)

- 4.1 Perquisites and BIK (including the value of living accommodation (VOLA)) are benefits arising from an employment. These benefits are gross income from employment under subsection 13(1) of the ITA and is taxable under section 4(b) of the ITA. However, there are differences between these benefits.
- 4.2 Perquisites are benefits in cash or in kind which can be converted into money received by an employee from his employer or from third parties in respect of having or exercising an employment. Perquisites are taxable under section 4(b) of the ITA as part of the gross income from employment under paragraph 13(1)(a) of the ITA.



- 4.3 BIK are benefits which are not convertible into money provided for the employee by or on behalf of the employer. These benefits are categorised as gross income from employment under paragraph 13(1)(b) of the ITA. The tax treatment on BIK is explained in detail in the Public Ruling No. 2/2004: Benefits-In-Kind dated 8 November 2004.
- 4.4 VOLA is living accommodation benefit provided for the employee by or on behalf of the employer. VOLA is gross income from employment under paragraph 13(1)(c) of the ITA. The tax treatment on VOLA is explained in detail in the Public Ruling No. 3/2005: Living Accommodation Benefit Provided For The Employee By The Employer dated 11 August 2005.
- 4.5 It is important for the employer to determine and categorise correctly whether a benefit otherwise than in money provided to the employee is a perquisite under paragraph 13(1)(a) of the ITA or a BIK under paragraph 13(1)(b) of the ITA. The distinction is important as the gross income from employment under paragraph 13(1)(a) of the ITA will affect the computation of the value of living accommodation enjoyed by the employee under paragraph 13(1)(c) of the ITA.

5. Perquisites

- 5.1 Paragraph 13(1)(a) of the ITA provides that the gross income of an employee in respect of gains or profits from an employment includes any wages, salary, remuneration, leave pay, fee, commission, bonus, gratuity, perquisite or allowance (whether in money or otherwise) in respect of having or exercising the employment. This means that the gross income of an employee from an employment under paragraph 13(1)(a) of the ITA comprises of not only wages, salary, leave pay, fee, commission, bonus and gratuity, but also includes any perquisite or allowance, whether in money or otherwise, received by an employee in respect of having or exercising the employment.
- 5.2 All perquisites are gross income under paragraph 13(1)(a) of the ITA and are chargeable to tax under section 4(b) of the ITA. Perquisites have the following characteristics:
- i. Perquisites can be received regularly or casually.
 - ii. Perquisites received can be in cash or in kind. If it is received in kind, such items must have money's worth and are convertible into money. The phrase "convertible into money" means that when the items are provided to the employee, they can be sold, assigned, transferred or convertible into cash.
 - iii. Perquisites can be received by an employee in respect of an employment contract entered into by him or is given by the employer or a third party voluntarily. In the case of perquisites received from third parties, the employee must declare such income in the Income Tax Form BE or B.



- iv. Notwithstanding the above, a perquisite is subject to tax only if it arises in respect of having or exercising an employment.

Example 1

On 1.4.2005, Alfred, an employee of a company, was granted 1,000 units of ordinary shares of that company free of charge. The price of the shares at the date of grant was RM4.50 per unit. All the shares were subsequently sold by Alfred on 1.9.2005 at the price of RM4.80 per unit.

The tax treatment on Alfred in respect of the receipt and sale of shares is as follows:

As the shares -

- have money's worth; and*
- are received from the employer in respect of having or exercising the employment,*

they are perquisites to Alfred and form part of his gross income from employment under paragraph 13(1)(a) of the ITA which is taxable under section 4(b) of the ITA. As the perquisites arose on 1.4.2005, when Alfred received them (subsection 25(1) of the ITA), the amount that is chargeable to tax for the year of assessment 2005 is $RM4.50 \times 1,000 = RM4,500$.

However, the subsequent profits arising from the sale of shares on 1.9.2005 are capital profits and are not subject to tax.

(Note: The tax treatment in respect of the shares offered to the employee free of charge by the employer is explained in detail in the Public Ruling No. 4/2004 - Employee Share Option Scheme Benefit dated 9 December 2004).

Example 2

Mei Hwa is employed as a waitress in a restaurant. She often assists the customers at menu selection. Due to her pleasant, warm, friendly and helpful attitude, she often receives tips from customers who patronise the restaurant. In 2005, Mei Hwa receives tips amounting to RM10,000.

The tax treatment on Mei Hwa in respect of tips received by her is as follows:

Tips amounting to RM10,000 are perquisites even though they are received voluntarily from third parties and not from Mei Hwa's employer. The perquisite is Mei Hwa's gross income from employment under paragraph 13(1)(a) of the ITA being reward for services rendered by reason of having or exercising an employment as a waitress. Mei Hwa has to declare the tips received and the tips would be taxed for the year of assessment 2005 (subsection 25(1) of the ITA).



- 5.3 The phrase "having an employment" means an employee can be taxed in respect of a perquisite received by him purely for having the employment or for holding an office or appointment without being actively involved in the performance of any duties.

Example 3

Alex, is a director (not a service director) of a controlled company. On 1.7.2005, at the Annual General Meeting of the company, the shareholders of the company passed a resolution for part payment of the entrance fees in respect of individual membership in a recreational club for members of the Board of Directors of the company. This is in addition to their ordinary fees to be paid. The amount paid by the company for each membership is RM16,000 and the payment was made on 30.9.2005. Alex is one of the members of the Board of Directors who received this benefit.

The tax treatment on Alex in respect of the benefit received is as follows:

The payment of RM16,000 is a perquisite since it is -

- *a benefit, in addition to the ordinary fee;*
- *paid to a recreational club for part settlement in respect of the individual membership entrance fees for Alex; and*
- *related to an appointment resulting in an employment.*

The perquisite is Alex's gross income from employment under paragraph 13(1)(a) of the ITA to be taxed for the year of assessment 2005, even though Alex (as a director but not a service director of a controlled company) is not actively involved in the performance of any duties.

- 5.4 The phrase "exercising an employment" means there are duties to be performed by an employee, where a part of the duties may be performed outside Malaysia but should be for the organisation situated in Malaysia - (paragraph 13(2)(c) of the ITA).
- 5.5 In the determination of whether an amount received (whether in cash or in kind) can be chargeable to tax, it is the substance of the amount received that is of importance and not the label that is attached to it. In other words, even though an amount received is labelled as a gift, but if it can be proved that the amount is received in respect of "having an employment" or "exercising an employment", such amount received is a perquisite and is chargeable to tax as part of the gross income from employment under paragraph 13(1)(a) of the ITA.

Example 4

Norman, is a sales manager with a trading company. On 27.12.2005, at the company's Annual Dinner, he received the following :

- i. A watch costing RM5,000 for serving the company for 20 years; and



- ii. Letter of appreciation and cash gift of RM10,000 for successfully securing an important contract for the company in April 2005. This award was made voluntarily by his employer.

The tax treatment on Norman in respect of the above is as follows:

- i. *The watch, valued at RM5,000, is a perquisite to Norman and is his gross income from employment under paragraph 13(1)(a) of the ITA. The amount is chargeable to tax under section 4(b) of the ITA when received i.e for the year of assessment 2005 as the watch has a cash value, can be sold, assigned or convertible into cash and is received in appreciation for past services performed.*
 - ii. *The certificate of appreciation is not chargeable to tax as it has no money's worth and is not convertible into money even though it is related to exercising an employment.*
 - iii. *The cash of RM10,000 is a perquisite and is Norman's gross income from employment under paragraph 13(1)(a) of the ITA chargeable to tax under section 4(b) of the ITA for the year of assessment 2005. The cash of RM10,000 is in appreciation of the excellent service rendered even though it is given by the employer voluntarily.*
- 5.6 Pure gifts or testimonials received by an employee from his employer or third parties purely for personal appreciation or for specific personal reasons are not taxable as such gifts are not related to having or exercising the employment. Examples of pure gifts or testimonials include -
- Wedding gifts whether in the form of cash, jewellery or other items given to an employee by the employer;
 - Cash given to an employee by the employer for passing the professional examination with excellent results;
 - Cash, other items or certificate of appreciation given to a bank employee by the employer or third parties for successfully foiling an attempted bank robbery.
 - Cash, other items and certificate of appreciation given to an employee for having achieved some extraordinary feats -
 - swimming across the English Channel;
 - sailing around the world within a specified period of time;
 - climbed the highest mountain in the world;
 - other similar feats.

6. Types of perquisites and the tax treatment

- 6.1 Among the types of perquisites commonly given to an employee by the employer are:
- Pecuniary liability of employees paid by the employer, such as income tax payment, electricity bills, water and telephone bills;



- Credit card facilities
- Loan interest
- Recreational club membership
- Tuition or school fees of child
- Life insurance premiums
- Gardener, driver, domestic help or guard
- Waiver of loan or advance
- Scholarship
- Assets given free of charge or sold at a discount
- Gift vouchers
- Gift of personal computer to the employee by the employer
- Excellent public service award
- Professional subscriptions

6.2 The value of a perquisite received by the employee is his gross income from employment under paragraph 13(1)(a) of the ITA. For perquisites having a market value, the value of the perquisite is ascertained as follows:

	RM
Market value of the perquisite	XX
Less:	
Amount paid for the perquisite received (if any)	<u>XX</u>
Value of the perquisite chargeable to tax on the employee	<u>XX</u>

For perquisites not having any market value, the value of the perquisite is ascertained as follows:

	RM
Amount of the perquisite	XX
Less:	
Amount paid for the perquisite received (if any)	<u>XX</u>
Value of the perquisite chargeable to tax on the employee	<u>XX</u>

6.3 Employee's pecuniary liabilities

All pecuniary liabilities of an employee which are paid by his employer whether voluntarily or under the terms of an employment contract are perquisites to the employee and is his gross income from the employment under paragraph 13(1)(a) of the ITA, irrespective whether the payment –

- is made direct to the person who should receive the amount owing;
- given to the employee so that the employee can settle his pecuniary liability; or



- given to the employee as a reimbursement.

Among the pecuniary liabilities of the employee paid by the employer are income tax, water bill, electricity bill, telephone bill, road tax, car insurance premiums, car parking fees and car maintenance charges.

The amount chargeable to tax in respect of pecuniary liabilities paid by the employer can be reduced if the employee makes use of such amenities in the performance of his official duties, on the condition that such official duties can be substantiated with a certification by the employer.

6.3.1 Income tax borne by the employer

The income tax of an employee borne by his employer for a basis year for a year of assessment is treated as a perquisite of that employee under paragraph 13(1)(a) of the ITA in that year of assessment when the actual amount of tax for that year of assessment can be ascertained, that is in the following basis year. The computation of the perquisite relating to the income tax liability of the employee borne by the employer and the computation of tax payable by the employee benefiting from such perquisites is explained in detail in the Public Ruling No. 2/2006: Tax Borne By Employers dated 17 January 2006.

6.3.2 Electricity bill, water and telephone bills

For electricity bills, water bills and telephone bills, where such bills are under an employee's name and where the employer -

- gives an amount of money to the employee for the employee to settle the amounts owing as shown in those bills; or
- pays the amounts owing as shown in such bills direct to the authorities concerned,

the amount paid by the employer is perquisite to the employee and is gross income from his employment under paragraph 13(1)(a) of the ITA taxable under section 4(b) of the ITA. The amount is assessed on the employee for the basis year for the year of assessment in which the perquisite is received (subsection 25(1) of the ITA). However, where -

- the employer subscribes to these utilities (electricity, water and telephone);
- the bills for these utilities are under the name of the employer and not that of the employee; and
- the employee only enjoys the benefits when provided by the employer who subscribes for them,

the amount of such benefits is BIK which is gross income from an employment of the employee under paragraph 13(1)(b) of the ITA, as



these benefits are not convertible into money although having money's worth.

6.3.3 Car insurance premium, road tax, parking fees and car maintenance charges

The amount to be taken as perquisites under paragraph 13(1)(a) of the ITA for the above items, is the amount of car insurance premiums, road tax, parking fees and car maintenance charges (personal liability of the employee) paid by the employer.

6.4 Credit card facilities

Where the employee is provided by his employer with a credit card used exclusively for performing his duties including entertaining the employer's customers, the annual membership fees of the credit card are not considered as perquisites to the employee. However, where the credit card is also used by the employee for private purchases and payments, any amounts paid by the employer in respect of such private purchases and payments, including the annual membership fee are perquisites under paragraph 13(1)(a) of the ITA.

6.5 Loan interest

6.5.1 The charge to tax on the employee in respect of the receipt of this benefit is based on the facts of each case. In general, this benefit is a perquisite forming part of the gross income from employment under paragraph 13(1)(a) of the ITA based on the cost borne by the employer when the employer provides the loan to the employee whether for:

- interest free loan;
- loan where only part of the interest is borne by the employer; or
- interest charged is below market rate.

In other words, the source of fund for the loan is the primary factor which determines whether the receipt of such benefit is taxable on the employee.

6.5.2 Internal funds

Where the loan given to the employee arises from the internal funds of the company, no benefit is taxed on the employee even though the employee actually derives monetary benefit from the loan given to him since the employer did not bear any cost when the loan was given to the employee. Such a tax treatment would be given in the case where an interest free loan is given to an employee from the excess business funds of the employer or without any loan taken from any other persons.



6.5.3 Funds from bank loan or loan from related companies

Where an employer obtains a loan from a third party to provide the interest free loan to the employee, the amount of perquisite forming the gross income from employment under paragraph 13(1)(a) of the ITA is the cost borne by the employer to the third party for provision of the loan facility. This treatment is also applicable in the case where the employer receives a preferential rate from the loan provider due to good credit standing. The preferential rate is regarded as the market rate for that employer.

Where an employer obtains a loan from a third party to provide the loan to the employee and the employee is required to pay only the nominal interest on the loan while the balance of the interest is borne by the employer, the amount of perquisite under paragraph 13(1)(a) of the ITA is the difference between the interest charged on the employer by the loan provider and the nominal interest paid by the employee.

The method of calculation of the perquisite arising from the benefit is:

	RM
Amount of interest charged on the employer by the loan provider	XX
Less:	
Amount of nominal interest paid by the employee	XX
Value of perquisite chargeable to tax on the employee	<u>XX</u>

Example 5

Wahid, a chief executive in a listed company, has obtained a staff housing loan in 2005 where he is being charged with interest at the rate of 4% per annum. The funds for the housing loan are obtained from a loan taken by the employer from a bank which charges interest at the preferential rate of 8% per annum. The market rate of interest for a similar loan is 10% per annum. In 2005 the employer paid interest to the bank amounting to RM6,000 while Wahid paid interest to the employer amounting to RM3,200.

The amount of perquisite taxable on Wahid as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2005 is computed as follows:

	RM
Amount of interest charged by the bank on the employer for the loan taken	6,000



Less:	
Amount of interest charged on Wahid	3,200
Value of perquisite chargeable to tax on Wahid	2,800

6.5.4 If the loan to the employee is given at the rate which is the same as the cost paid by the employer, there is no perquisite to be taxed on the employee.

6.5.5 In summary, perquisites related to this benefit would arise only where-

- the funds for providing the loan facility originate from external funds; and
- the rate of interest charged on the employee for the loan provided by the employer is lower than the rate of interest borne by the employer.

6.6 Recreational club membership

The tax treatment for this benefit is based on the facts of each case.

6.6.1 Individual membership

In this situation, the membership is owned by the individual. The entrance, monthly or annual membership subscription or term membership fees and other related reimbursements are the pecuniary liabilities of the employee. Such fees paid by the employer to a recreational club for the benefit of an employee are perquisites to the employee and is his gross income from employment under paragraph 13(1)(a) of the ITA.

6.6.2 Corporate membership

In contrast to an individual membership, a corporate membership is owned by the employer. When the employer pays the entrance fee and the monthly or annual subscriptions of a corporate membership to a recreational club for the benefit of the employee, the entrance fee is not a perquisite to the employee as the membership is owned by the employer. The monthly or annual subscription is a BIK under paragraph 13(1)(b) of the ITA and is not a perquisite under paragraph 13(1)(a) of the ITA as this benefit is not convertible into money even though there is money's worth.

6.7 Tuition or school fees of child

6.7.1 Payment or reimbursement to an employee by the employer in respect of tuition or school fees for the employee's children whether studying in or outside Malaysia is a perquisite to the employee and is his gross income from employment under paragraph 13(1)(a) of the ITA.

6.7.2 However, where the employee receives reimbursement from an education refund plan, this reimbursement is not treated as a benefit to the employee.



An education refund plan is a fund established by the employer to enable an employee of the company, upon the successful completion of a part-time course or study at the certificate, diploma or degree level, to claim reimbursements for the expenses on registration fees, course or tuition fees, examination fees incurred by him to acquire that qualification. The course or study undertaken must be for the purpose of enhancing the education and skills of the employee and is directly related to the performance of the employee's duties.

6.8 Insurance premiums

- 6.8.1 Where the employer pays the annual insurance premium for an insurance scheme in which the employee, members of his family or his nominee is appointed as the beneficiary to the policy, the amount of annual premium is a perquisite to the employee and is his gross income from employment under paragraph 13(1)(a) of the ITA.
- 6.8.2 However, certain insurance premiums or contributions paid by the employer are not considered as perquisites to the employee and therefore are not taxable on him. Such insurance premiums are -
- insurance premiums which are obligatory for foreign workers as a replacement to SOCSO contributions.
 - group insurance premiums to cover workers in the event of an injury or accident.
 - insurance premiums on insurance policies under the Aviation Travel Insurance for employees for coverage of employees for travelling on official duty.
 - contributions by employer to the health care management organisation for payment of the medical and treatment costs of employees.

6.9 Gardener, driver, domestic help or guard

- 6.9.1 Where the gardener, driver, domestic help or guard is hired by the employee or the employer allows the employee to make claims for reimbursement of the salaries of the gardener, driver, domestic help or guard, the amount of salary or the reimbursement paid by the employer is a perquisite to the employee and is his gross income from employment under paragraph 13(1)(a) of the ITA.

Example 6

Chong Hin, is a partner in an accounting firm. He accepted an offer to become a managing director of Bina Teguh Sdn Bhd after the company has agreed to pay his house rent, his driver's and domestic help's salaries.



The amount of the house rent, the driver's and domestic help's salaries paid by the employer are perquisites to Chong Hin and are taxable on him.

- 6.9.2 However, where the gardener, driver, domestic help or guard is employed by the employer and the employee is entitled to the benefit of that gardener, driver, domestic help or guard provided by the employer to him, the benefit is a BIK to the employee and is his gross income from employment under paragraph 13(1)(b) of the ITA.

Example 7

Using the facts in Example 6, if the company agrees to provide the house, driver and domestic help to Chong Hin free of charge in fulfilling the condition for his acceptance of the appointment, the tax treatment on Chong Hin is as follows:

<i>Item</i>	<i>Provision in the ITA</i>	<i>Amount to be taxed (RM)</i>
<i>House</i>	<i>Paragraph 13(1)(c)</i>	<i>30% X paragraph 13(1)(a) of the ITA Or Defined value of the living accommodation, whichever is the lower</i>
<i>Driver's salary</i>	<i>Paragraph 13(1)(b)</i>	<i>Amount expended by the employer Or Prescribed value i.e. RM600 per month per person (concession)</i>
<i>Domestic help's salary</i>	<i>Paragraph 13(1)(b)</i>	<i>Amount expended by the employer Or Prescribed value i.e. RM400 per month per person (concession)</i>

- 6.9.3 However, in the case where a driver is not specifically provided to any employee but the driver comes from a pool of drivers provided by the employer for the use of other employees solely for business purposes, no benefit will be taxable on the employee.

6.10 Scholarship

Paragraph 24, Schedule 6 of the ITA provides that any sums paid by way or in the nature of a scholarship or other similar grant or allowance to an individual, whether or not in connection with an employment of that individual is exempted



from income tax. However, the salary paid to an employee during the study leave period is taxable as income from employment as the employee is regarded as having an employment, even though he is not exercising his employment.

6.11 Waiver of loan or advance

Where an employer provides a loan or advance to his employee and subsequently waived the amount of the loan or advance, the amount of loan or advance waived is a perquisite to the employee as it is payment for services performed. Such a perquisite will arise in cases where the employer provides a loan to an employee to enable the employee to attend courses or undergo training and subsequently waives the loan or advance after the employee has served the required time with the employer. This perquisite is his gross income from employment under paragraph 13(1)(a) of the ITA and is taxable for the basis period for the year of assessment in which the loan or advance is waived.

Example 8

Gwen works with a legal firm. In February 2002, her employer gave her a loan of RM20,000 to enable her to attend a one-year course in law. The loan contract provides that if Gwen works with the employer for a period of 24 months after the completion of the course, the loan need not be repaid. Gwen successfully fulfilled this condition under the contract in January 2005 and the loan was subsequently waived.

The tax treatment on the loan is as follows:

The amount of loan waived by the employer amounting to RM20,000 is a perquisite to Gwen and is her gross income from employment under paragraph 13(1)(a) of the ITA as it is payment for services performed. The perquisite is taxable for the year of assessment 2005 i.e in the year in which the loan is waived (subsection 25(2) of the ITA).

6.12 Assets provided free of charge or sold at discounted prices

- 6.12.1 Where assets such as houses, cars or other items are provided free of charge or sold at discounted prices by the employer to his employee, the difference between the market price of such assets and the amount paid by the employee (if any) is a perquisite to the employee. The amount is gross income from employment under paragraph 13(1)(a) of the ITA.

Example 9

AMV is a company selling imported luxury cars. The company has a Staff Purchase Discount Plan for its employees at the managerial level. According to the Staff Purchase Discount Plan, the employees at the



managerial level can purchase the cars sold by the company at discounted prices as follows:

Type of asset	Market price per unit (RM)	Discount given (%)
Car Model AMV Superclass	1,100,000	10

The discount of 10% on the price of the car received by the employee is a perquisite as -

- *the car has money's worth and can be convertible into money; and*
- *the employee upon purchasing the car, has ownership rights over the car and is subsequently able to sell the car to a third party.*

Thus, the amount of the discount is gross income from employment under paragraph 13(1)(a) of the ITA.

6.13 Gift vouchers

6.13.1 Normally, gift vouchers are not taxable in the hands of the employee unless they are of a recurring nature and are provided in the circumstances where the employee expects such gifts as part of his remuneration.

6.13.2 Where it is the practice of the employer to give gift vouchers to the employees on festive occasions such as Christmas, Chinese New Year, Deepavali, Hari Raya Aidil Fitri or Gawai Day, based on the length of service of the employee and such vouchers can be used to buy goods from a particular shop, the value of the gift vouchers is a perquisite to the employee and it is his gross income from employment under paragraph 13(1)(a) of the ITA.

6.14 Gift of personal computers

Where an employee receives a gift of a personal computer from his employer, the market value of the personal computer is a perquisite to the employee and the amount is gross income from employment under paragraph 13(1)(a) of the ITA in the year the benefit is received (subsection 25(2) of the ITA).

The exemption from income tax on an amount equal to the value of the benefit of one new personal computer received as a gift by an employee from his employer was effective from the year of assessment 2001 until the year of assessment 2003 (inclusive) - *P.U.(A) 503, Income Tax (Exemption) Order (No. 56) Order 2000 dated 22 December 2000.*



6.15 Excellent Public Service award

The performance award given to the officers and staff of the public sector by the Government for excellent service rendered in the performance of their duties, must be treated as gross income from employment under paragraph 13(1)(a) of the ITA and is subject to tax.

6.16 Professional subscriptions

Subscriptions to a professional body paid by an employer on behalf of his employee will not be considered as a perquisite if membership to that professional body is essential to the business of the employer in terms of enhancement of knowledge for the employee to facilitate him in carrying out his duties. However, where it cannot be proved that the membership is relevant to the business of the employer, then the professional subscription paid on behalf of the employee is a perquisite under paragraph 13(1)(a) of the ITA.

7. Employer's responsibilities

- 7.1 In accordance with subsection 83(1) of the ITA, the employer is required to report in the employee's statement of remuneration (Form EA and EC) and Form E for the employer, all payments in respect of services provided by the employee including all types of perquisites. This includes the benefits provided for the spouse, family, servants, dependent or guest of the employee. The failure by the employer to comply with this subsection will render the employer liable to prosecution under subsection 120(1) of the ITA.
- 7.2 In accordance with section 82 of the ITA, the employer is also required to keep records and receipts pertaining to all claims on expenses incurred on the employees. These records and receipts must be kept for a period of seven (7) years from the end of the year of assessment in which the Income Tax Form is furnished for the purposes of verification during a tax audit. The failure by the employer to comply with this section will render the employer liable to prosecution under section 119A of the ITA.

8. Employee's responsibilities

- 8.1 In accordance with subsection 77(1) of the ITA, the employee is required to report in the Income Tax Form BE or B (whichever is applicable) all payments received in respect of having or exercising the employment including all types of perquisites received from the employer or third parties. This includes benefits received for the spouse, family, servants, dependent or guest of the employee.



The failure by the employee to comply with this section will render the employee liable to prosecution or penalty under section 112 of the ITA. Where the employee under declares his income, he is liable to prosecution or penalty under section 113 of the ITA.

- 8.2 In accordance with section 82A of the ITA, the employee is required to keep records and documents pertaining to all receipts from the employer or third parties in respect of having or exercising an employment including the receipts of perquisites. Such records or documents must be kept for a period of seven (7) years from the end of the year of assessment in which the Income Tax Form is furnished for purposes of verification during a tax audit.

9. Schedular Tax Deduction (STD)

Where an employee receives a perquisite from his employment, the employer must ensure that the tax to be charged on the perquisite is deducted from the employee's remuneration based on the Schedule (Rule 3) of the monthly Income Tax Deductions under the Income Tax (Deduction From Remuneration) Rules in the month in which the perquisite is paid. In the case where the salary of the employee is not sufficient to absorb the monthly income tax deduction on the perquisite, the employer has to obtain the approval of the Collection Branch to allow the employee to pay tax on the perquisite by installments with the issuance of the Directive of Tax Deduction (CP 38).

10. This Ruling is effective for the year of assessment 2005 and subsequent years of assessment.

**Director General
of Inland Revenue**



**LEMBAGA HASIL DALAM NEGERI
INLAND REVENUE BOARD**

PUBLIC RULING

BENEFITS-IN-KIND

Translation from the original Bahasa Malaysia text.

PUBLIC RULING NO. 2/2004

DATE OF ISSUE: 8 NOVEMBER 2004



**INLAND REVENUE BOARD
MALAYSIA**

BENEFITS-IN-KIND

**Public Ruling No. 2/2004
Date of Issue: 8 November 2004**

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DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

**Director General of Inland Revenue,
Malaysia**



**INLAND REVENUE BOARD
MALAYSIA**

BENEFITS-IN-KIND

**Public Ruling No. 2/2004
Date of Issue : 8 November 2004**

-
1. This Ruling explains:
 - i. the tax treatment in relation to benefits-in-kind (BIK) received by an employee from his employer for exercising an employment; and
 - ii. the method of ascertaining the value of BIK in order to determine the amount to be taken as gross income from employment of an employee.
 2. The related provisions in the Income Tax Act 1967 (*the Act*) pertaining to BIK are -
 - **Paragraph 13(1)(b)** - which provides that BIK is part of gross income from employment of an employee; and
 - **Subsection 32(1)** - which determines the amount of BIK to be taken as gross income from employment of an employee.
 3. The words used in this Ruling have the following meanings:
 - 3.1 "Members of his/her immediate family" means his wife or wives and his children, or her husband and her children.
 - 3.2 "Child" means a legitimate child or step-child of an individual or his wife, or a child proved to the satisfaction of the Director General to have been adopted by the individual or his wife in accordance with any law.
 - 3.3 "New" in relation to a motorcar means a motorcar including a reconditioned motorcar at the time when it was first registered in Malaysia.
 - 3.4 "Motorcar" means a motor vehicle other than a motor vehicle licensed by the appropriate authority for commercial transportation of goods or passengers.
 - 3.5 "Cost of motorcar" means actual cost of the motorcar inclusive of accessories but excluding financial charges, insurance premium and road tax at the time when it was new.
 - 3.6 "Cost of leave passage" means cost of fares.
 - 3.7 "Employer" in relation to an employment means-
 - a. the master, where the relationship of master and servant subsists;
 - b. where the relationship does not subsist, the person who pays or is responsible for paying any remuneration to the employee who has the employment, notwithstanding that the person and the employee may be the same person acting in different capacities.
 - 3.8 "Employee" in relation to an employment means-
 - a. the servant, where the relationship of master and servant subsists;
 - b. where the relationship of master and servant does not subsist, the holder of the appointment or office which constitutes the employment.
 - 3.9 "Employment" means-
 - a. employment in which the relationship of master and servant subsists;



- b. any appointment or office, whether public or not and whether or not that relationship subsists, for which the remuneration is payable.

3.10 "Perquisites" means benefits that are convertible into money received by an employee from the employer or third parties in respect of having or exercising the employment.

4. What is BIK?

- 4.1 Paragraph 13(1)(b) of the Act provides that the gross income of an employee from an employment also includes any amount equivalent to the BIK provided to the employee by/on behalf of his employer to be personally enjoyed by that employee.
- 4.2 BIKs are benefits not convertible into money, even though they have monetary value. The phrase 'not convertible into money' means that when the benefit is provided to the employee, that benefit cannot be sold, assigned or exchanged for cash either because of the employment contract or due to the nature of the benefit itself.
- 4.3 All BIKs received by an employee are taxable except:
 - i. medical, dental or child-care benefit;
 - ii. a benefit consisting of -
 - a. leave passage in Malaysia of not more than 3 times in one calendar year; or
 - b. overseas leave passage of not more than once in any calendar year limited to a maximum amount of RM3,000.The exemption of this benefit is only applicable if it is provided to the employee and members of his immediate family.
 - iii. benefits used by the employee solely for purposes of performing his employment duty.
- 4.4 However, in addition to the above, the following benefits are also regarded as not taxable:-
 - (i) Goods and services offered at discounted prices;
 - (ii) food and drink provided free of charge;
 - (iii) free transportation between pick-up points or home and the place of work (to and fro);
 - (iv) insurance premiums which are obligatory for foreign workers as a replacement to SOCSO contributions; and
 - (v) group insurance premium to cover workers in the event of an accident.
- 4.5 In the case of accommodation provided by/on behalf of the employer to his employee, this benefit is not covered under paragraph 13(1)(b) of the Act. Instead, it is specifically dealt with under paragraph 13(1)(c) of the Act and will be explained in detail in a separate ruling.
- 4.6 The same applies to benefits that are convertible into money. They represent perquisites from the employment of an employee and are taxable under paragraph 13(1)(a) of the Act. These benefits will also be explained in detail in a separate ruling.

5. Ascertainment of the value of BIK



- 5.1 Subsection 32(1) of the Act provides that the value of BIK to be taken as gross income from an employment of an employee is an amount which is just and reasonable in the circumstances. Two methods may be used to determine the value of BIK provided to the employee by the employer. The methods are:

- the formula method; and
- the prescribed value method.

5.2 The formula method

- 5.2.1 Under this method, each benefit provided to the employee is ascertained by using the formula below:

$$\frac{\text{Cost of the asset that is provided as benefit/amenity}}{\text{Prescribed average life span of the asset}} = \text{Annual value of the benefit}$$

Here, cost means the actual cost incurred by the employer.

- 5.2.2 For the purposes of applying the formula method, the prescribed average life span of the various assets are as in Appendix 1.

Example 1

Employee A is provided with a refrigerator. The cost of the refrigerator is RM2,000 and the prescribed average life span of the asset is 10 years.

Based on the above formula, the annual value of the BIK for refrigerator is:

$$\frac{\text{RM2,000}}{10} = \text{RM200}$$

The amount of RM200 must be taken into account as part of Employee A's gross income from employment and this amount should be reported by the employer in the employee's CP8A/8C.

- 5.2.3 The prescribed average life span of the assets as tabulated in Appendix 1 must be applied for any benefit/amenity provided regardless whether the asset is old or new.
- 5.2.4 The value of BIK based on the formula method provided to the employee by the employer can be abated if the BIK is-
- i. provided for less than a year; or/and
 - ii. shared with another employee; or/and
 - iii. used for purpose of the business of the employer.

5.3 The prescribed value method

- 5.3.1 As a concession, the prescribed value method can be used as an alternative to determine the value of the BIK provided by the employer to his employee.
- 5.3.2 The schedules for the prescribed values of the benefits commonly provided to the employee are provided in Appendix 2.



5.3.3 The value of BIK based on the prescribed value method provided to the employee by the employer can be abated if the BIK is-

- i. provided for less than a year; or/and
- ii. shared with another employee.

Under the prescribed value method, there is no abatement for business usage on the BIK provided to the employee.

5.4 Consistency

Whichever method is used in determining the value of the benefit provided, the basis of computing the benefit (whether the formula method or the prescribed value method) must be consistently applied throughout the period of the provision of the benefit.

6. Particular benefits-in-kind

6.1 Motorcar and other related benefits

6.1.1 Where a motorcar is provided, the benefit to be assessed is the private usage of that motorcar and the petrol provided. A motorcar which is provided to the employee is regarded to be used privately if:

- it is used for travelling between the office and the employee's home; and
- it is kept at the employee's home where the motorcar can be used by the employee or his family at any time.

However, toll fees which are paid by the employer is regarded as inclusive in the value of the BIK on the motorcar. Maintenance costs such as servicing, repairs, annual road tax and annual insurance premium are not regarded as part of the benefit of the employee.

6.1.2 The computation of BIK in respect of a motorcar should be based on the formula method. Under this method, an abatement of 20% is given which is deemed to be the value of the motorcar at the time when it is returned to the employer by the employee. Hence, the formula to be applied in respect of BIK on a motorcar is as follows:

$$\frac{\text{Cost of the motorcar}}{8 (\text{Prescribed Average Life Span})} \times 80\% = \text{Annual value of benefit of the motorcar}$$

Example 2

Employee A is provided with a new Honda City. The benefit is provided to him throughout the year 2004. The cost of the motorcar is RM81,000.

The annual value of BIK in respect of the motorcar which is taxable as part of Employee A's gross income from employment for the year of assessment 2004 is as follows:



$$\frac{81,000}{8} \times 80\% = RM8,100$$

- 6.1.3 However, as a concession, the prescribed value method can be used. The prescribed value for a motorcar is given in Appendix 2. Under the prescribed value method, the valuation of the benefit will be based on the cost of the motorcar at the time when it was new. This treatment is also applicable to:

- a secondhand motorcar; and
- a leased / rented motorcar

Example 3

The facts are the same as in Example 2.

Using the prescribed value method, the annual value of BIK in respect of the motorcar which is taxable as part of Employee A's gross income from employment for the year of assessment 2004 is RM3,600.

Example 4

Employee B is provided with a used car which was purchased by his employer for RM120,000. The cost of the motorcar when new was RM205,000.

Using the prescribed value method, the annual value of BIK in respect of the motorcar which is taxable as part of Employee B's gross income from employment for the year of assessment 2004 is RM9,000 instead of RM5,000.

Example 5

Employee C is provided by his employer with a new car which is leased from a leasing company. The cost of the motorcar when new is RM90,000. The employer paid a monthly lease rental of RM3,000 for 48 months.

Using the prescribed value method, the annual value of BIK which is taxable as part of Employee C's gross income from employment for the year of assessment 2004 is RM3,600. Payment for the lease rental is ignored.

- 6.1.4 Where an employee enjoys the benefit of a motorcar with free petrol, the value of BIK in respect of petrol to be included as part of the employee's gross income from employment will depend on the method used to value the BIK of the motorcar. The table below indicates the manner in which BIK in respect of petrol is determined:

<i>Based on the formula method</i>	<i>Based on the prescribed value method</i>
Amount to be taken is:- the actual amount of petrol	The amount to be taken is:- the prescribed value as provided in

expenditure incurred by employer.	Appendix 2 under The Prescribed Value Of Motorcar And Its Related Benefits.
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Example 6

Throughout the year 2004, Employee D is provided with a 3 year-old used car which was purchased by his employer for RM180,000 together with the amenity of free petrol. The cost of the motorcar when new was RM206,000. The petrol bill incurred by the employer in respect of this motorcar in the year 2004 was RM6,000.

The annual value of BIK in respect of the motorcar and petrol which are taxable as part of Employee D's gross income from employment for the year of assessment 2004 are as follows:

<i>Type of BIK</i>	<i>Based on the formula method (RM)</i>	<i>Based on the prescribed value method (RM)</i>
<i>Motorcar</i>	$\frac{180,000}{8} \times 80\% = 18,000$ <i>Cost of motorcar</i> <i>Average life span of the motorcar</i> X 80%	9,000 (instead of 7,000) ♦
<i>Petrol</i>	6,000 (actual value of petrol)	2,100 (instead of 1,800)

- 6.1.5 Where the motorcar is not provided throughout the calendar year, the value should be adjusted appropriately in accordance to the period provided.

Example 7

Employee E is provided with a new motorcar costing RM120,000 for the period of January to September 2004. He is also provided with the amenity of free petrol. The cost of petrol incurred by his employer for this period on the motorcar is RM2,700.

The annual value of BIK in respect of the motorcar and petrol which are taxable as part of Employee E's gross income from employment for the Year of Assessment 2004 are as follows:

<i>Type of BIK</i>	<i>Based on the formula method (RM)</i>	<i>Based on the prescribed value method (RM)</i>

Motorcar	$\frac{120,000}{8} \times 80\% \times \frac{9}{12} = 9,000$	$5,000 \times \frac{9}{12} = 3,750$
Petrol	2,700 (actual value of petrol)	$1,500 \times \frac{9}{12} = 1,125$

- 6.1.6 Where the motorcar is shared with another employee, the value of the BIK in respect of the motorcar and petrol will be reduced proportionately.

Example 8

Using the above Example, the motorcar is shared with another employee.

The annual value of BIK in respect of the motorcar and petrol which are taxable as part of Employee E's gross income from employment for the year of assessment 2004 will be as follows:

Type of BIK	Based on the formula method (RM)	Based on the prescribed value method (RM)
Motorcar	$9,000 \times \frac{1}{2} = 4,500$	$3,750 \times \frac{1}{2} = 1,875$
Petrol	$2,700 \times \frac{1}{2} = 1,350$	$1,125 \times \frac{1}{2} = 562.50$

- 6.1.7 In case where different cars are provided during a calendar year, the appropriate values for the respective periods should be ascertained in arriving at the annual value of the benefit.

Example 9

Employee F is provided with a new motorcar costing RM120,000 for the period from January to September 2004. For the period from October to December 2004, he is given the benefit of a new and bigger motorcar. The cost of this new motorcar is RM180,000. Employee F enjoys the benefit of free petrol throughout the year. The cost incurred by the employer in respect of petrol are as follows:

♦ Old car	RM2,700
♦ New car	RM1,200

The annual value of BIK which are taxable as part of Employee F's gross income from employment for the Year of Assessment 2004 are as follows:

Type of benefits	Based on the formula method (RM)	Based on the prescribed value method
Motorcar: Jan-Sept 2004	$120,000/8 \times 80\% \times 9/12 = 9,000$	$5,000 \times 9/12 = 3,750$



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<i>Oct-Dec 2004</i>	$180,000/8 \times 80\% \times 3/12 = 4,500$	$7,000 \times 3/12 = 1,750$
<i>Petrol:</i>		
<i>Jan-Sept 2004</i>	$2,700 \times 9/12 = 2,025$	$1,500 \times 9/12 = 1,125$
<i>Oct-Dec 2004</i>	$1,200 \times 3/12 = 300$	$1,800 \times 3/12 = 450$

- 6.1.8 Where the prescribed value method is applied to value the BIK in respect of the motorcar provided and where the motorcar provided is more than 5 years old, the annual value of the BIK in respect of that motorcar can be reduced to half (1/2) of the prescribed value. However, the value of the BIK in respect of petrol remains unchanged.

(Note: This abatement is not applicable if the value the BIK in respect of the motorcar is determined under the formula method.)

Example 10

Employee G is provided with a 7-year old Volvo with free petrol throughout the year 2004. The cost of the Volvo when new was RM285,000. His employer has incurred RM6,000 on petrol in respect of this Volvo.

The annual value of BIK in respect of the Volvo and petrol which are taxable as part of Employee G's gross income from employment for the year of assessment 2004 are as follows:

<i>Type of benefit</i>	<i>Based on the formula method (RM)</i>	<i>Based on the prescribed value method (RM)</i>
<i>Motorcar</i>	$\frac{285,000 \times 80\%}{8} = 28,500$ (there is no entitlement to reduce the BIK in respect of the motorcar to 1/2 if the motorcar provided is more than 5 years old)	$15,000 \times \frac{1}{2} = 7,500$ (value of BIK in respect of motorcar can be reduced to 1/2 if the motorcar provided is more than 5 years old)
<i>Petrol</i>	6,000	2,400

- 6.1.9 However, where the BIK in respect of the motorcar and its related benefit are valued under the formula method, a reduction in the value of the benefits can be made if the:
- motorcar is used partly for business purposes; or/and
 - employee is required to pay a sum of money to his employer for the benefit provided.
- 6.1.10 In order to substantiate claims made for business purposes, sufficient records must be kept by the employee as evidence for purpose of verification in the case of an audit.

Example 11

Employee J is provided with a 6-year old motorcar with free petrol throughout the year 2004. The motorcar was purchased by the employer at a cost of RM200,000. The total mileage of the motorcar in the year 2004 is 36,000 km out of which 12,000 km is in respect of J's private use. His employer has expended RM8,400 on petrol in respect of this motorcar. J is required to pay his employer RM1,200 to subsidize the cost of petrol that is incurred by his employer. The cost of the motorcar when new was RM280,000.

The annual value of BIK which are taxable as part of Employee J's gross income from employment for the Year of Assessment 2004 are as follows:

<i>Type of benefit</i>	<i>Based on the formula method (RM)</i>	<i>Based on the prescribed value method (RM)</i>
Motorcar	<p>Steps:</p> <p>i. $200,000/8 \times 80\% = 20,000$</p> <p>ii. $20,000 \times 12,000/36,000 = 6,667$</p> <p>The value to be included as gross income from employment = RM6,667.</p> <p>(There is no abatement to reduce the value to 1/2 of the prescribed value although the motorcar is > 5 years old. However, a reduction is given for business use.)</p>	<p>$15,000 \times 1/2 = 7,500$</p> <p>The value is to be included in as gross income from employment is RM7,500.</p> <p>(The value in respect of the motorcar is reduced to 1/2 of the prescribed value since the motorcar is > 5 years old..)</p>
Petrol	<p>Steps</p> <p>i. $8,400 \times 12,000/36,000 = 2,800$</p> <p>ii. $2,800 - 1,200 = 1,600$</p> <p>The value to be included as gross income from employment is RM1,600. (Abatement/deduction can be given in respect of:</p> <p>i. the business use of the benefit; and</p> <p>ii. expenses paid by the employee.)</p>	<p>2,400</p> <p>The value is to be included in as gross income from employment is RM2,400.</p> <p>(There is no abatement for business use</p>

6.1.11 In all cases where motorcar and/or petrol is provided to an employee, the employer should report in each of the employee's statement of remuneration the type, year of manufacture and the model of the motorcar provided.

6.2 Petrol provided without car

The benefit that is taxable is the total value of petrol provided to the employee.

6.3 Driver provided

Where a driver is provided, the value of this benefit to be included as gross income from employment is fixed at RM600 per month. In the case where a driver is not specifically provided to any employee but he comes from a pool of drivers provided by the employer solely for business purposes, no benefit will be taxable on the employee.

6.4 Household furnishings, apparatus and appliances

6.4.1 The formula method as given in paragraph 5.2 is to be used to determine the value of any BIK related to household furnishings, apparatus and appliances provided to the employee by his employer. As a concession, the prescribed value method may be used. However, if this method of valuation is chosen, there will be no further deduction for any expense incurred by the employee in acquiring the benefit. The prescribed value in respect of these benefits is given in Appendix 2 under the heading of "Prescribed value of household furnishings, apparatus and appliances".

6.4.2 The value may be adjusted by reference to whether any or all of the above categories of furnishings are provided.

Example 12

Employee K is being provided with all the benefits related to household furnishings, apparatus and appliances as stated in Appendix 2 except for those in Category 1.

*He will be assessed on the value of these BIKs amounting to RM3,360 - RM840
= RM2,520.*

6.4.3 The values may also be adjusted suitably by reference to the period provided.

Example 13

Employee Z is provided with all the benefits under Category 1 with effect from 1.4.2004.

The value of the BIK in respect household furnishings, apparatus and appliances of for the year of assessment 2004 is $RM840 \times 9/12 = RM630$.

6.4.4 An adjustment on the value of the BIK may also be made if the furnishing / apparatus / appliances are shared with other employees.

Example 14

The facts are the same as in Example 13 and Employee Z is required to share the benefits provided to him with another employee.



*The value of these BIK for the year of assessment 2004 will be $RM630 \times 1/2$
= RM315.*

- 6.4.5 Fans and water heaters are disregarded as they are treated as forming part of the residential premises.

6.5 Other assets

Other assets provided to the employees for entertainment, recreation or other purposes such as piano, organ, television, stereo set, swimming pool and others will constitute as additional benefits and should be separately assessed based on the formula.

7. Other benefits

- 7.1 The prescribed value for other benefits are listed in Appendix 2 under the heading of "Prescribed values of other benefits".

- 7.2 Other benefits not listed should be valued based on the formula:

$$\frac{\text{Cost of asset provided as benefit}}{\text{Prescribed average life span of the asset}} = \text{Annual value of the benefit}$$

- 7.3 Where a telephone (including mobile telephone) is provided to the employee by the employer, the benefits can be categorized as follows:

- the private usage of the hardware; and
- the private bills of the employee that is being paid by the employer.

- 7.3.1 The BIK in respect of private usage of telephone can be calculated either by using the formula method or the prescribed value method. However, the principle of consistency must be applied throughout the period the benefit is provided whichever method is used.

- 7.3.2 Where the prescribed value method is used, the value of the BIK in respect of this benefit is as stated in Appendix 2 under the heading of "Prescribed value of other benefits".

- 7.3.3 Where the formula method is used to value the BIK in respect of the private usage of telephone, the calculation of the benefit is as follows:

- In respect of the benefit on the hardware -

$$\frac{\text{Cost of the asset (telephone)}}{\text{Prescribed average life span of the asset}} = \text{Annual value of the benefit}$$

- In respect of the private usage of the telephone bills -
actual cost of the employee's private bills paid by the employer.

8. In accordance with subsection 83(1) of the Act, the employer is required to report annually in the employee's Statement of Remuneration and in the Form E for Employer, all values of the BIK provided to his employees including benefits provided for wife, family, servants,



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dependent or guest of the employee. Failure to comply with this subsection will render the employer liable to prosecution under subsection 120(1) of the Act.

9. A claim for a deduction can only be made in respect the formula method. Any claim for deduction in respect of official use of any BIK must be made by the employee himself in his annual return. Records pertaining to the claims must be kept for a period of seven years for purpose of audit.
10. This Ruling is effective from the year of assessment 2004 and subsequent years of assessment. This Ruling supersedes Income Tax Ruling 1997/2 issued on 25 August 1997.

**Director General
of Inland Revenue**

APPENDIX 1

**PRESCRIBED AVERAGE LIFE SPAN OF VARIOUS ASSETS PROVIDED BY
EMPLOYERSTO EMPLOYEES**



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ASSETS	PRESCRIBED AVERAGE LIFE SPAN (YEARS) ^Δ
1. Motorcar ^Δ	8
2. Furniture and fittings: i. Curtains and carpets i. Furniture, sewing machine i. Air conditioner i. Refrigerator ^Δ	5 15 8 10
3. Kitchen equipment (i.e. crockery, rice cooker, electric kettle, Toaster, coffee maker, gas cooker, cooker hood, oven, dish washer, washing machine, dryer, food processor, etc.) ^Δ	6
4. Entertainment and recreation: ii. Piano iii. Organ iv. TV, video recorder, CD/ DVD player, stereo set v. Swimming pool (detachable), sauna ^Δ	20 10 7 15
5. Miscellaneous ^Δ	5

APPENDIX 2

**PRESCRIBED VALUE OF BENEFITS IN KIND
COMMONLY PROVIDED BY EMPLOYERS TO EMPLOYEES**



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1. THE PRESCRIBED VALUE OF MOTORCAR AND ITS RELATED BENEFITS

Cost of motorcar (New) RM	Annual prescribed benefit of motorcar RM	Annual prescribed benefit of petrol RM
Up to 50,000	1,200	600
50,001-75,000	2,400	900
75,001-100,000	3,600	1,200
100,001-150,000	5,000	1,500
150,001-200,000	7,000	1,800
200,001-250,000	9,000	2,100
250,001-350,000	15,000	2,400
350,001-500,000	21,250	2,700
500,001 and above	25,000	3,000

2. PRESCRIBED VALUE OF HOUSEHOLD FURNISHINGS, APPARATUS AND APPLIANCES

CATEGORY	TYPE OF BENEFIT	ANNUAL PRESCRIBED VALUE OF BIK PROVIDED (RM)
1Δ	Semi-furnished with furniture in the lounge, dining room or bedroom.	840 Δ
2	Semi-furnished with furniture as in Column 1 and one or two of the following: • air-conditioners • curtains and alike • carpets	1,680 Δ
3	Fully furnished with benefits as in Columns 1 and 2 as above plus one or more of kitchen equipment, crockery, utensils and appliances	3,360 Δ
4	Service charges and other bills such as water, electricity and telephone	Service charges and bill paid by the employer.

APPENDIX 2 (Continuation)

3. PRESCRIBED VALUE OF OTHER BENEFITS

Item	Type of benefit	Value of BIK per year RM
1	Telephone (including mobile phone)	Hardware: 300 per telephone Bills : 300 per telephone



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2	Gardener	3,600 per gardener
3	Household servant	4,800 per servant
4	Recreational club membership	Membership subscription paid by the employer



**LEMBAGA HASIL DALAM NEGERI
INLAND REVENUE BOARD**

PUBLIC RULING

TAX BORNE BY EMPLOYERS

Translation from the original Bahasa Malaysia text.

PUBLIC RULING NO. 2/2006

DATE OF ISSUE: 17 JANUARY 2006



TAX BORNE BY EMPLOYERS

**LEMBAGA HASIL DALAM NEGERI
MALAYSIA**

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DIRECTOR GENERAL'S PUBLIC RULING

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**Director General of Inland Revenue,
Malaysia**



TAX BORNE BY EMPLOYERS

**LEMBAGA HASIL DALAM NEGERI
MALAYSIA**

**Public Ruling No. 2/2006
Date of Issue: 17 January 2006**

1. This Ruling explains:

- i. the computation of the perquisite relating to income tax of the employee borne by the employer; and
- ii. the computation of tax payable by the employee who is entitled to this perquisite.

2. The provisions of the Income Tax Act 1967 (ITA) related to this Ruling are sections 2, 7, 13, 25, 83, subsection 112(3), section 131 and Part 1 of Schedule 1.

3. The words used in this Ruling have the following meanings:

3.1 "Resident", in relation to an employee, is an employee resident in Malaysia for a basis year for a year of assessment by virtue of section 7 of the ITA.

3.2 "Individual" means a natural person.

3.3 "Employer", in relation to an employment, means -

- a. where the relationship of master and servant subsists, the master;
- b. where that relationship does not subsist, the person who pays or is responsible for paying any remuneration to the employee who has the employment, notwithstanding that that person and the employee may be the same person acting in different capacities.

3.4 "Employee", in relation to an employment, means -

- a. where the relationship of master and servant subsists, the servant;
- b. where that relationship does not subsist, the holder of the appointment or office which constitutes the employment.

3.5 "Reimbursement", in relation to any perquisite received by the employee, means an expense incurred by the employee which is subsequently reimbursed by the employer.

3.6 "Employment" means -

- a. employment in which the relationship of master and servant subsists;
- b. any appointment or office, whether public or not and whether or not that relationship subsists, for which remuneration is payable.

3.7 "Perquisite", in relation to an employment, means benefits in cash or in kind that are convertible into money received by an employee from the employer or third parties in respect of having or exercising the employment.

3.8 "Basis year", in relation to a year of assessment for an employment source, is the basis period for that year of assessment.

3.9 "Year of assessment" means the calendar year.



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3.10 "Basis period", in relation to gross income from employment, is as ascertained by section 25 of the ITA.

3.11 "Not resident", for a basis year for a year of assessment in relation to an employee, means an employee other than a resident employee.

4. Income Tax Of The Employee Borne By The Employer - A Perquisite To The Employee

Income tax is a personal monetary liability of an employee. When the income tax liability of an employee is paid by the employer, this benefit falls within the definition of "perquisite" and is gross income from employment under paragraph 13(1)(a) of the ITA.

5. The Tax Treatment On Income Tax Of The Employee Borne By The Employer

The agreement by the employer to pay the income tax of the employee does not relieve the employee from tax liability on the amount of income tax borne by the employer. The tax treatment on income tax of the employee borne by the employer is as follows:

5.1 Computation Of Perquisite In Relation To Income Tax Borne By The Employer

The income tax of an employee borne by his employer for a basis year for a year of assessment is treated as income of that employee in that basis year when the actual amount of tax for that year of assessment can be ascertained, that is in the following basis year. As such, an employee would not be taxed on the benefit in the basis year when his employment commences as the benefit only arises in the following year.

Example 1

Hendrik, a citizen of Sweden who is married and has a non-schooling child, arrives in Malaysia on 25.2.2005 to commence employment on 1.3.2005. The contract of service stipulates the following matters:

- 1) his employment in Malaysia is for 3 years;
- 2) he is paid a monthly salary of RM20,000 for the first 10 months and after that would receive an annual increment of RM12,000 until the cessation of the employment contract;
- 3) he is entitled to receive bonus based on the company's performance; and
- 4) his income tax would be borne entirely by the employer.

The computation of tax payable by Hendrik for the relevant years of assessment borne by the employer is as follows:



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Year of assessment 2005	RM	RM
Salary RM20,000 X 10 (1.3.2005 - 31.12.2005)		200,000
Less:		
Deduction for self - section 46 ITA	8,000	
Deduction for wife - section 47 ITA	3,000	
Deduction for child - section 48 ITA	<u>1,000</u>	<u>12,000</u>
Chargeable income		<u>188,000</u>

Tax on the first RM150,000	27,975.00
Tax on the balance RM38,000 @ 27%	<u>10,260.00</u>
Income tax payable ¹	<u>38,235.00</u>

¹ Income tax payable by Hendrik for the year of assessment 2005 totalling RM38,235.00 borne by the employer is a perquisite to him and is treated as gross income from employment under paragraph 13(1)(a) of the ITA for year of assessment 2006, i.e. the year of assessment in which actual income tax for the year of assessment 2005 is ascertained.

Year of assessment 2006	RM	RM
Salary RM21,000 X 12 (1.1.2006 - 31.12.2006)		252,000
Tax for year of assessment 2005 borne by the employer ¹		<u>38,235</u>
Total income		290,235
Less:		
Deduction for self - section 46 ITA	8,000	
Deduction for wife - section 47 ITA	3,000	
Deduction for child - section 48 ITA	<u>1,000</u>	<u>12,000</u>
Chargeable income		<u>278,235</u>
Tax on the first RM250,000		54,975.00
Tax on the balance RM28,235 @ 28%		<u>7,905.80</u>
Income tax payable ²		<u>62,880.80</u>

² Income tax payable of RM62,880.80 by Hendrik for the year of assessment 2006 borne by the employer is a perquisite to him and is treated as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2007.

5.2 Computation Of Perquisite If There Is An Additional Assessment

If there is additional tax for a year of assessment which is borne by the employer, this additional tax must be regarded as income of the employee for the year of assessment in which the additional assessment is made and this will not be related back to the year of assessment concerned.

Example 2

Using the facts in Example 1, where -

- 1) the employer declares bonus for 2005 amounting to RM40,000 for Hendrik in 2007;
- 2) the additional tax for year of assessment 2005 on the bonus is borne by the employer; and



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3) the additional assessment on the bonus is made in 2007, the computation of tax borne by the employer and the tax payable by Hendrik for the respective years of assessment are as follows:

Year of assessment 2005 - additional assessment	RM	RM
Salary RM20,000 X 10 (1.3.2005 - 31.12.2005)		200,000
Bonus ³		<u>40,000</u>
Total income		240,000
Less:		
Deduction for self - section 46 ITA	8,000	
Deduction for wife - section 47 ITA	3,000	
Deduction for child - section 48 ITA	<u>1,000</u>	<u>12,000</u>
Chargeable income		<u>228,000</u>
Tax on the first RM150,000		27,975.00
Tax on the balance RM78,000 @ 27%		<u>21,060.00</u>
Income tax payable		49,035.00
Less: original tax - year of assessment 2005		<u>38,235.00</u>
Additional tax i.e. tax on bonus 2005 ⁴		<u>10,800.00</u>

⁴ Additional tax for the year of assessment 2005 resulting from the receipt of bonus RM40,000³ is RM10,800. This amount of RM10,800 is a perquisite to Hendrik. It will not be related to the year of assessment 2006 but is regarded as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment in which the additional assessment is made, i.e. for the year of assessment 2007.

Year of assessment 2006 - no change

Hendrik's tax for the year of assessment 2006 amounting to RM62,880.80 borne by his employer will not be revised and is maintained.

Year of assessment 2007	RM	RM
Salary RM22,000 X 12 (1.1.2007 - 31.12.2007)		264,000
Tax for the year of assessment 2006 borne by the employer		62,881
Additional tax for the year of assessment 2005 borne by the employer ⁴		<u>10,800</u>
Total income		337,681
Less:		
Deduction for self - section 46 ITA	8,000	
Deduction for wife - section 47 ITA	3,000	
Deduction for child - section 48 ITA	<u>1,000</u>	<u>12,000</u>
Chargeable income		<u>325,681</u>
Tax on the first RM250,000		54,975.00
Tax on the balance RM75,681 @ 28%		<u>21,190.68</u>
Income tax payable ⁵		<u>76,165.68</u>

⁵ The tax payable by Hendrik for the year of assessment 2007 amounting to RM76,165.68 borne by the employer is treated as gross income from employment under paragraph 13(1)(a) of the ITA for the following year of assessment, i.e. year of assessment 2008.



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5.3 Computation Of Perquisite If There Is A Reduced Assessment

Where in a year of assessment there is a change which results in a reduced assessment for that year of assessment, the tax for that year of assessment and the following years of assessment (regardless whether it results in an additional or reduced assessment) has to be recomputed to ascertain the actual income tax which should be borne by the employer.

Example 3

Using Example 2, where Hendrik makes an appeal on the tax for year of assessment 2005 and the following years of assessment based on section 131 of the ITA as he has overlooked making claims for deduction in respect of life insurance premiums under section 49 of the ITA amounting to RM6,000 per year which has been expended, the tax for the respective years of assessment must be recomputed to ascertain the actual income tax to be borne by the employer.

The actual income tax payable by Hendrik for the respective years of assessment is computed as follows:

Year of assessment 2005 - reduced assessment	RM	RM
Salary RM20,000 X 10 (1.3.2005 - 31.12.2005)		200,000
Bonus		<u>40,000</u>
Total income		240,000
Less:		
Deduction for self - section 46 ITA	8,000	
Deduction for wife - section 47 ITA	3,000	
Deduction for child - section 48 ITA	1,000	
Deduction for life insurance premiums - section 49 ITA	<u>6,000</u>	<u>18,000</u>
Chargeable income		<u>222,000</u>
Tax on the first RM150,000		27,975.00
Tax on the balance RM72,000 @ 27%		<u>19,440.00</u>
Income tax payable ⁶		47,415.00
Less: tax for the year of assessment 2005 - see Example 2		<u>49,035.00</u>
Tax discharged as a result of claim for life insurance premiums		<u>1,620.00</u>

⁶ The actual tax for the year of assessment 2005 borne by the employer after taking into account the deduction for life insurance premiums allowable to Hendrik is RM47,415.00. This amount is a perquisite to Hendrik and must be treated as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2006. As such, the income tax payable by Hendrik for the year of assessment 2006 must be recomputed to ascertain the actual income tax borne by the employer for that year of assessment.



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Total income		299,415
Less:		
Deduction for self - section 46 ITA	8,000	
Deduction for wife - section 47 ITA	3,000	
Deduction for child - section 48 ITA	1,000	
Deduction for life insurance premiums - section 49 ITA	<u>6,000</u>	<u>18,000</u>
Chargeable income		<u>281,415</u>
Tax on the first RM250,000		54,975.00
Tax on the balance RM31,415 @ 28%		<u>8,796.20</u>
Income tax payable ⁷		63,771.20
Less: original assessment - year of assessment 2006 - see Example 1		<u>62,880.80</u>
Additional tax payable as a result of claim for life insurance premiums		<u>890.40</u>

⁷ The actual income tax borne by the employer for the year of assessment 2006 after taking into account the life insurance premiums allowed to be claimed by Hendrik is RM63,771.20. This amount is a perquisite to Hendrik and must be treated as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2007. Therefore, the income tax payable for the year of assessment 2007 is recomputed to ascertain the actual income tax to be borne by the employer for that year of assessment.

Year of assessment 2007 - reduced assessment	RM	RM
Salary RM22,000 X 12 (1.1.2007 - 31.12.2007)		264,000
Tax for the year of assessment 2006 borne by the employer ⁷		<u>63,771</u>
Total income		327,771
Less:		
Deduction for self - section 46 ITA	8,000	
Deduction for wife - section 47 ITA	3,000	
Deduction for child - section 48 ITA	1,000	
Deduction for life insurance premiums - section 49 ITA	<u>6,000</u>	<u>18,000</u>
Chargeable income		<u>309,771</u>
Tax on the first RM250,000		54,975.00
Tax on the balance RM59,771 @ 28%		<u>16,735.88</u>
Income tax payable		71,710.88
Less: original tax for year of assessment 2007 - see Example 2		<u>76,165.68</u>
Tax discharged as a result of the claim for life insurance premiums		<u>4,454.80</u>



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5.4 Computation Of Perquisite In The Case Where The Employer Agrees To Pay Only A Portion Of The Employee's Tax

Where the employer agrees to pay only a portion of the employee's tax for a year of assessment, only that portion of tax borne by the employer is treated as gross income from employment of the employee under paragraph 13(1)(a) of the ITA.

Example 4

Miyamoto, a Japanese citizen, starts work in Malaysia with a Japanese company from 1.7.2005. According to the employment contract signed with the employer, it was agreed that -

- 1) he is to work in Malaysia for 2 years;
- 2) he is paid salary of RM18,000 per month;
- 3) the employer will bear half (1/2) of his income tax liability; and
- 4) he is provided amenities as follows:
 - telephone - RM600 per year;
 - car and petrol - RM7,800 per year;
 - free living accommodation. The rent paid by the employer for the provision of the accommodation is RM3,000 per month.

The computation of tax payable by Miyamoto for the years of assessment 2005 and 2006 is computed as follows:

Year of assessment 2005	RM	RM
Paragraph 13(1)(a) ITA		
Salary RM18,000 X 6 (1.7.2005 - 31.12.2005)		108,000
Paragraph 13(1)(b) ITA		
Telephone	300	
Car and petrol	<u>3,900</u>	4,200
Paragraph 13(1)(c) ITA		
30% X 108,000 = RM32,400		
Or		
Defined value of accommodation = RM3,000 X 6 = RM18,000		
Whichever is the lower		<u>18,000</u>
Gross / adjusted /statutory income from employment / total income		130,200
Less :		
Deduction for self- section 46 ITA		<u>8,000</u>
Chargeable income		<u>122,200</u>
Tax on the first RM100,000		14,475.00
Tax on the balance RM22,200 @ 27%		<u>5,994.00</u>
Income tax payable ⁸		<u>20,469.00</u>

⁸ As the employer only agrees to bear half (1/2 X RM20,469) of the income tax payable by Miyamoto, only RM10,234.50 is perquisite to Miyamoto that is regarded as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2006 i.e. the year of assessment in which the actual income tax for the year of assessment 2005 can be ascertained.



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Year of assessment 2006	RM	RM
Paragraph 13(1)(a) ITA		
Salary RM18,000 X 12 (1.1.2006 - 31.12.2006)		216,000
Income tax for the year of assessment 2005 ⁸		<u>10,235</u>
		226,235
Paragraph 13(1)(b) ITA		
Telephone	600	
Car and petrol	<u>7,800</u>	8,400
Paragraph 13(1)(c) ITA		
30% X RM226,235 = RM67,871		
Or		
Defined value of accommodation = RM3,000 X 12 = RM 36,000		
Whichever is the lower		<u>36,000</u>
Gross / adjusted / statutory income from employment / total income	270,635	
Less :		
Deduction for self - section 46 ITA		<u>8,000</u>
Chargeable income		<u>262,635</u>
Tax on the first RM250,000		54,975.00
Tax on the balance RM12,635 @ 28%		<u>3,537.80</u>
Income tax payable ⁹		<u>58,512.80</u>

⁹ As the employer agrees to bear only half (1/2 X RM58,512.80) of the income tax payable by Miyamoto for the year of assessment 2006, only RM29,256.40 is a perquisite to him and this amount must be treated as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2007.

5.5 Computation Of Perquisite Where An Employee Defaults In Furnishing The Return Form

Where an employee has defaulted or has not furnished the Return Form B or BE within the stipulated time, the tax payable by the employee includes the penalty imposed on him under subsection 112(3) of the ITA. The total amount of tax payable by the employer is a perquisite to the employee and must be treated as gross income from employment under paragraph 13(1)(a) of the ITA.

Example 5

Using the facts in Example 4, where Miyamoto is late in furnishing the Return Form BE for 2005 within the time stipulated and he is charged with a penalty under subsection 112(3) of the ITA, the income tax of Miyamoto which is borne by the employer for the respective years of assessment is computed as follows:

Year of assessment 2005

Tax payable by Miyamoto must include the penalty imposed on him under subsection 112(3) of the ITA. Therefore, the tax payable by Miyamoto for the year of assessment 2005 is RM20,469 + penalty RM100 = RM 20,569.00. As



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Miyamoto's employment has just commenced in 2005, the tax benefit borne by the employer does not arise in the year of assessment 2005 but will arise in the following year of assessment i.e. in the year of assessment 2006 when the actual tax payable for the year of assessment 2005 can be ascertained.

Year of assessment 2006

As the employer agrees to bear only half ($1/2 \times RM20,569.00$) of the income tax payable by Miyamoto, the amount of perquisite to be added to the gross income from employment for Miyamoto under paragraph 13(1)(a) of the ITA for the year of assessment 2006 is only RM10,284.50.

5.6 Computation Of Perquisite In Leaver Cases

5.6.1 In the case of an employee who has left or intends to leave Malaysia (leaver case) and is entitled to the tax benefit under paragraph 13(1)(a) of the ITA, the provisions of subsections 25(5) and 25(6) of the ITA must be applied in accordance with the situations as follows:

i. Application of subsection 25(5) of the ITA

According to this provision, where the tax benefit receivable for a later period is received in an earlier period, the tax benefit will be deemed to have been received in the earlier period and will therefore become taxable in that earlier period.

ii. Application of subsection 25(6) of the ITA

Where an employee -

- has left Malaysia in the basis year for a year of assessment;
- is not resident in Malaysia for the basis year for the following year and does not derive any pension from Malaysia for that basis year; and
- ceases to derive gross income from employment from Malaysia on the expiration of a period of leave following his departure from Malaysia,

the tax benefit for the basis period following the year of his departure shall be treated as income for the basis period in which he leaves Malaysia.

For the purposes of the application of the above subsection, the determination of the residence status of an individual is explained in detail in APPENDIX A of the Public Ruling No.2/2005: Computation Of Income Tax Payable By A Resident Individual dated 6 June 2005.

5.6.2 For leaver cases in paragraph 5.6.1 above, the computation of tax has to be made twice for the final year the employee is in Malaysia to determine the actual amount of tax payable by the employer on behalf of the employee.



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Example 6

Sam, who is single, commences employment in Malaysia on 1.7.2005.

According to the agreement signed with his employer:

- 1) his employment in Malaysia is for 2 ½ years;
- 2) his monthly salary is RM10,000 for the first six (6) months and after which he is given a salary increase at the rate of RM12,000 a year until the employment contract ceases on 31.12.2007; and
- 3) his income tax is borne entirely by the employer.

Sam goes on paid leave commencing on 1.12.2007 and he leaves Malaysia on 1.12.2007.

The tax payable by Sam which is borne by his employer for the respective years of assessment is computed as follows:

Year of assessment 2005	RM
Salary RM10,000 X 6 (1.7.2005 - 31.12.2005)	60,000
Less :	
Deduction for self - section 46 ITA	<u>8,000</u>
Chargeable income	<u>52,000</u>
Tax on the first RM50,000	3,475.00
Tax on the balance RM2,000 @ 19%	<u>380.00</u>
Income tax payable ¹⁰	<u>3,855.00</u>

¹⁰ The tax payable by Sam for the year of assessment 2005 amounting to RM3,855.00 borne by the employer is a perquisite to him and must be treated as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2006, i.e. the year in which actual tax for year of assessment 2005 is ascertained.

The tax payable by Sam for the year of assessment 2006 borne by the employer is computed as follows:

Year of assessment 2006	RM
Salary RM11,000 X 12 (1.1.2006 - 31.12.2006)	132,000
Tax for the year of assessment 2005 borne by the employer	<u>3,855</u>
Total income	135,855
Less:	
Deduction for self - section 46 ITA	<u>8,000</u>
Chargeable income	<u>127,855</u>

	RM
Tax on the first RM100,000	14,475.00
Tax on the balance RM27,855 @ 27%	<u>7,520.85</u>
Income tax payable ¹¹	<u>21,995.85</u>



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¹¹ The income tax payable for the year of assessment 2006 amounting to RM21,995.85 borne by the employer on behalf of Sam is a perquisite to him and must be treated as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2007.

Consequently, the tax payable by Sam for the year of assessment 2007 borne by the employer after taking into account the above is computed as follows:

- (1) As Sam left Malaysia on 1.12.2007, the income tax for the year of assessment 2007 borne by the employer (which should be the income for the year of assessment 2008) is also treated as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2007. This is in accordance with subsection 25(5) of the ITA which provides that, where an employment income for a later basis period is received in the earlier period, the employment income is deemed to have been received in the earlier period and is assessed in that period.
- (2) For this purpose, the computation of tax has to be made twice to ascertain the actual amount of tax payable by the employer for the year of assessment 2007.

Year of assessment 2007	RM
Computation of tax for purposes of the final computation	
Salary RM12,000 X 11 (1.1.2007 - 30.11.2007)	132,000
Leave pay RM12,000 (1.12.2007 - 31.12.2007)	12,000
Tax for year of assessment 2006 borne by the employer ¹¹	<u>21,996</u>
Total income	165,996
Less:	
Deduction for self - section 46 ITA	<u>8,000</u>
Chargeable income	<u>157,996</u>
Tax on the first RM150,000	27,975.00
Tax on the balance RM7,996 @ 27%	<u>2,158.92</u>
Income tax payable ¹²	<u>30,133.92</u>



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Final computation:

Salary 12,000 X 11 (1.1.2007 - 30.11.2007)	132,000
Leave pay RM12,000 X 1 (1.12.2007 - 31.12.2007)	12,000
Tax for the year of assessment 2006 borne by the employer ¹¹	21,996
Tax for the year of assessment 2007 borne by the employer ¹²	<u>30,134</u>
Total income	196,130
Less:	
Deduction for self - section 46 ITA	<u>8,000</u>
Chargeable income	<u>188,130</u>
Tax on the first RM150,000	27,975.00
Tax on the balance RM38,130 @ 27%	<u>10,295.10</u>
Income tax payable ¹³	<u>38,270.10</u>

¹³ The actual tax payable by Sam for the year of assessment 2007 (i.e. the final year of assessment for which he is in Malaysia) borne by the employer is RM38,270.10.

Example 7

Using the facts in Example 6, if -

- Sam's employment contract ceases on 31.1.2008;
 - Sam leaves Malaysia on 30.11.2007; and
 - is given full paid leave from 1.12.2007 to 31.1.2008 where his salary was paid at the end of each month,
- the provision of subsection 25(6) of the ITA is applicable as Sam -
- left Malaysia on 30.11.2007;
 - is not resident in Malaysia for the following basis year;
 - does not derive pension from Malaysia for the following basis year; and
 - ceases to receive gross income from employment from Malaysia at the end of the leave period following his departure from Malaysia.

This means, the income tax payable by Sam for the year of assessment 2007 borne by his employer (which should be a perquisite and treated as gross income from employment under paragraph 13(1)(a) of the ITA for the basis year 2008) is treated as income for the basis period in which he left Malaysia, i.e. for the year of assessment 2007.



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The tax payable by Sam for the respective years of assessment is computed as follows:

Years of assessment 2005 & 2006 - as explained in Example 6

Year of assessment 2007 - Resident RM

Computation of tax for purposes of the final computation:

Salary RM12,000 X 11 (1.1.2007 - 30.11.2007)	132,000
Leave pay RM12,000 X 1 (1.12.2007 - 31.12.2007)	12,000
Leave pay:	
RM13,000 X 1 (1.1.2008 - 31.1.2008) - subsection 25(6) ITA	13,000
Tax for the year of assessment 2006 borne by the employer ¹¹	<u>21,996</u>
Total income	178,996
Less:	
Deduction for self - section 46 ITA	<u>8,000</u>
Chargeable income	<u>170,996</u>

Tax on the first RM150,000	27,975.00
Tax on the balance RM20,996 @ 27%	<u>5,668.92</u>
Income tax payable ¹⁴	<u>33,643.92</u>

Final computation:

Salary RM12,000 X 11 (1.1.2007 - 31.12.2007)	132,000
Leave pay RM12,000 X 1 (1.12.2007 - 31.12.2007)	12,000
Leave pay:	
RM13,000 X 1 (1.1.2008 - 31.1.2008) - subsec 25(6) ITA	13,000
Tax for the year of assessment 2006 borne by the employer ¹¹	21,996
Tax for the year of assessment 2007 borne by the employer ¹⁴	<u>33,644</u>
Total income	212,640
Less:	
Deduction for self - section 46 ITA	<u>8,000</u>
Chargeable income	<u>204,640</u>

Tax on the first RM150,000	27,975.00
Tax on the balance RM54,640 @ 27%	<u>14,752.80</u>
Income tax payable ¹⁵	<u>42,727.80</u>

¹⁵ The income tax payable by Sam for 2007 (the last year of assessment in which he is in Malaysia) borne by his employer is RM42,727.80.



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However, Sam has the right to elect that subsection 25(6) of the ITA should not be applied on him. In this situation, Sam's income is assessed on a normal basis and the computation is as follows:

Years of assessment 2005 & 2006 - as in Example 6

Year of assessment 2007 - Resident

	RM
Salary RM12,000 X 11 (1.1.2007 - 31.12.2007)	132,000
Leave pay RM12,000 X 1 (1.12.2007 - 31.12.2007)	12,000
Tax for the year of assessment 2006 borne by the employer ¹¹	<u>21,996</u>
Total income	165,996
Less:	
Deduction for self - section 46 ITA	<u>8,000</u>
Chargeable income	<u>157,996</u>

Tax on the first RM150,000	27,975.00
Tax on the balance RM7,996 @ 27%	<u>2,158.92</u>
Income tax payable ¹⁶	<u>30,133.92</u>

¹⁶ The tax payable by Sam for the year of assessment 2007 borne by the employer is a perquisite to him and must be treated as gross income from employment under paragraph 13(1)(a) of the ITA for the year of assessment 2008.

Year of assessment 2008 : Not resident

RM

Computation of tax for purposes of the final computation:

Leave pay RM13,000 X 1 (1.1.2008 - 31.1.2008)	13,000
Tax for the year of assessment 2007 borne by employer ¹⁶	<u>30,134</u>
Total income / Chargeable income	<u>43,134</u>

Income tax payable RM43,134 @ 28% ¹⁷	<u>12,077.52</u>
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Final computation:

Leave pay RM13,000 X 1 (1.1.2008 - 31.1.2008)	13,000
Tax for the year of assessment 2007 borne by the employer ¹⁶	30,134
Tax for the year of assessment 2008 borne by the employer ¹⁷	<u>12,078</u>
Total income / Chargeable income	<u>55,212</u>

Income tax payable RM55,212 @ 28% ¹⁸	<u>5,459.36</u>
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¹⁸ The tax payable by Sam as an individual who is not resident for the year of assessment 2008 borne by the employer i.e. for the final year in which he is in Malaysia is RM15,459.36.



TAX BORNE BY EMPLOYERS

**LEMBAGA HASIL DALAM NEGERI
MALAYSIA**

**Public Ruling No. 2/2006
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6. Schedular Tax Deduction (STD)

Where an employee receives a perquisite from his employment, the employer must ensure that the tax to be charged on the perquisite is deducted from the employee's remuneration based on Schedule (Rule 3) of the Monthly Income Tax Deductions under the Income Tax (Deduction From Remuneration) Rules in the month in which the perquisite is paid. In the case where the salary of the employee is not sufficient to absorb the monthly income tax deductions on the perquisite, the employer has to obtain the approval of Collection Branch to allow the employee to pay tax on the perquisite by installments with the issuance of the Directive of Tax Deduction (CP38).

7. This Ruling is effective for the year of assessment 2005 and subsequent years of assessment.

**Director General
of Inland Revenue**

Chapter 5

Investment Income

Chapter Outline:

- 5.1 Introduction
- 5.2 Dividends
 - 5.2.1 Basis Periods
 - 5.2.2 Other issues concerning dividends
- 5.3 Interest Income
 - 5.3.1 Basis Periods
 - 5.3.2 Other issues relating to Interest
- 5.4 Royalty Income
 - 5.4.1 Additional Notes
- 5.5 Rental Source
 - 5.5.1 Issues related to rent
 - 5.5.2 Example of Rental Source
- 5.6 Conclusion

Chapter Objectives

Students must be able to:

- Recognize the different classes of Investment Income
- Explain the tax treatment of Interest Income
- Explain the tax treatment of Dividend Income
- Explain the tax treatment of Royalty Income
- Explain the tax treatment of Rental Income
- Explain the concept of basis periods for each of these sources
- Understand the tax treatment of advance receipts
- Know the derivation rules for the various Investment Income
- Understand IRB's approach for computing tax on Investment Income
- Understand basic case laws that challenges the IRB approach to tax computation of investment Income
- Understand the IRB Public Ruling on taxation of Rental Income

5.1 Introduction

As financial planners we will run into individuals who will have investment income. Investment income, just like business or employment needs to be cycled through the various stages of classification, derivation, basis periods and what constitutes gross income. We will now explore the basic aspects of investment income.

5.2 Dividends

Definition:

There is no ITA definition for dividends. Therefore you have to use the ordinary meaning of dividends and whatever court interpretation of dividends exists, of which there are some classic examples.

It has been held that „a limited company not in liquidation can make no payment by way of return of capital to its shareholders except as a step in an authorized reduction of capital. Any other payment by it by means of which it parts with money to its shareholders must and can only be made by way of dividing profits.“ (*Hill v Permanent Trustee Company of New South Wales Ltd.*)

A distribution of assets in specie has been held to be income (*Pool v The Guardian Investment Trust Co Ltd* (8 TC 167) The distribution of shares is therefore considered a distribution of net dividend. For YA2007 and prior years there will be a need to gross up the net dividend paid.

Derivation:

Section 14. General provisions as to Dividend Income

- (1) Subject to this section, where a company resident for the basis year for a year of assessment pays, credits or distributes a dividend in the basis period for that year of assessment, the dividend shall be deemed to be derived from Malaysia.
- (2) Where a company resident for the basis year for a year of assessment was not resident for the basis year for the year of assessment immediately preceding that year of assessment, only dividends paid, credited or distributed by the company on or after the day on which the management and control of any business of the company (or, in the case of a company which does not carry on a business, the management and control of its affairs by its directors or other controlling authority) were first exercised in Malaysia in that first mentioned basis year shall be deemed to be derived from Malaysia.
- (3) Where –
 - (a) The management and control of the business of a company (or, if it has more than one business, of all its businesses); or
 - (b) In the case of a company which does not carry on a business, the management and control of its affairs by its directors or other controlling authority,

Cease to be exercised in Malaysia in the basis year for a year of assessment and the company is not resident for the basis year of the year of assessment following

that first mentioned year of assessment, dividends paid, credited or distributed in that first mentioned basis year after the cessation shall not be deemed to be derived from Malaysia.

- (4) Where a dividend consists of property other than money, that dividend shall be taken to consist of an amount equal to the market value of the property at the time of the distribution of the dividend.

5.1.1 Basis Periods

Section 23. Interpretation of ss. 24 to 28

- (1) A dividend deemed to be derived from Malaysia by virtue of Section 14 shall be treated as paid on the day on which cash or its equivalent (whether in the form of a voucher, cheque or otherwise) in respect of the dividend is posted or delivered by or on behalf of the payer, and as distributed in specie on the day on which it is posted or delivered by or on behalf of the distributor;
- (2) Where any dividend deemed to be derived from Malaysia by virtue of Section 14 is paid or credited without deduction of tax or is distributed in specie, the amount of the gross income in respect of that dividend shall be taken to be such an amount as, after deduction of tax at the rate deductible at the rate of payment crediting or distribution, would be equal to –
 - (i) the amount in fact paid;
 - (ii) the amount in fact credited; or
 - (iii) the market value of the dividend at the date of distribution, as the case may be.

Section 26. Basis period to which gross income in respect of dividend is related

- (1) Subject to subsection (2), where gross income from a source consists of a dividend deemed to be derived from Malaysia by virtue of Section 14, all gross income from that source paid, credited or distributed in the relevant period shall be taken to be gross income of the relevant person for the relevant period:

Provided that, where this section has applied to a dividend which has been credited, it shall not apply to that dividend when paid.

5.1.2 Other issues concerning dividends

1. **Gross Income:** Dividends are actually profit of the company distributed to the shareholders. The company is required to distribute dividends net of tax. Therefore shareholders will receive only net dividend unless it is an exempt dividend. The company must account to IRB the tax portion of the dividends distributed. Dividends in YA2007 and prior years are always grossed up when the shareholders declare their dividends. For example if someone receives a net dividend of RM 7,200. He will report his dividend as gross in his tax return. Using 27% as the corporate tax rate, the gross dividend will be $100/73 \times 7,200 = 52,560$.

2. Dividend imputation: The gross dividend will be taxed at the shareholder's own marginal tax bracket. However, under Section 110, a tax credit for tax paid on the dividends by the paying company, will be given as a set-off to the shareholder. If say the individual paid tax at his own tax bracket of 13% on the gross dividend, and he receives a Section 110 set-off of 27%, he will effectively get a refund or a tax credit against tax payable of 14%. That is a sizeable tax credit for a low-income taxpayer. This tax credit will become a thing of the past from YA2008 as the country moves from the imputation tax system to the single tier company tax system. Companies will pay tax at the prevailing company tax rate and there will be no more tax imputation. The dividend distributed is net of tax and the dividends are no longer taxable on the recipients. The profits have already suffered tax at the company tax rate and there is no further tax implication. Effectively all shareholders are paying tax at the company tax rate.
3. Foreign dividends: With effect from YA2004 foreign income remitted to Malaysia is not taxable. Only Malaysian banks, insurance, air and shipping companies will be taxable on a world income scope. Investors and other persons who invest overseas can now receive income without any Malaysian tax consequence.

5.2 Interest Income

Definition

Income derived from an investment on which the payments reflect the time value of money or income derived as percentage of return on bank or savings deposits, bonds, or mortgages.

Income declaration: Section 5 proviso

Provided that in ascertaining the chargeable income of an individual resident in Malaysia there shall be excluded the income consisting of interest accruing in or derived from Malaysia and received from a person referred to in subsection (4) of Section 109c in respect of interest paid or credited to that individual.

Derivation

Section 15. Derivation of interest and royalty income in certain cases

Gross income in respect of interest or royalty shall be deemed to be derived from Malaysia –

- (a) if responsibility for payment of the interest or royalty lies with the Government or a State Government; or
- (b) (i) if responsibility for payment of the interest or royalty in the basis year for a year of assessment (the responsibility of any guarantor being disregarded in the case of interest) lies with a person who is resident for that basis year; and
(ii) in the case of interest it is payable in respect of money borrowed by that person and employed in or laid out on assets used in or held for the production of any gross income of that person derived from Malaysia or the debt in respect of which the interest is paid is secured by any property or asset situated in Malaysia; or

- (c) if the interest or royalty is charged as an outgoing or expense against any income accruing in or derived from Malaysia.

5.2.1 Basis Periods

Section 27. Basis period to which gross income in respect of interest, etc., is related

- (1) Subject to this section where gross income from a source in Malaysia of the relevant person –
 - (a) Consists of any interest, discount, rent or royalty or of any pension, annuity or other periodical payment to which Section 4 (e) applies; and
 - (b) First becomes receivable in the relevant period, it shall when it has been received be treated as gross income of the relevant person for the relevant period.
- (2) Where gross income from a source of the relevant person is gross income to which subsection (1) applies and is receivable in respect of a period in this subsection referred to as the overlapping period which overlaps that relevant period, that gross income when received shall be apportioned between the part of the overlapping period which overlaps the relevant period and the remaining part or parts of the overlapping period the apportionment, unless Director General having regard to the facts of any particular case otherwise directs, being made in the proportion that the number of days of the overlapping period that fall into the relevant period bears to the total number of days of the overlapping period and so much of that gross income as is apportioned to the overlapping part of the overlapping period shall be treated as gross income of the relevant person from that source for the relevant period :

Provided that –

- (a) Where that gross income is in respect of an amount of interest calculated for two or more periods of accrual which together make up the overlapping period, the gross income in respect of the interest in respect of each period of accrual shall be ascertained and –
 - (i) if any such period of accrual falls into the relevant period, subsection (1) shall apply to the gross income so ascertained in respect of that period of accrual;
 - (ii) if any such period of accrual overlaps the relevant period, this subsection (without this paragraph of this proviso) shall apply to the gross income so ascertained in respect of that period of accrual as if that period of mentioned gross income were gross income receivable in respect of the overlapping period;
- (3) Where gross income mentioned in subsection (1) becomes receivable in the relevant period and is in respect of –
 - (a) a period which commences after the end of the relevant period; or

- (b) a period which overlaps the relevant period and which partly elapsed after the end of the relevant period, subsection (2) shall not apply and that gross income shall when received be treated as gross income of the relevant person for the relevant period:
- (4) In subsection (2) "period of accrual" means a period throughout which there is no change in the rate of interest or in the principal sum in respect of which interest is payable.

5.2.2 Other issues relating to Interest

- 1) Tax exemption: There are plenty of exemptions for interest income. A deposit of less than RM 100,000 is exempt. Interest earned on any deposit for 12 months or more is exempt. Interest earned in many institutions like Lembaga Tabung Haji, MBSB and National Savings Bank (BSN) are exempt.

Even if the deposit is more than 100,000 say 300,000 the tax is on interest earned over the 100,000 deposit, namely 200,000.

- 2) A Malaysian resident who has taxable interest income is only taxable at a 5% withholding tax rate. Banks withhold this amount and pay it over to IRB. The taxpayer does not declare this income..
- 3) Foreigners who place deposits in Malaysian banks and finance companies are exempt from tax.
- 4) Interest earned on most interest-bearing investment securities approved by the Securities Commission is exempt. (Schedule 6). The exceptions will be convertible loan stock or convertible bonds.
- 5) Interest paid to non-residents on loans that are not approved will suffer a withholding tax rate of 15%.

5.3 Royalty Income

Definition

"Royalty" includes –

- (a) Any sums paid as consideration for the use of, or the right to use –
 - (i) Copyrights, artistic or specific works, patents, designs or models, plans, secret processes or formulae, trademarks, or tapes for radio or television broadcasting, motion picture films, films or video tapes or other means of reproduction where such films or tapes have been or are to be used or reproduced in Malaysia or other like property or rights;
 - (ii) Know how or information concerning technical industrial, commencement or scientific knowledge, experience or skill;

- (b) Income derived from the alienation of any property, know how or information mentioned in paragraph (a) of this definition;

5.3.1 Additional Notes:

1. Royalty is classified as a Section 4(d) income.
2. A lump sum paid for the use of patents, rights etc. is taxable even though it is non-recurring lump sum
3. Derivation of Royalty income – Derivation and basis periods follow that of Interest. Section 15 states that royalty income is derived from Malaysia if
 - a. Responsibility for payment of royalty lies with the govt. or state govt.
 - b. Responsibility lies with a person resident for that basis year
 - c. If the royalty is charged as an outgoing or expense against any income accruing in or derived from Malaysia.
4. The withholding tax for royalties paid to non-residents is 10%,
5. Basis of assessment. With effect from YA 2004 companies, trusts and co-ops use their financial year-end, while the others use the calendar year.
6. Deduction of expenses -. The normal rules of Section 33 and Section 39 apply.
7. Exemptions
 - a Para 32 Schedule 6
 - i. Royalty income of RM 10,000 derived by a resident individual from publication or right to use any artistic work (other than original painting), and royalty in respect recording discs or tapes
 - b. Para 32A – Income of RM 12,000 derived by an individual resident in Malaysia for any translation of books or literary work at the request of any agency of the Ministry of Education or the Attorney-General's chambers
 - c Para 32B – Income of RM 20,000 in respect of payment for the publication of or the right to use any literary work or any original painting.
 - d Para 32C – Income from the performance in cultural performances approved by the Minister unless the payment is a normal emolument of his official duties
 - e Para 32D – Income of RM 20,000 being payment for any musical composition unless the payment is emoluments in performance of his official duties.
 - f Para 32E – Honorarium payments – in respect of services provided for purposes of validation, moderation or accreditation of franchised educational programs verified by Lembaga Akreditasi Negara is tax-exempt
8. Scientific research – 50% of Statutory Income in relation to a scientific research carried out by an individual, which has been commercialised and verified by the Minister of Science, Technology and Environment for a period of 5 years is exempt. (Exemption order 6 of 2004).

5.4 Rental Source

Rent is an important source of income from a financial planning perspective. Property always forms a significant part of somebody's portfolio of assets. If not anything their residence becomes an important asset to be freely owned before retirement.

Rent is just another source of income but is mostly regarded as non-business. There are specific advantages to have rental source treated as a business source. The reading of the IRB Public Ruling relating to letting of property will be useful.

Definition

"Rent" includes any sum paid for the use or occupation of any premises or part thereof or for the hire of any thing

Section 19. Supplementary Provisions

- (3) Where –
 - (a) It is necessary for the purposes of Chapter 4 to ascertain the amount of any interest, rent or any payment of any other kind which is payable for the basis period (or for a part of the basis period) for a year of assessment; and
 - (b) The period for which the interest, rent or payment is payable (in this subsection referred to as the relevant period) overlaps that basis period, the interest, rent or payment shall be taken to accrue evenly over the relevant period, and so much of the interest, rent or payment as is thus found to accrue during the period of the overlap shall be taken to be the amount of the interest, rent or payment which is payable for that basis period or that part of that basis period, as the case may be.

Section 27. Basis period to which gross income in respect of interest, etc., is related

- (1) Subject to this section where gross income from a source in Malaysia of the relevant person –
 - (a) Consists of any interest, discount, rent or royalty or of any pension, annuity or other periodical payment to which Section 4 (e) applies; and
 - (b) First becomes receivable in the relevant period, it shall when it has been received be treated as gross income of the relevant person for the relevant period.
- (3) Where gross income mentioned in subsection (1) becomes receivable in the relevant period and is in respect of –
 - (a) a period which commences after the end of the relevant period; or
 - (b) a period which overlaps the relevant period and which partly elapsed after the end of the relevant period,

Subsection (2) shall not apply and that gross income shall when received be treated as gross income of the relevant person for the relevant period:

Section 29. Basis period to which income obtainable on demand is related

- (1) Notwithstanding anything in Sections 23 to 28, where the circumstances are such that the relevant person is entitled to any gross income (other than gross income to which Section 24 or 26 applies) accruing in or derived from Malaysia and is able to obtain the receipt thereof on demand, that gross income shall be treated as being received by him at the time those circumstances arise.

5.4.1 Issues related to rent

1. Rent is classified as Section 4(d) income. It is basically an investment income
2. Rent may constitute business income under Section 4(a) following the American Leaf Blending case-

“so it is clear that rents, despite the fact that they are referred to in Section 4(d), may nevertheless constitute income from a source consisting of a business if they are receivable in the course of carrying on a business of putting the taxpayer’s property to profitable use by letting it for rent.”

3. RB PR 1/2004 states various circumstances under which rental income is to be treated as business income

Based on PR 1/2004, rental income falls under Section 4(a) if a company owns the minimum unit of properties under any of the following categories:

Type	No. of units owned (minimum)
(i) Factory	1
(ii) Warehouse	1
(iii) Office / shopping complex	
- The whole complex	1
- Standard lot	4
(iv) Shop house	4 Floors
(v) Residential property	4
(vi) Mixture of properties	4

4. This does not apply to Investment Holding companies.
5. Once the rental source is ascertained to be business source, the rental income will be assessed as one business source, totalling rental income from all landed properties.
6. Under PR1/2004 non-company taxpayers such as individuals and associations can have their income assessed as business if they actively provide ancillary or support services/facilities to the properties let out. Ancillary or support services include

- a. Security guard service
 - b. Air conditioning (centralized/split units) system
 - c. Supply of hot water, escalators, lift services
 - d. Provision of recreational facilities such as clubhouse, gymnasium, tennis/squash/badminton courts and swimming pool
 - e. Cleaning or house keeping
 - f. Maintenance of common property, garden, landscaping, and exterior lighting
7. Such support services must be actively provided. Those provided by management corporations of buildings in the normal course would not constitute provision.

The PR1/2004 requires rental income to be assessed as investment income to be grouped into 3 sources:

- a. Residential properties
- b. Shop house/commercial properties; and
- c. Vacant land

The rental income commences on the date of first letting of the property.

5.4.2 Example of Rental Source

Jimbaran Sdn. Bhd provided the following information regarding its residential properties for the year-ended 31.12.2007.

Property No. 1 (Shop house)	RM	RM
Receipts		
Rental: January 2007 – March 2007		27,000
April 2007– May 2007		vacant
June 2007 – May 2008		96,000
Deposit (refundable)		16,000
Deposit for electricity and water		<u>5,000</u>
		144,000
Payments		
Deposit refunded to ex-tenant	9,000	
Assessment	4,800	
Quit Rent	700	
Repairs (carried out in May 2007)		
Repainting	4,000	
Renovation to Kitchen	10,000	
Replacement of damaged tiles	5,000	
Installation of air-conditioning unit	2,800	<u>(36,300)</u>
Excess of receipts over payment		107,700

Property No. 2 (Condominium in Seputih)

Receipts

Rental (April 2007 – December 2007)	22,500
Deposit (refundable)	5,000
Deposit for electricity and water	<u>1,000</u>
	28,500

Payments

Assessment	3,000
Quit Rent	500
Interest on property loan (Jan 2007 – Dec 2007)	27,890

Penalty for late payment of quit rent	200	
Legal fees for tenancy agreement	<u>350</u>	(31,940)

Excess of payments over receipts (3,440)

(Property No. 2 was acquired in December 2004 and was first rented out on 1.4.2007)

- (a) Based on the above information, calculate the Aggregate Income of Jimbaran Sdn Bhd for the YA2007.
- (b) What would be the answer for (a) in the event that property no.1 is a factory?

Answer to Example**(a) Jimbaran Sdn. Bhd****Computation of aggregate income for YA2006**

Section 4(d)	RM	RM
Property 1 (Shop house)		
Rental: January – March 2007		27,000
June – December 2007 (8,000 x 7)		56,000
January – May 2008 (8,000 x 5)		40,000
[Advance receipt taxable per s 27(3)]		<u>123,000</u>
Less: Expenses		
Assessment	4,800	
Quit rent	700	
Repairs		
Repainting	4,000	
Replacement of damaged tiles	5,000	<u>(14,500)</u>
Adjusted / Statutory Income		108,500
Property 2 (Condominium) (9 months)	RM	RM
Rental: April – December 2007		22,500
Less: Expenses		
Assessment (3,000 x 9/12)	2,250	
Quit rent (500 x 9/12)	375	
Interest (27,890 x 9/12)	<u>20,918</u>	<u>(23,543)</u>
Adjusted / Statutory Income		<u>NIL</u>
Aggregate Income		108,500

- (b) If property 1 were a factory, then the rental income would be treated as business income under S 4(a) in accordance with the IRB Rulings. The assessment would be calculated on an aggregate basis, i.e. on the combined rental income of all properties. Rental income is treated as one source instead of two sources per part (a).

Advance rental would be excluded in the event rental income is assessed under S 4(a). Business income is assessed on an accrual basis.

	RM
Gross rental income (RM 83,000 + RM 22,500)	105,500
Less: Rental expenses (RM 14,500 + RM 23,543)	(38,043)
Adjusted Income / Aggregate Income	67,457

Notes cont'd

8. **Derivation of Rental Income – there is no specific provision in the ITA.**
 - a. **Immovable properties** – if the landed properties are situated in Malaysia, it can be concluded that the rent is derived from Malaysia irrespective of where the owner is and if the tenancy agreement was concluded outside Malaysia
 - b. **Movable properties** – usually represents a lease or rent of plant or machinery. The rental source would depend on the place the property is used or the place the business of the lessor is carried on.
 - c. **f the lessor's business** is carried on in Malaysia then it is Section 4(a) business income
 - d. Rental income from movable assets received by a **non-resident** (foreign lessor) is subject to **a final withholding tax of 10%** as a special class of income under Section 4A and derived from Malaysia under Section 15A.
9. **Basis of assessment** – with effect from YA2004 Companies, Trusts, and Co-operative societies will use their financial year-end for reporting income. Others will follow the calendar basis year.
10. Under Section 27(1) rental income is taxed on a receipt basis and when received will be assessable in the period when it first becomes receivable.
11. **Advance rental** is taxed in the year received even if it is for years in advance. (Section 27(3). Deposits must be distinguished from advance rental. Deposits are not taxable and are taxable only when they are converted as rental advances. Deposits are used as „security“ for any damage to property.
12. **Deduction of expenses** – Section 33(1) general provision will apply to all sources of income
13. **Examples of allowable deductions will include;**
 - a. Cost of repairs and maintenance of the property
 - b. Insurance premium on fire/burglary policies
 - c. Cost of supervision and rental collection
 - d. Cost of obtaining tenant to replace the old tenant
 - e. Interest paid on loan facility taken to finance the property
 - f. Cost of renewing rental agreement and other miscellaneous expenses

14. **Expenses which will not qualify:**
 - a. Initial expenses e.g. Cost of obtaining the first tenant such as advertising, commission and legal expenses on the first rental agreement. These are expenses incurred in creating a source of income and not incurred in the production of income.
 - b. Once the rental source exists expenses incurred during periods of non-occupation are allowed.
 - c. Excess of expense over income in a rental source is not allowed anywhere, as it is a non-business loss. Only business losses are set-off against aggregate income and if not absorbed fully is carried forward and allowed against future statutory income from business.
 - d. Expenses related to advance rental received is only allowed in the period where advance rental was assessed.
15. **Capital Allowances** – only a business source is entitled to claim capital allowances. Therefore a Section 4(d) source cannot claim CA for furniture and fittings and appliances provided in earning the rental income. But the costs of furniture and fittings can be considered on a replacement basis.
16. **Buildings can qualify as an Industrial building** and claim industrial building allowances against their rental income.(Schedule 3 Para 60). Factories and warehouses are common examples of industrial buildings.
17. **Rental Source** – treated as one or many sources. IRB ruling states three categories – residential, commercial and vacant land.
18. **Case law – P Securities Sdn Bhd v DGIR.** It was decided that investment income could be only one source unlike business. Therefore it was erroneous for IRB to disintegrate the source as between income producing and non-income producing. It is not stated in the Act. So there is valid reason for taxpayer to group rental source as one. This decision by the Special Commissioners has been confirmed by the High Court.
19. **Case law- KPHDN v Multi-Purpose Holdings**
 - a. The company being an investment holding company derives dividend income from holding shares in various companies, interest income from loans to related companies and from placement of funds with financial institutions and income from rental and plantation.
 - b. It was held that “income which is chargeable to tax are categorized under six groups and that Revenue cannot further sub-divide each source by treating each counter of share and each loan as a separate source; to treat each counter and each loan as a separate source is undoubtedly to disintegrate the groupings or categories further than what is authorized by the Act.”
 - c. **These two case laws has basically stated that interest, rent and dividends etc. should be treated as separate sources and no further sub-division is needed. If need be you may need to support your claim to IRB stating the grouping of rent etc. as one source as per the decided case laws.**

5.5 Conclusion

The chapter has discussed different aspects of Investment Income. Among the points discussed are: Dividends, Basis Periods, Other issues concerning dividends, Interest Income, Royalty Income, Rental Source. The different aspects have been explained to provide a comprehensive knowledge on investment income in the context of taxation.

Self-Assessment

- Q1. State the circumstances under which dividend income is deemed derived from Malaysia?
- Q2. Explain how the dividend tax imputation system works.
- Q3. Give three instances where interest income is tax exempt
- Q4. What is the withholding tax rate on royalties paid to non-residents?
- Q5. What are the typical expenses allowable against rental income?

Suggested Answers

- A1 Dividend income is deemed derived from Malaysia if the company paying or crediting the dividend is resident in Malaysia.
- A2. Dividend tax imputation system is effective up to YA 2007 and for a six years transition period. Under the imputation system the tax paid by the company is given back to the shareholder as a tax credit when declaring the gross dividend in his personal tax return. The dividend is taxed at gross on the shareholder at the shareholder's marginal tax bracket. If the corporate tax rate is higher than the individual's personal tax rate there will be benefit accruing to the shareholder from the credit. Effective from YA 2008 there will be a single tier corporate tax system where the tax paid by the company is the final tax and there will be no further tax on dividends distributed.
- A3. i) Interest deposited in Malaysian banks and Finance companies are exempted if the deposits are below RM 100,000 or if the deposits are placed for 12 or more months.
ii) Deposits placed in Bank Simpanan Malaysia and Lembaga Tabung Haji are exempt
iii) Interest earned on Bon Simpanan Malaysia or Merdeka Bonds are tax exempt
- A4. The withholding tax rate on royalties to non-residents is 10%.
- A5. Section 33, ITA 1967 states that all outgoings and expenses wholly and exclusively incurred in the production of income is allowable. Capital and private expenses are not tax deductible. Typical expenses would include:
- Interest expense on the capital used to purchase the property
 - Repairs and maintenance expenses incurred
 - Rent collection expenses
 - Cost of advertisements and promotion for finding the next tenant
 - Costs related to bringing in the first or initial tenant is not allowable.
 - Initial expenses such as renovation or costs of securing the first tenant are not allowable. They are deemed as capital expenditure.



**LEMBAGA HASIL DALAM NEGERI
INLAND REVENUE BOARD**

PUBLIC RULING

**INCOME FROM LETTING
OF REAL PROPERTY**

Translation from the original Bahasa Malaysia text.

PUBLIC RULING NO.1/2004

DATE OF ISSUE: 30 June 2004



**INLAND REVENUE BOARD
MALAYSIA**

**INCOME FROM LETTING
OF REAL PROPERTY**

**Public Ruling No. 1/2004
Date of Issue : 30 Jun 2004**

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~~DIRECTOR GENERAL'S PUBLIC RULING~~

A Public Ruling is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

**Director General of Inland Revenue,
Malaysia**

**INCOME FROM LETTING
OF REAL PROPERTY**

**INLAND REVENUE BOARD
MALAYSIA**

**Public Ruling No. 1/2004
Date of Issue : 30 Jun 2004**

1. This Ruling considers:
 - 1.1 the treatment of rent as a non-business source of income under section 4(d) of the Income Tax Act 1967 (the *Act*);
 - 1.2 the situations or circumstances where rent or income from the letting of property can be treated as business income of a person under section 4(a) of the *Act*; and
 - 1.3 how all properties of a person are to be grouped in several categories in computing the statutory income under section 4(d) of the *Act*.
2. For the purpose of this Ruling, the words used have the following meanings:
 - 2.1 "Rent" or "rental income" or "income from letting" includes any sum paid for the use or occupation of any property or part thereof, including premiums and other payments in connection with the use or occupation of the property.
 - 2.2 "Letting" a property means granting the use or occupation of the property under an agreement or a term of contract, and includes the sublease or subletting of a rented or leased property.
 - 2.3 "Property" means real property which includes any land and any interest, option or other right in or over such land, and includes any building on land.
 - 2.4 "Person" includes a company, a co-operative society, a partnership, a club, an association, a Hindu joint family, a trust, an estate under administration and an individual, but excludes a unit trust.
 - 2.5 "Ancillary or support services / facilities" include some or all of the following: security guard service; air-conditioning (centralized or split units); supply of hot water; escalators and / or lifts; recreational facilities (clubhouse, gymnasium, tennis / squash / badminton courts, swimming pool, etc.); cleaning or housekeeping (including garbage disposal); maintenance of common property, garden, landscaping, exterior lighting and other external fixtures.
 - 2.6 "Management corporation" means a management corporation established under the Strata Titles Act 1985 (Act 318), the Land (Subsidiary Title) Enactment 1972 (Sabah No. 9 of 1972) or the Strata Titles Ordinance 1995 (Laws of Sarawak, Chapter 18).
 - 2.7 "Commercial unit" means a unit in an office complex, a commercial centre or a shopping complex, or a floor or a unit in a shophouse with a separate strata title.
 - 2.8 "Shophouse" means a single or multiple-storey building where at least the ground floor is designed or used for occupation as a shop or premises for

carrying on trading or commercial activities, other than a commercial unit or a residential property used as a shop.

- 2.9 "Residential property" means a property designed or used for occupation as residence or dwelling, such as houses, apartments or condominium units, other than a shophouse or part of a shophouse used as a residence. Where, with the written approval of the relevant authorities, a residential property is converted into a shop or an office (for example, a bungalow that is converted into a showroom or office), that property may be regarded as a shophouse or commercial unit, as the case may be.
- 2.10 "Strata or subsidiary title" means a strata title issued under the provisions of the Strata Titles Act 1985 (Act 318) or a subsidiary title issued under the provisions of the Land (Subsidiary Title) Enactment 1972 (Sabah No. 9 of 1972) or the Strata Titles Ordinance 1995 (Laws of Sarawak, Chapter 18). A property for which a strata or subsidiary title "is in the process of being issued" means a property for which a proper application has been made to the relevant authorities.
- 2.11 "Related or connected person", in relation to a company, means any person who is in a position to influence or be influenced by the other person, or to control or be controlled by the other person, and includes a director, an employee, a related company or its directors or employees, a relative of a director, or a person who controls or is controlled by the company.
- 2.12 "Associate", in relation to a company, means a director or subsidiary of that company and a director or employee of that subsidiary.
- 2.13 "Director" includes a person who occupies the position of a director or a person in accordance with whose directions or instructions the directors or staff of a company are accustomed to act.
- 2.14 "Employee" means the servant (where the relationship of master and servant subsists in an employment) or (where it does not) the holder of an appointment or office for which remuneration is payable.
- 2.15 "Related company" means the situation where one company holds not less than 20% of the ordinary shares or preference shares of the other.
- 2.16 "Arm's length basis" refers to the circumstances, decisions or outcomes that would have been arrived at if unrelated or unconnected persons were to deal with each other wholly independently and out of reach of personal influence.
- 2.17 "Significantly less than the market rate" means less than 70% of the economic rent or the amount that would have been payable as rent if the lease or tenancy or occupation of the premise had been negotiated by independent parties dealing on an arm's length basis. Unless there are business or commercial

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reasons to justify such a substantial difference, it should be presumed that the situation has been influenced or controlled by the related or connected person.

3. Generally, rent is regarded as a non-business source of income and is charged to income tax under section 4(d) of the Act. Where the property concerned is managed and let in such a systematic or organized manner that the letting can be regarded as carrying on a business, the income from the letting can be charged to tax under section 4(a) of the Act.

4. **Rent as a business source**

- 4.1 Where, in conjunction with the letting of a property, a person also provides ancillary or support services / facilities, the letting of the property can be considered a business source of income of that person and the income received charged to tax under section 4(a).
- 4.2 To qualify for the treatment mentioned in paragraph 4.1 above, the services / facilities should be actively provided by the person (that is, the services / facilities are procured, managed and / or supplied by the person who lets the property) and not passively or incidentally derived from the ownership or lease of the property, as in the case of services and facilities provided by the management corporation of a subdivided building to the proprietors / tenants of the individual units.

Example 1

An individual owns an apartment complex consisting of 24 units (located in 2 blocks of 3 storeys each) and lets out individual units to tenants on both short and long term tenancies. The lifts that are provided for access to the upper floors are maintained by the owner. Security is provided on a 24-hour basis by a security firm hired by the owner. Housekeeping service is provided optionally at an additional charge; a maid is employed by the owner for this purpose.

The letting of the apartment units can be treated as a business source of the individual since the services and facilities are actively provided.

Example 2

A company owns 3 units in a condominium and lets them out to 3 different persons. Proprietors of the individual units are entitled to the use of the swimming pool, tennis courts and other facilities. All the facilities are maintained by the management corporation of the building, which also provides 24-hour security.

*The letting of the condominium units should **not** be considered a business source of the company as the facilities and services are available to the*

tenants merely by extension of the rights of the company as proprietor of the units and cannot be regarded as being actively provided by it. The rental income should be regarded as arising in a passive manner and treated as non-business income under section 4(d).

5. Special treatment for a company (other than an investment holding company or a company limited by guarantee which is taxed as a club or association) where rent can be regarded as a business source

5.1 *Special-purpose commercial building*

The letting of a special-purpose building built:

5.1.1 for commercial purpose such as a commercial complex, an office complex or a shopping complex; or

5.1.2 as a factory or warehouse;

can be considered a business source of a company and the income therefrom charged to tax under section 4(a).

Example 3

A company owns a 3-storey complex built for commercial purpose comprising 15 units which can be used either as offices or retail outlets and lets them to various tenants.

The letting of the property can be treated as a business source under section 4(a) as the building is a commercial building complex.

Example 4

A company owns a building which is let to another company which uses it as a factory for the manufacture of consumer goods.

The letting of the property can be regarded as a business source under section 4(a) as the building is in use as a factory.

5.2 *Commercial units, shophouses and residential properties*

The letting of 4 or more commercial units, 4 or more floors of shophouses or 4 or more residential properties or any combination of 4 units of the above may be treated as a business source of a company and the income therefrom charged to tax under section 4(a). [The entire property (except for a shophouse) constituted under the particular title should be included in the letting].

Example 5

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A company owns 3 commercial units in a shopping complex, each with a separate strata title. It also holds the lease for an adjoining unit which is situated in between the 2 units owned by it. It lets out all 4 units to a single tenant.

Since there is a letting of 4 commercial units, it can be considered a business source under section 4(a). [The rent that the company pays for the intermediate unit can be allowed as a deductible expense].

Example 6

A company owns a commercial unit in a shopping complex with an area of 2,000 square feet under one strata title. The company subdivides the unit into 4 sub-units by putting up partitions and additional doors, and lets out the sub-units to 4 separate tenants.

*Since the letting involves 1 commercial unit, the company is **not** eligible to treat the letting of the property as a business source. The rental income should be charged to tax under section 4(d).*

Example 7

A company, which owns a 2-storey shophouse, holds on a lease of an adjoining shophouse. It lets out the 2 shophouses to one tenant.

The letting of the properties can be considered a business source under section 4(a).

Example 8

A company owns a 4-storey shophouse. It lets out the shophouse to 4 different tenants, each occupying one floor.

Since the 4 floors are let, the letting of the shophouse can be regarded as a business source under section 4(a).

Example 9

A company owns 5 properties: 2 bungalows, a double-storey terrace house and 2 condominium units. One of the condominium units is occupied rent-free by the managing director of the company; all the other properties are let to non-related persons.

Disregarding the property occupied by the managing director [see paragraph 5.4], the company still has the minimum of 4 residential properties which can be taken into account. The letting of the properties can, therefore, be considered a business source under section 4(a).

Example 10

A company holds on a lease a commercial unit in a shopping complex, a 2-storey shophouse and a bungalow. All the properties are let to various persons.

The letting of the properties can be considered a business source under section 4(a).

Example 11

A company owns 2 apartment units, 1 commercial unit and a piece of vacant land and holds a lease on 1 shophouse, all of which are rented out.

Disregarding the vacant land which cannot be taken into account for this purpose, there is a total of 4 properties which can be taken into consideration. The letting of the properties can, therefore, be regarded as a business source under section 4(a).

5.3 *Separate strata or subsidiary titles for subdivided properties*

For the purpose of paragraph 5.2 above, a floor may be subdivided into 2 units with 2 separate strata or subsidiary titles: in such a case, each unit will be considered separately.

Example 12

A company owns a 2-storey shophouse. Each floor is subdivided into 2 units. Each unit has a separate strata title and can be used independently from the other units. The company lets the whole shophouse to one tenant who is allowed to make renovations to internally connect the units.

The letting of the property can be considered a business source under section 4(a) as there are 4 commercial units.

5.4 *Letting of property to, or occupation of property by, related or connected person(s)*

If a property is let to, or occupied by, a related or connected person, that property cannot be taken into account for the purpose of determining the eligibility for any of the treatment provided under paragraph 5.2 above, unless it can be shown that the letting or occupancy is on an arm's length basis, that is:

- a. there is payment of rent in respect of the letting or occupation by the related or connected person(s); and
- b. the amount of that rent is not significantly less than the market rate.

Example 13

A company owns 6 condominium units, 3 of which are occupied by directors of the company who pay nominal rent of RM500 per month each. The other 3 units are let for RM2,000 per month each to persons who are not related or connected to the company or its directors.

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*Since the 3 properties let to connected persons (the directors) must be disregarded (the rent paid being significantly less than the market value of RM2,000), the company does **not** have a minimum of 4 residential properties which can be taken into account and is, therefore, **not** eligible for the treatment under paragraph 5.2. The rental income should be charged to tax under section 4(d).*

Example 14

A company owns 2 properties: a 1-storey shophouse and a condominium unit. All of the properties are let to unrelated persons. It also holds the lease for a 2-storey shophouse. The upper floor of the leased shophouse is occupied by the company's employees as residence. It sublets the ground floor to an unrelated person.

Disregarding the floor occupied by the company's employees as residence, the letting of the 1-storey shophouse, the ground floor of the leased shophouse and the condominium unit does not enable the company to be eligible for treatment under paragraph 5.2. The rental income should be charged to tax under section 4(d). [However, if the company's employees pay rent to the company at market rates, the rental income can be charged to tax under section 4(a)].

5.5 Letting for less than the entire duration of the basis period

Where because of one or more of the following situations:

- a. the letting of one or more of the properties temporarily ceases by reason of repair or renovation of the building; termination of tenancy; legal injunction or other official sanctions; or any other similar circumstances beyond the control of the company;
- b. the acquisition of one or more properties and the commencement of letting at any time during the basis period; or
- c. the disposal of one or more properties and / or the cessation of letting at any time during the basis period;

the minimum conditions under paragraph 5.2 are fulfilled for part of the basis period for a year of assessment, the letting of the properties can still be considered a business source. Where the failure to fulfil the minimum conditions is only temporary as in situation (a) above, the letting of the properties can be considered a business source under section 4(a).

Example 15

A company owns a bungalow, an apartment, 2 commercial units and a piece of vacant land, all of which are let to various tenants. The letting of the properties has been treated as a business source of the company in prior years.

During the basis period for a particular year of assessment, the tenancy of the bungalow ceases and it remains vacant for the rest of the basis period despite the efforts of the company to find a new tenant (including advertisements in various newspapers). The situation remains the same for the next 20 months.

The letting of the properties can still be regarded as a business source of the company for that year of assessment since the minimum condition under paragraph 5.2 has been fulfilled. Furthermore, the cessation in letting of one of the properties is only temporary, as the bungalow continues to be held available for letting.

Example 16

A company owns 2 two-storey shophouses, both of which are let. The letting of the properties has been treated as a business source of the company in prior years. In December 2003, one of the shophouses is partially destroyed by fire and substantial repairs are required before it can be reoccupied. The tenancy is terminated by mutual consent as the tenant is unwilling to wait for the building to be repaired. The repairs are not completed until March 2005, when the building is let out once again.

The letting of the properties can still be regarded as a business source of the company for the basis period for year of assessment 2004 as the temporary interruption in the ability of the company to meet the minimum requirements is beyond its control.

Example 17

During a particular year, a company which owns and lets out 3 residential houses acquires an apartment unit which it immediately lets out through the real estate agent who manages its other properties.

The letting of the properties can be regarded as a business source of the company for that year of assessment since it is able to meet the minimum condition of 4 residential properties at some time during the basis period.

Example 18

A company owns two 2-storey shophouses which are let and the letting of the properties has been treated as a business source in prior years. During the basis period for a particular year of assessment, it disposes one of the shophouses.

*The letting of the properties can still be regarded as a business source for that particular year of assessment, but **not** for the subsequent year of assessment since it will then not be able to fulfil the minimum condition of at least 4 floors of shophouses.*

6. Date of commencement

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- 6.1 The source of income from a property used for the purpose of letting commences on the date of first letting of the property.

Example 19

A company purchases a condominium on 01.04.2004. After renovations have been completed, the condominium is let on 01.10.2004.

The source of income from the property commences on 01.10.2004.

- 6.2 Paragraph 6.1 above does not apply in the case of letting of property that falls under paragraph 4. In the case of letting of property that falls under paragraph 4, the source of income commences on the date the property is made available for letting. A property is made available for letting when the property is ready to be occupied by tenants and the property is advertised for letting or a property agent has been appointed for letting out the property.

Example 20

On 25.03.2004 a company purchases a 25-storey office building. The company advertises the letting of the building on 01.04.2004. The company will provide lifts, lighting and central air-conditioning to the whole building and cleaning of common areas. The expected date of commencement of letting is 01.07.2004. Renovation to the building is completed on 31.08.2004.

The business of letting of property can be said to have commenced on 01.09.2004.

7. Treatment of all properties as a single source / several sources

7.1 *Treatment of rental income as one business source*

Where the minimum conditions under any of the paragraphs 4 and 5 have been fulfilled and a decision has been made to treat the letting as a business source, all properties of the person should be treated as one business source. This business source of letting of properties should be treated as a separate business source from other businesses.

Example 21

A company, which owns two 2-storey shophouses and a piece of vacant land, decides to treat its income from letting as a business source. It qualifies to do so as it satisfies the condition in paragraph 5.2 (4 floors or more of shophouses). After deducting allowable expenses (assessment, property insurance, quit rent, repairs, etc.), the position is as follows:

<i>Property</i>	<i>Adjusted income</i>	<i>Adjusted loss</i>
Shophouse #1	36,000	-
Shophouse #2	-	2,000
Vacant land	-	1,000
<i>Total</i>	36,000	3,000

Since the company qualifies for the treatment under paragraph 5.2, its rental income can be regarded as a business source and its statutory income from the business of letting should be calculated as follows:

<i>Adjusted income</i>	<i>36,000</i>
<i>Less: Adjusted loss</i>	<i>(3,000)</i>
<i>Statutory income from letting</i>	<i><u>33,000</u></i>

7.2 *Treatment of rental income as a non-business source*

In the case where rent is a section 4(d) source, rent from each property is treated as a separate source of income. However, as a concession, in computing the adjusted income from rent, the properties of the person can be grouped into the following categories:

- Residential properties;
- Shop-house / commercial properties; and
- Vacant land.

The grouping into the above categories should include only those properties which have commenced receiving rental income.

Example 22

An individual has the following position:

<i>Property</i>	<i>Gross income</i>	<i>Allowable expenses</i>
Shoplot #1	24,000	8,000
Shoplot #2	12,000	14,000
Apartment	30,000	12,000
Vacant land	1,200	1,500
<i>Total</i>	67,200	35,500

His adjusted income / statutory income from rent should be calculated as follows:

- Residential properties

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<i>Gross income from rent</i>	<i>30,000</i>
<i>Less: allowable expenses</i>	<i><u>12,000</u></i>
<i>Adjusted income / statutory income from rent</i>	<i><u>18,000</u></i>
 b. Shop-house / commercial properties	
<i>Gross income from rent</i>	<i>36,000</i>
<i>Less: allowable expenses</i>	<i><u>22,000</u></i>
<i>Adjusted income / statutory income from rent</i>	<i><u>14,000</u></i>
 c. Vacant land	
<i>Gross income from rent</i>	<i>1,200</i>
<i>Less: allowable expenses</i>	<i><u>1,500</u></i>
<i>Adjusted income / statutory income from rent</i>	<i><u>Nil</u></i>

8. Capital allowance / industrial building allowance

- 8.1 Where the letting of property is treated as a business source, capital allowance / industrial building allowance can be claimed on capital expenditure incurred on plant and machinery and industrial building. The provisions and rules relating to capital allowances shall also apply in the business of letting of properties.
- 8.2 Where the letting of property is treated as a business source and there is temporary cessation of letting of property such as repair of building or termination of tenancy, the company can continue to claim capital allowance / industrial building allowance provided the property is maintained in good condition and is available for letting (after completion of repair).
- 8.3 Where the letting of property has been treated as a business source and capital allowance has been claimed and subsequently, the letting of property ceases to be treated as a business source, the residual expenditure of the assets (after deduction of capital allowances) will be reduced by notional allowances for each subsequent year of assessment.

Example 23

A company lets 4 fully-furnished condominiums. The rent has been treated as a business source and capital allowance has been claimed on furniture, electrical fittings and air-conditioners. One of the condominium is sold in April 2004. At the end of the basis period for year of assessment 2004 and 2005 the company owns 3 condominiums.

The balancing allowance or balancing charge for year of assessment 2004 will be calculated on furniture, electrical fittings and air-conditioners that are

sold together with the condominium in April 2004. Capital allowance for year of assessment 2004 will be given for the furniture, electrical fittings and air-conditioners in the remaining condominiums. For year of assessment 2005, no capital allowance will be given as the company does not qualify under paragraph 5.2 to treat the rent as a business source. Instead, notional allowances will be deducted to arrive at the residual expenditure of the assets.

- 8.4 Where the letting of property is treated as a non-business source and subsequently, the company qualifies to treat the letting of property as a business source, the qualifying expenditure of assets used in the letting such as furniture and air-conditioners will be the market value on the day the assets are brought into use in the business.

Example 24

A company closes its accounts on 30 June each year. As the company owns 2 furnished condominiums, the income from letting is treated as a rental source under section 4(d). In March 2004 the company acquires 2 additional condominiums and both are let in May 2004 after renovation has been made and furnishings have been installed.

As the company lets 4 condominiums in the basis period for year of assessment 2004, it qualifies to treat the letting of properties as a business source. The qualifying expenditure for assets in use on or prior to 30 June 2003 will be the market value on the day the assets are brought into use in the business, that is, on 1 July 2003. No initial allowance will be given.

- 8.5 Where the letting of property is treated as a non-business source and the property qualifies as an industrial building, industrial building allowance can be claimed.

9. Replacement cost of furnishings

Where the letting of a furnished property is treated as a non-business source, cost of replacing items such as furniture and air-conditioners can be claimed as a deduction.

10. Subletting of building used in the business

Where a building is used for the purpose of a business and part of the building is sublet, the rent arising from the subletting is treated as part of the existing business source.

11. Effective date

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This Ruling is effective for year of assessment 2004 and subsequent years of assessment. This Ruling supersedes Director General Ruling No. 1/95 issued on 25 May 1995.

12. Transitional treatment under the Director General Ruling No. 1/95

If a company has been treated as carrying on a business of letting under Director General Ruling No. 1/95 (old Ruling), this treatment shall continue until such time the company is no longer eligible to do so under the old Ruling such as the disposal of 1 or more units of property acquired in the basis period for year of assessment 2003 or earlier (old property). Where 1 or more units of old property have been sold and the company does not qualify to treat the letting of the remaining old property as a business source under the old Ruling, the old Ruling shall cease to apply to the company. The old Ruling shall not apply to properties acquired on or after the first day of the basis period for year of assessment 2004.

Example 25

A company has 3 commercial units that have been let since 1998. The income from rent has been treated as a business source. During the basis period for year of assessment 2005, the company sells one of the commercial unit. Using the funds from the sale, the company purchases another commercial unit and lets it out in the same year.

For year of assessment 2004 and 2005, the company can treat the rent as income from a business as the company has let 3 old commercial properties and the old Ruling continues to apply. In year of assessment 2006 the income from rent is not treated as a business source as neither the conditions in the old Ruling (the company has only 2 old commercial properties) nor the conditions in the Ruling have been satisfied.

**Director General
of Inland Revenue**

Chapter 6

Exempt Income under Schedule 6

Chapter Outline:

- 6.1 Introduction
- 6.2 Schedule 6 Exemptions
- 6.3 Others
- 6.4 Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- State the main exemptions given under this Schedule especially when related to employment income
- State the nature of exemptions for retirement gratuities, and compensation for loss of employment.
- Understand the income exemption given to various approved funds and organizations
- Recognize the exemptions given to the different „royalty“ income
- State the exemption given to interest earned from bonds and government securities
- State the exemption given to annuities by Malaysian Life Insurers
- Explain how double deduction works for certain approved expenses

6.1 Introduction

Income derived from Malaysia may be exempted from income tax either under Schedule 6 of the Income Tax Act 1967 or the Income Tax Exemption Order or certain specific provisions in the Income Tax Act (ITA) 1967.

6.2 Schedule 6 Exemptions

The following incomes are tax exempt under Schedule 6 of the ITA 1967:-

- a) Official emoluments of Ruler or Ruling Chief as defined in Section 76 of the ITA 1967.
- b) Income and official emoluments of diplomatic and consular staff which are exempt by virtue of laws relating to diplomatic and consular privileges.
- c) Wound and disability pensions granted to persons in respect of service in various armed and defence forces in Malaysia or in a Commonwealth Country and pensions granted to wives or dependent relatives of members of any of the forces.
- d) Disability pensions granted in respect of war service injuries to members of civil defence organisation in any territory within Malaysia.
- e) Bounties paid out of funds provided by Parliament to members of Royal Malaysian Naval Volunteer Reserve, Malaysia Territorial Army and Royal Malaysia Air Force Volunteer Reserve.
- f) Emoluments of members of armed forces or civil servants of Commonwealth countries performing duties in Malaysia where the emoluments are payable out of the public funds of and subject to foreign tax of that Commonwealth country.
- g) Sums received by way of death gratuities or as consolidated compensation for death or injuries.
- h) The income of any Co-operative Society:
 - i) in respect of a period of 5 years commencing from the date of registration as such Co-operative Society; and
 - ii) Thereafter where the members' funds of such Co-operative Society as at the first day of the basis period for the year of assessment is less than RM 750,000.

"Members' fund" means the aggregate of:

- 1) The paid up capital in respect of shares and subscription excluding bonus shares to the extent they were issued and of capital reserve created by revaluation of fixed assets;
- 2) Statutory reserve fund;
- 3) Reserve other than those capital reserves which were created by revaluation of fixed assets and provision for depreciation, renewal or replacement and diminution in value of assets;

- 4) Balance of share premium account excluding any amount credited therein at the instance of issuing bonus shares at premium out of capital reserves created by revaluation of fixed assets; and
- 5) Balance of profit and loss appropriation account.

EXAMPLE

The ABC Society was registered as a co-operative society on 1 January 2001. The following information has been extracted from its accounts for the relevant years.

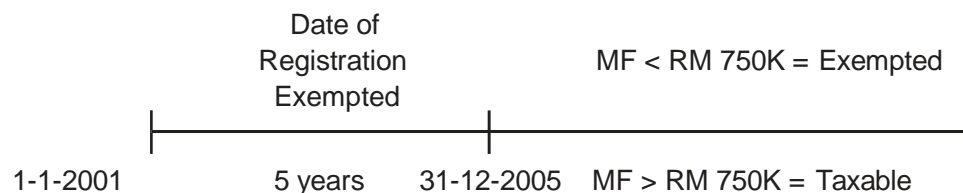
Year Ended 31 December	Net Profit per Audited Accounts RM'000	Payment to a Co-operative Educational Fund RM'000
2004	500	300
2005	800	380
2006	300	50
2007	700	160

Balance of Members' Fund as at 31 December

	RM'000
2003	600
2004	880
2005	700
2006	780
2007	800

Required:

Determine whether the Society is exempted up to Year of Assessment 2004 to 2007.



Based on the above, the income for Years of Assessment 2001 to Year of Assessment 2005, (within 5 years) will be exempt and YA 2006 and 2007 will be taxable since [Members' Fund > RM 750,000].

- i) Dividend paid, credited or distributed to any member by a Co-operative Society shall be tax exempt.
- j) **CHARITABLE INSTITUTIONS**

The word charitable as per the IRB guideline of October 1995 and in line with the classification of charities in **CIT v Pemsel** is classified into 4 heads:

- the relief of poverty
- the advancement of education
- the advancement of religion and
- other purposes beneficial to the community not falling under any of the preceding heads

The law in Malaysia applicable to charitable trusts follows similar principles to that in the UK with such modifications as are necessary to prevent it from operating unjustly and oppressively.

With effect from YA 2001, the tax exemption for charitable institutions is tied in to the S44 (6) status of an approved institution or organisation i.e. there is no longer a need for a separate application to be recognised as a charitable institution. Once approved for S44 (6) status, automatically they would be granted Para 13 Schedule 6 exemption.

EXEMPTION UNDER PARA 13 SCHEDULE 6

Scope

- ◆ institution or organisation
 - approved for the purposes of S44(6)
- ◆ religious institution / organisation
 - not operated or conducted primarily for profit
 - established in Malaysia
 - exclusively for religious worship / advancement of religion

Eligibility to carry on a business

- ◆ it is in the course of the actual carrying out of a primary purpose of the institution
- ◆ the work in connection with the business is mainly carried on by persons for whose benefit the institution / organisation was established
- ◆ otherwise 25% rule will apply:
 - Not more than 25% of accumulated funds
 - at the beginning of the basis period
 - is used for the business
 - profits generated are used solely for charitable purposes / primary purpose

Mechanics

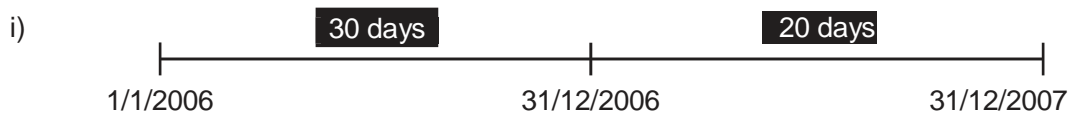
- ◆ dividend income is not exempt (Dividend income is exempt from YA2008)
- ◆ not applicable to RPGT (RPGT has been abolished from 1st April 2007)

Section 44(7)

- ◆ All institution or organisation approved for the purposes of S44(6) may carry out charitable activities outside Malaysia with prior consent of the Minister
- k) The income of a trade union registered under any written law relating to trade union in so far as the income does not consist of the gains or profits from a business carried on by the union or dividends shall be tax exempt.

- l) income derived by an individual from an employment exercised by a non-resident individual while in Malaysia is tax exempt if:
- i) The period or periods do not exceed 60 days in that basis year; or
 - ii) The period does not exceed a continuous period of 60 days which overlaps two successive basis years; or
 - iii) The continuous period of not exceeding 60 days which overlaps those basis years together with a period or periods do not exceed 60 days.

For example:



The employment income is tax exempt as Para 21(a) applies.



The employment income of the above two years of assessment is tax exempt under Para 21(b).



Para 21(c) exemption shall apply to the above.

The above exemptions shall only apply if that individual is a non-resident in the relevant basis year. It does not apply to a public entertainer (unless he is paid out of public funds of a foreign government) and to directors of Malaysia resident companies.

A public entertainer means a stage, radio or television artist, a musician, athlete or an individual exercising any profession, vocation or employment of a similar nature.

- m) Income of a person non-resident in Malaysia for the basis year for a year of assessment in respect of interest derived from Malaysia on an approved loan.

An „approved loan“ means any loan or credit made to the Government, State Government, local authority or statutory body by a person not resident in Malaysia where the loan or credit agreement was executed in Malaysia or where the loan or credit agreement was executed outside Malaysia with the prior approval of the Minister.

- n) Income of any person, other than a resident company carrying on the business of banking insurance, or sea & air transport derived from sources outside Malaysia and received in Malaysia is exempt.

For a resident company, the exempted foreign income will be credited to an exempt account from which exempt dividends can be paid. If the initial recipient of the dividends is a corporate entity, then it can also pay out tax exempt dividends to its own shareholders i.e. a two-tier tax exemption.

(The position has changed from YA 2008 as dividends are no longer taxed on the shareholders.)

- o) Pensions derived from Malaysia and paid to a person for the basis year for a year of assessment on reaching the age of 55, or on reaching the compulsory age of retirement from employment specified under any written law or if the Director General is satisfied that the retirement was due to ill-health -

- a) in respect of services rendered in exercising a former employment in Malaysia; or
- b) under an approved scheme.

Gratuity or pension derived from Malaysia and paid to a person resident for the basis year for a year of assessment under any written law applicable to the President or Deputy President of the Senate, Speaker or Deputy Speaker of the House of Representatives, Speaker of the State Legislative Assembly, member of the Senate, member of the House of Representatives or member of the State Legislative Assembly:

Provided that

- a) the exemption in respect of pension shall apply only when the person has attained the age of 55 or if the Director General is satisfied that such person ceased to be President, Deputy President, Speaker, Deputy Speaker or member due to ill-health; and
- b) where such person is eligible for exemption in respect of pension under this paragraph and also under paragraph 30 of this Schedule, exemption shall be applicable only to the higher or the highest pension payable, as the case may be.

Provided that where a person is paid more than one pension, this paragraph shall apply to the higher or the highest pension paid, as the case may be.

- p) Income of ten thousand ringgit for the basis year for a year of assessment derived by an individual resident in Malaysia for that basis year from royalty or payment in respect of the publication of, or the use of or the right to use, any artistic work (other than any original painting) and from royalty in respect of recording discs or tapes.
- q) Income of twelve thousand ringgit for the basis year for a year of assessment, by an individual resident in Malaysia, being payment received in that year in respect of any translation of books or literary work at the specific request of any agency of the Ministry of Education or the Attorney General's Chambers:

Provided that the exemption shall not apply where the payment arises to the individual as part of his emoluments in the exercise of his official duties.

- r) Income of RM20,000.00 for the basis year for a year of assessment derived by an individual resident in Malaysia for that basis year from royalty (other than royalty in respect of recording discs or tapes) or payment in respect of the publication of, or the use of or the right to use any literary work, any original painting
- s) Royalty income for the basis year for a year of assessment derived by an individual resident in Malaysia for that basis year from an approved cultural performance or income of an individual for the basis year for a year of assessment being payment by way of fee or honorarium in respect of services provided for purposes of validation, moderation or accreditation of franchised educational programs in higher educational institutions and the services are verified by the Lembaga Akreditasi Negara:

Provided that the exemption shall not apply where the payment arises to the individual as part of his emoluments in the exercise of his official duties.

- t) Income of any person not resident in Malaysia for the basis year for a year of assessment, in respect of interest derived from Malaysia (other than such interest accruing to a place of business in Malaysia of such person) and paid or credited by any person (whether the same person or not) carrying on the business of banking or finance in Malaysia and licensed under the purview of Bank Negara.
- u) Provided that the exemption under this paragraph shall not apply to interest paid or credited on funds required for the purpose of maintaining net working funds as prescribed by the Central Bank of Malaysia.
- v) Income of any person derived from exercising an employment on board a Malaysian ship as defined in this Act.

A „Malaysian ship“ means a sea-going ship registered as such under the Merchant Shipping Ordinance 1952, other than a ferry, barge, tug boat, supply vessel, crew boat, lighter, dredger, fishing boat or other similar vessel.

Sums received by way of annuities granted under annuity contracts issued by Malaysian life insurers are tax exempt in the hands of the annuitants.

3Interest paid or credited to any individual, unit-trust and listed closed-end fund:-

- i) in respect of securities or bonds issued or guaranteed by the Government; or
- ii) in respect of debentures, other than convertible loan stock, approved by the Securities Commission; or
- iii) in respect of Bon Simpanan Malaysia issued by the Central Bank of Malaysia
- iv) There is also a tax exemption for Islamic securities approval by Securities commission such sukuk issuance based on ijarah.

- w) Compensation for loss of employment during the basis year by an employee or consideration for any covenant entered into by the employee restricting his right to take up employment of the same or similar kind is exempt:-
- a) If the Director-General is satisfied that the payment is made on account of loss of employment due to ill-health.
 - b) in the case of payment in relation to a period of employment with the same employer or with companies in the same group. Exemption in such cases is limited to RM 6,000 per year multiplied by the number of completed years of service with that employer or group of companies.

The above exemption does not apply to a director of a controlled company who is not a full-time service director.

Lump-sum payments including „golden handshakes“ made to employees can be assessed as compensation for loss of employment under Section 13(1) (e) or as gratuity under Section 13(1) (a).

The tax treatment and the exemption available are different under Schedule 6 of the ITA 1967. The basis of assessment of such lump-sum payments such as “spread-back” over the period of employment exclude lump-sum payments falling under Section 13(1)(d) or 13(1)(e).

Where the contract of employment provides for a lump-sum payment to the employee, such payment would not be treated as compensation for loss of employment. It shall be assessed as gratuity under Section 13(1) (a) where Section 25(4) shall apply.

Payment for compensation for loss of employment generally would have the following characteristics as decided in *Heywood v CIR*:-

- 1) There was no contractual entitlement to such payment
- 2) It was paid for cessation of his employment.
- 3) The employee still has the prospect of taking up future employment up to his retirement age of 55.

EXAMPLE 1

Harry joined Golden Sdn Bhd on 1 January 2002 and was made redundant by the company on 31 December 2007. He received the following income for the year ended 31 December 2007.

a)	Salary	RM 20,000
b)	Bonus	RM 4,000
c)	Compensation for loss of employment	RM 30,000

Compute the Statutory Adjusted Income from employment for Harry for the Year of Assessment 2007.

HARRY**Income Tax Computation
Year of Assessment 2007**

	RM	RM
Statutory Income Employment		
Section 13(1) (a)		
Salary		20,000
Bonus		4,000
Section 13(1) (e)		
Compensation for loss of employment	30,000	
Less: Para 15(1) (b) Sch 6 Exemption RM 6,000 x 6 completed years of service	36,000	
		<u>Ni</u> <u>24,000</u>

EXAMPLE 2

Woon, a director of a controlled company received the following for the year ended 31 December 2007.

- a) Director's Remuneration
- | | |
|--------|-----------|
| Salary | RM 20,000 |
| Bonus | RM 4,000 |
- b) Compensation for loss of employment RM 10,000

Woon approached you regarding his tax position and informed you that he joined the company on 1 January 1999 as a non-service director.

WOON**Income Tax Computation
Year of Assessment 2007**

	RM
Statutory Income Employment	
Section 13(1) (a)	
Salary	20,000
Bonus	4,000
Section 13(1) (e)	
Compensation for loss of employment	10,000
Adjusted Income	<u>34,000</u>

The exemption in Para 15(1) (a) and (b) does not apply to a Director of a controlled company who is not a full-time service director.

EXAMPLE 3

Liang approached you regarding the amount of compensation for loss of employment of RM 10,000 which he received from Freddie Sdn Bhd. The following information is also provided:

- a) Liang worked for Chew Corporation Sdn Bhd from 1 January 2002 to 31 December 2004.
- b) Liang joined Freddie Sdn Bhd, a subsidiary of Chew Corporation Sdn Bhd on 1 January 2005 and was made redundant on 31 December 2007.

Advise him on whether he is entitled to claim exemption under Para 15(1) (b) for his years of service.

The full amount Liang received from Freddie Sdn Bhd is exempted from tax for the Year of Assessment 2007 by virtue of Para 15(1) (b) of Sch 6.

Section 13(1) (e)

Compensation for loss of employment	RM 10,000
Less: Para 15(1) (b) Sch 6 exemption	RM 36,000
	<hr/>
Section 13(1)(e) income	Nil
	<hr/>

Although Liang has worked for two companies, they are treated as one; one being a holding company and the other a subsidiary company.

Para 15(2) of Schedule 6 states that a period of employment with different employers where the management and control of those businesses substantially remain with the same person or is conducted through a central agency shall be treated as a period of employment with the same employer.

- x) Gratuity received by an individual is exempted from tax if:
 - a) the Director-General is satisfied that the retirement was due to ill-health, or
 - b) the retirement takes place on or after reaching the age of 55, or on reaching the compulsory age of retirement from employment specified under any written law and in either case the employment has spanned at least 10 years with the same employer or with companies in the same group.

Payment of gratuity to the Employee Provident Fund or a staff provident fund under a collective agreement can be assessable to tax as it was held that such payment accrued to the tax payers and it was receivable at the time the payment was credited to the Employee Provident Fund. In a local high court case, such payment was held to be assessable and the provision of Section 25(4) of spread-back shall apply accordingly.

EXAMPLE 1

Han was born in 1949 and was employed by Gee Sdn Bhd in 1994. He retired from the company on 31 December 2007. The company paid him a gratuity of RM 70,000 in appreciation of his 14 years service with the company. The following is the salary received by him for the last 10 years.

<i>Basis Year</i>	<i>Salary RM</i>
1998	30,000
1999	40,000
2000	45,000
2001	55,000
2002	70,000
2003	75,000
2004	85,000
2005	90,000
2006	95,000
2007	95,000

Han approached you regarding his tax position for the Year of Assessment 2007 and the gratuity he received in 2007.

HAN**Income Tax Computation
Year of Assessment 2007**

	RM
Statutory Income	
Employment	
Salary	95,000
Gratuity	exempted
Gross Income/Adjusted Income	95,000

The whole amount of gratuity of RM 70,000 is exempted from tax as Han is over the age of 55 and has served the company for more than 10 years.

EXAMPLE 2

Billy who joined Heavy Corporation Sdn Bhd on 1 July 2003 and left the company on 30 September 2007, provides you with the following income received until 30 September 2007.

a)	Salary	RM 30,000
b)	Gratuity	RM 153,000
c)	Allowances	RM 5,000

Compute the Statutory Income from employment source for Billy.

BILLY
Income Tax Computation
Year of Assessment 2007

	RM
Employment	
Salary	30,000
Gratuity	27,000
Allowance	5,000
	<hr/>
	62,000

$$\begin{array}{rcl}
 & \text{No of months in 2007} & \\
 & \text{Total no of months of employment} & \times \text{ Gratuity} \\
 9 & & \\
 \times 153,000 & = & \text{RM } 27,000 \\
 5 & &
 \end{array}$$

Additional Assessments would be raised for the following years:-

Years of Assessment 2004 to 2006	-	RM 36,000 additional income for each year of assessment
Year of Assessment 2003	-	RM 18,000 additional income

Special note:

A third situation has been created for tax exemption in respect of gratuities.

Para 25 (1) (c) states that , if the retirement takes place on reaching the compulsory age of retirement pursuant to a contract of employment or collective agreement at the age of 50 but before 55 and that employment has lasted for ten years with the same employer or with companies in the same group;

Provided that the sum exempted shall not exceed an amount ascertained by multiplying six thousand ringgit by the number of completed years of service in that employment.

The 2008 Budget has revised this provision by giving full exemption for gratuities given under these circumstances. There is no reference to number of years of completed service and RM 6,000. As long as there is ten years of service and it is contractual retirement from age 50 to age 55 this provision applies.

- y) Annuities from Malaysian Life Insurance Companies
 Para 36 of Schedule 6 exempts sums received by way of annuities granted under annuity contracts issued by Malaysian life insurers.

For the purpose of this paragraph "Malaysian Life Insurers" means life insurers and takaful operators whose ownership or membership are held in majority by Malaysian citizens.

6.3 Others

a) Income Tax (Exemption) (No.12) Order 1996, PU (A) 64 (For resident individuals)

Bank Simpanan Nasional	Savings A/c	No Limit
	Save As You Earn scheme	No Limit
	Fixed Deposit (including	
	Negotiable certificates of deposits.	
	> 12 months	No Limit
	not > 12 months	Up to RM100,000
Bank & Finance Company licensed Under Banking and Financial Institutions Act 1989	Savings A/c	Up to RM100,000
	Fixed Deposit (including	
	Negotiable certificates of deposits	
	> 12 months	No Limit
	not > 12 months	Up to RM100,000
Lembaga Tabung Haji	Bonus accruing on Savings a/c	No Limit
Bank Pertanian Malaysia	Fixed Deposit (including	
Bank Kerjasama Rakyat Malaysia Bhd	Negotiable certificates of deposits	
Malaysia Building Society Berhad	> 12 months	No Limit
Borneo Housing Mortgage Finance Bhd	not > 12 months	Up to RM100,000
Bank Pertanian Malaysia Registered Co-operative Society Malaysia Building Society Berhad	Savings A/c	Up to RM100,000
Borneo Housing Mortgage Finance Bhd Any Other Institution Approved by Minister		

b) Income Tax (Exemption) (No.13) Order 1996, PU (A) 65 (For individuals) Income Tax (Exemption) (No.6) Order 1998, PU (A) 155

Interest-Free Banking Scheme with a Bank & Finance Company licensed under Banking And Financial Institutions Act 1989/ Islamic Banking Act 1983 & BSN	Savings A/c	Up to RM100,000
	Investment A/c:	
	> 12 months	No Limit
	not > 12 months	Up to RM100,000

6.4 Conclusion

The chapter has discussed different aspects of Exempt Income under Schedule 6. Among the points discussed are: Schedule 6 Exemptions and Others. The different aspects have been explained to provide a comprehensive knowledge on exception.

Self Assessment

Q1 Mr A was assigned by his employer in the United States to work in Malaysia from:

1 June 2006 to 15 July 2006; and
20 December 2006 to 31 January 2007.

The total remuneration paid in 2006 and 2007 were RM 40,000 and RM 15,000 respectively.

Required:

To state whether the above receipts are exempted under the Income Tax Act.

Suggested Answers

A1 Employment income received by an individual shall be chargeable to income tax under Section 4(b). However, paragraph 21 of Schedule 6 provides for exemption if certain conditions are satisfied.

It appears that the employment income does not qualify for tax exemption as the period from 1 June 2006 to 15-7-2006 which together with a continuous period from 20-12-2006 to 31-1-2007 exceeded 60 days - Para 21(c) of Schedule 6.

Note:

As Singapore has a tax treaty with Malaysia, the employment income may be tax exempt as the period does not exceed 120 days. To qualify for exemption under the DTA, certain conditions as specifically agreed upon need to be satisfied.

Chapter 7

Business Taxation – Computation of Gross Income

Chapter Outline:

- 7.1 Introduction
- 7.2 What constitutes Business Income
- 7.3 Badges of Trade
- 7.4 Capital or Revenue
- 7.5 Is the business income derived from Malaysia?
- 7.6 Basis Periods and Basis Years for Business
- 7.7 Commencement of Business
- 7.8 Capital or Revenue Receipt in business operations
- 7.9 Gross Income as per Income Tax Act 1967
- 7.10 Gross Income in layman's terms
- 7.11 Adjusted Income
- 7.12 Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- State the definition of business
- Explain what constitutes Gross Income for a business
- Explain the badges of trade and the need for this analysis
- State when business income is derived from Malaysia
- Identify the issues regarding basis periods for a business for an individual and a company
- Explain the basic methods by which change in accounting periods are handled
- Identify the difference between capital and revenue receipts
- Explain the implications of Section 22, ITA 1967
- Explain why case laws are useful in deciding whether a receipt is income or capital

7.1 Introduction

Computation of Gross Income

- ◆ Special provisions exist for the computation of gross income for each class of income under the Income Tax Act 1967. The 'Classification' of income therefore precedes the computation of gross income.
 - We then determine the basis period of the source
- ◆ For **each source** there is then the recognition of what constitutes **Gross Income**
- ◆ The Gross Income must be accrued or derived from Malaysia. Special **derivation rules** exist for each source of income
- ◆ Next the Gross Income is adjusted according to certain provisions in the Act to give you the Adjusted Income. The main provisions are contained in Section 33 and Section 39.

In the case of a source of income like business we need to find out the following:

1. Confirm the classification of income as business
2. Confirmation that the business income is derived from Malaysia
3. The relevant basis period for the business source
4. The various provisions relating to the ascertainment of the Gross Income from business.
5. How to adjust the gross income to derive the Adjusted Income
6. How to compute the Capital Allowances to arrive at the Statutory Income
7. Fit them together with other sources of income to compute the Chargeable Income

Business taxation is perhaps the most complicated of all sources of income. There are many issues that need to be understood. In a free enterprise system, business will be the backbone of the economy. It is businesses that produce the goods and services that the society needs. It also produces the goods and services that can be exchanged with other nations in international trade. So let us enter this difficult part of tax study regarding business taxation.

7.2 What constitutes Business Income

Section 2 of ITA 1967 gives the **definition of business**.

“Business” includes profession, vocation and trade and every manufacture, adventure or concern in the nature of trade, but excludes employment.

Employment is defined in the ITA but all the other words in this definition are not defined. Therefore the words profession, vocation and trade must be given the ordinary meaning using a dictionary or based on definitions given by judges in some decided case laws. Textbooks on taxation give elaborate definitions as expounded by honorable judges. For our study we need to be just familiar with what these words generally mean.

a) **Profession**

The meaning of “profession” generally refers to a person using his intellectual or manual skill to obtain the end product. A doctor or painter in the Arts field would qualify in this regard as a professional. It would also refer to a professional person who carries on business on his own account, like a lawyer having his own legal practice.

b) **Vocation**

A vocation may mean a career or occupation. However, it may be an employment, trade or profession. So to be classified as business it must not be an employment as defined in the ITA. The meaning of vocation can be construed as something you are earning or making a living with. A person who placed bets systematically was held in a decided case law to be carrying on a vocation. The gains derived were chargeable to tax even if the vocation was unlawful.

c) **Trade**

“Trade” normally consist of a series of transactions where there is continuity and repetition of buying and selling or manufacturing and selling.

Where there is only one transaction, it may be held to be in the nature of trade where such gains would be chargeable to tax as the definition of business includes “adventure or concern in the nature of trade”.

Isolated transactions can be difficult to classify as business. But a body of case laws have been developed which can identify an isolated transaction as trade. We call it the “badges of trade” which may be used to determine whether the receipt or gains can constitute to be an adventure or concern in the nature of trade.

Why the attention to ‘Badges of Trade’?

In chapter one you studied that only income is taxable and therefore any capital gains will not be regarded as income. It would constitute a realization of capital. The buying and selling of an investment asset does not constitute a trade or source of income and is regarded as a capital receipt from the disposal of a capital asset.

In Malaysia this is very meaningful as there is no Capital Gains Tax. Therefore, unless a transaction is considered a trade or business the gains realized will not be taxable.

Therefore the term ‘badges of trade’ has great significance from the point of view of taxation.

7.3 Badges of Trade

The following badges may be used to determine whether a receipt is considered capital or income.

a) **Purpose / Intention**

This is usually the most important consideration to determine whether the gain derived is capital or income. In *Pilkinton v Randall (1966) 42 TC 662*, the Court examined the motive of the taxpayer in deciding whether the receipt was capital or income. The gain derived was held to be income as the taxpayer’s intention of purchasing his sister’s share of the property was to sell it after developing it by building roads and sewers.

b) Repetition / Frequency of Transactions

Where the same type of object or article is repeatedly bought and sold, it would generally lead to the inference that there is trading in that article.

In *Pickford v Quirke* 13 TC 251, the Court held that although the transactions, considered separately, were capital, they, together, constitute the carrying on of a trade.

There is no general rule laid down in deciding on the number of transactions for a person to be considered a trader rather than an investor.

c) Organisation / Transaction by Companies

The Court would examine the nature of the company's operation and not just the capacity of the company alone. In *CIR v Eccentric Club* 12 TC 689, it was always presumed that a company was formed with the intention of carrying on a business.

d) Financing / Mode of Acquisition

A person who borrows more than he could normally afford to purchase an article would favour that he was involved in a trading adventure.

For example, a person may purchase an asset for purposes of development. Where his financial position indicates that he does not have the adequate fund/resource to carry out the development and that asset acquired was realised at a profit, such gains derived would be normally considered to be a trading adventure unless he could prove otherwise.

e) Improvement / Supplementary Work

Supplementary work such as modification, processing, packaging, renovating of the item sold would suggest that a trade is carried on. In *Cape Brandy Syndicate v CIR* (1921), the company, after purchasing a quantity of brandy, proceeded to blend and re-case the brandy before selling it in lots, was held to be carrying on a trade.

f) Timing / Length of Ownership

If the period of ownership between acquisition and disposal of asset is long, there is a strong inference of investment. The gain derived would not be taxable as it is a capital gain.

Where there is a quick resale there will be an impression that a trade was conducted and the gain would be taxable - *Turner v Last* (1965)

g) Ways of Disposal of An Item

Organised activity employed in disposing of an asset such as advertisement, setting up an office, employment of staff, would favour the presence of a profit making scheme or a trading adventure.

h) Interest in Similar Field

Interest in similar field may indicate that the asset acquired was for profit rather than for investment.

However, a trader can purchase an asset similar to his stock in trade for investment where the gains derived would be capital as decided in *Hudson V Wrighton and LCY Sdn Bhd V DGIR*

i) Nature / Subject Matter

A person engaged in trade frequently does so by buying and re-selling articles or objects with a view to making profit. There are 3 reasons for purchasing an article:

- i) for the purchaser's own use or the use of his family or friend; or
- ii) for investment which includes not only things which yield income but also articles which give aesthetic pleasure; or
- iii) for resale at a profit.

Purchasing of large quantities of articles is obviously not considered to be for personal enjoyment or for investment. In *Rutledge v CIR (1929)*, the gain derived from disposing a million rolls of toilet paper was held to be a trading adventure.

j) Circumstances Responsible for Realisation

A forced sale, to provide cash required in an emergency, negates the idea that an item was purchased with the intention of dealing.

The above badges are only broad guidelines in determining whether a particular set of circumstances constitutes a trade

7.4 Capital or Revenue?

In most situations it is easy to state that a transaction is a capital disposal and not a trading transaction. Investment transactions are part and parcel of our lives. Shares, unit trusts, properties, fixed-income securities are commonly bought and sold. They are principally held as investments. Investments provide regular income in most cases. However after some duration or when certain circumstances dictate, assets are sold to realize their capital value. Such disposals can produce a capital gain. These capital gains are not taxable under the Income Tax Act

Let us look at some examples of income and capital gains

Stocks or shares are the capital assets. The dividends that are received are income derived from the asset. This income will be taxable. However, when the shares are sold the receipt becomes a capital receipt. The asset, which was the source of income, is being sold. Therefore it becomes a capital disposal. The difference between the selling price and the cost of purchase represents a capital gain.

A similar example would be any real estate purchased. The rent is income that is taxable. However, when the real estate property is sold the money received is a capital receipt. The difference between the selling price and the cost price represents a capital gain and thus is not taxable as income. Starting from January 1st 2014, all properties disposed within three years or less is subjected to 30% RPGT (previously 15% for two years and below and 10% for three years and below). Properties that are disposed within four years of purchase are subjected to 20% tax and 15% for five years. The property tax is levied upon anyone selling their properties; however for individuals selling or disposing their property after the 5th year, no RPGT will be levied. Companies however, will pay a flat rate of 5% starting on the 6th year and thereafter

It would be interesting to see if the Inland Revenue Board will be applying the 'badges of trade' insignia more frequently in the coming years. People might have the idea of making a vocation out of buying and selling properties, or other capital assets.

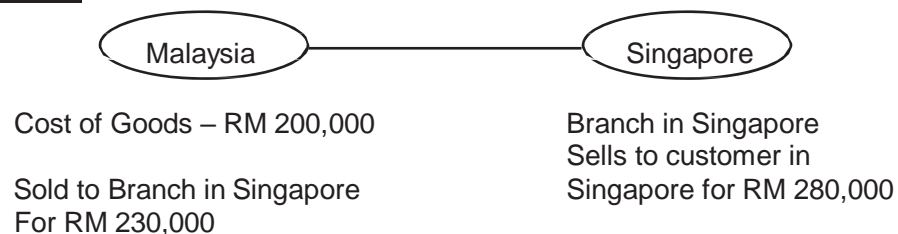
7.5 Is the business income derived from Malaysia?

Section 12 (1) of the ITA 1967 provides the circumstances under which business income is deemed derived from Malaysia.

Generally, it is provided that, so much of the gross income from the business, as is not attributable to operations of the business carried on outside Malaysia, shall be deemed to be derived from Malaysia.

The derivation is therefore based on the operations being carried on in Malaysia, a territorial basis of taxation.

ILLUSTRATION 1



The profit of RM 50,000 (RM 280,000 less RM 230,000) is a non-Malaysian source of income as it is attributable to the operation of the business carried on in Singapore.

Profit of RM 30,000 shall be deemed to be derived from Malaysia and therefore would be charged to Malaysian income tax.

The profit of RM 50,000 (non-Malaysian source) would be charged to tax in Singapore. Under the current tax rules even if the profit is remitted back to Malaysia it is not taxable. As explained in chapter one, only four types of businesses pay tax on a world income scope; air and sea transport undertakings and banks and insurance companies.

Where there is no branch in Singapore, and the Malaysian company sells the goods directly to the customer in Singapore, the profit of RM 80,000 (RM 280,000 less RM 200,000) is deemed derived from Malaysia.

Section 12(1)(b) is the other category under which business income is deemed derived from Malaysia. Under this section if the business consists of manufacturing, growing, mining, producing or harvesting in Malaysia of any article, product, produce or other thing and gross income is derived from the sale of the article, product or produce to any place outside Malaysia such income is derived from Malaysia.

A further subsection states that if an article, product or produce is exported in the course of carrying on a business and it is not regarded as a normal sale, the market value of the article, product or produce at the time of the export will be treated as gross income derived from Malaysia from that business. This section will rope in barter or counter trade and any tax evasion scheme using transfer pricing.

Section 12(2) relates to the derivation of gross income from dividends and interest, (from wherever derived), where such income is derived from the carrying on a business and these dividends and interest are earned from capital (stock in trade) of the business. This section refers to financial institutions that turn their capital to profit from investing in shares, debentures or bonds or loans. Such investments come from their stock in trade (capital) and any dividends or interest, wherever derived, are deemed derived from Malaysia

Where the operation of the business is not carried on in Malaysia, then the income may not be deemed derived from Malaysia, and therefore escapes taxation. Whether the business operations are carried on in Malaysia or outside is a question of fact. However, certain factors may be considered for purposes of determining whether or not the persons concerned are trading in Malaysia or trading with Malaysia. Such factors, includes: -

- 1) Whether the contract, which gave rise to the trading profit, is concluded in Malaysia? In this case the operations are carried on in Malaysia.
- 2) Whether the title of the goods passes from the seller to the buyer in Malaysia? This will be considered a Malaysian operation.
- 3) Whether an agent (other than an independent agent) has been appointed and stocks are being regularly maintained in Malaysia? This constitutes a Malaysian operation.
- 4) Whether a permanent establishment exists in Malaysia (only applies to countries which have concluded double taxation agreement with Malaysia). A permanent establishment implies you are now trading in the country.

7.6 Basis Periods and Basis Years for Business

We now enter the tax premise of basis periods, which used to be a nightmare for most students. Under current laws we must first determine who the taxpayer is. Companies, trusts and co-operative societies follow a different basis period for their different sources of income compared to individuals.

An individual may have a specific financial year or accounting period for his business, but when it comes to taxation for a particular year of assessment the income is based on the calendar basis year. An individual is assessed on a calendar year basis on all his sources of income. Companies, trusts and co-operative societies are taxed based on their financial year, which can be any accounting period of 12 months which need not end on 31st December. When we say a year of assessment or a basis year we mean the calendar year 1st of January to 31st December. This new treatment by IRB, distinguishing individuals from companies, trusts and co-operative societies as to basis periods has made things much easier.

Accounting Periods and Basis Periods

A business normally makes up its accounts to a 12-month accounting period. The income statement reflects the income and expenses earned and incurred during this accounting period. This accounting period is also referred to as the financial year. The balance sheet prepared at the financial year-end is also important for tax computation purposes.

The Inland Revenue Board does not interfere with normal accounting principles and rules. But it also has its own terminology and provisions.

Under the ITA 1967 the following definitions are used:

Section 2: Meaning of YEAR OF ASSESSMENT

Year of assessment means calendar year.

Section 20: BASIS YEARS

The calendar year coinciding with a year of assessment shall constitute the basis year for that year of assessment.

Section 21: BASIS PERIOD of a person other than a company, trust body or co-operative society

The basis year for a year of assessment shall constitute, in relation to a source of a person, other than company, trust body or co-operative society, the basis period for that

Section 21A: BASIS PERIOD of a company

Section 21A(1): the basis year for a year of assessment shall constitute, in relation to a source of a company, trust body or co-operative society the basis period for that year of assessment

Section 21A(2): Where a company, trust body or co-operative society has made up the accounts of its operations for a period of twelve months on a day other than 31 December in the basis year, that period shall constitute the basis period for that year of assessment for any of its sources of income.

Section 21A(3): Where a company, trust body or co-operative society has made up accounts of its operations for a period of twelve months ending on a day other than 31 December and there is **a failure to make up the accounts** of the company, trust body or co-operative society ending on the corresponding day in the following basis year, the Director General may direct that the basis period for the year of assessment in which the failure occurs, or the basis periods for that year and the following year of assessment, shall consist of a period or periods(which may be of any length) as specified in the direction.

Section 21A(4): Where a company, trust body or co-operative society commences operations on a day in a basis year and makes up its accounts for a period of twelve months ending on a day other than 31 December, there shall be no basis period in relation to any of its sources of income for the first year.

Section 21A (6): Where a company, trust body or co-operative society on the day on which it **commences a new operation** is already carrying on one or more operations, the basis period of the existing operation or operations for a year of assessment in which that day falls shall constitute for the new operation the basis period for that year of assessment and there shall be no basis period for the new operation for that year of assessment preceding that year.

Basis Period summary

In layman's terms the above sections can be explained as follows:

When we talk about a source of income we must determine the relevant basis period for that source. This requires us to first determine who is the taxpayer, whether it is a company, trust body or co-operative society or an individual. For an individual the basis period will be the basis year. By definition the basis year is the calendar year coinciding with the year of assessment. For the year of assessment 2007 the basis year is also 2007. For companies, trusts and co-operative societies the basis period is not necessarily the basis year. It can use its financial year or 12-month accounting period as its basis period. All sources of income of companies, trusts and co-operative societies will use this basis period. Instead of determining the basis period for each source of income we now follow who the taxpayer is. Tax computation is much simpler now.

If there is a failure by the company, trust or co-operative society to submit accounts to the same accounting date, the D-G will call it a failure year and direct the basis periods. There used to be a great injustice in that when there was a revision there used to be overlapping periods and the income of the overlapping periods was taxed twice. Today there is no double taxation. Profits are taxed only once in the first overlapping period and losses are allowed only once in the earlier overlapping period. This was due to the amendment to Section 42 by the Income Tax (Amendment) Act 1999.

Change in accounting dates

When there is a change in accounting dates there will be a failure to submit accounts to the usual accounting date. We have to first recognize whether the usual accounting date was 31 December or other than 31 December.

Guidelines for the Directions of Basis Periods

Where the normal accounting date is 31 December

The basis period in the year of change will end in 31st December. For e.g. if a company submitted accounts as follows:

1.1.2005 – 31.12.2005
1.1.2006 – 30.6.2006
1.7.2006 – 30.6.2007

The basis period will be adjusted as follows:

The failure year is 2006. Therefore YA2006 will be 1.1.2006 – 31.12.2006. YA2007 will be accepted as 1.7.2006 to 30.6.2007.

There is therefore an overlapping period from 1.7.2006 to 31.12.2006. The adjusted income of the overlapping period will only be taxed in YA2006, and will be excluded in the tax computation for YA2007. (Section 42, ITA 1967)

Where the normal accounting date is other than 31 December New accounts prepared for more than 12 monthsSituation 1: New accounts ending in the following year.

The new accounting period is the basis period for the year of assessment in the failure year.

For example: Accounts submitted as follows: Year ended 30.6.2005 (12 months)

1.7.2005 – 30.11.2006 (17 months)

1.12.2006 – 30.11.2007 (12 months)

There will be no adjustment. YA 2006 will be 1.7.2005 – 30.11.2006

Situation 2: New accounts ending in the third year

The new accounting period spans three basis years. The new accounting period will be apportioned equally and the two periods will be taken to be the basis periods for the first 2 years of assessment commencing in the failure year.

Example: Usual year-end 30th November. Accounts submitted as follows:

1.12.2005 – 30.11.2006

1.12.2006 – 31.3.2008 (16 months)

1.4.2008 – 31.3.2009

Apportion will be: YA2007 1.12.2006 – 31.7.2007 (8 months)

YA2008 1.8.2007 – 31.3.2008 (8 months)

Situation 3: New accounts prepared for less than 12 monthsNew accounts ending in the following year

The new accounting period is the basis period for the year of assessment in the failure year.

Example: Year-ended 30.9.2005 (12 months)

1.10.2005 – 30.6.2006 (9 months)

1.7.2006 – 30.6.2007 (12 months)

The new accounts of 1.10.2005 – 30.6.2006 will be accepted as basis period for YA2006.

Situation 4: New accounts ending in the same year

The new accounting period together with the following accounting period is the basis period for the year of assessment in the failure year.

Example:

Normal year-end 1.7.2005 – 30.6.2006 (12 months)

Change to: 1.7.2006 – 31.12.2006 (6 months – ending in the same year) Next year:

1.1.2007 – 31.12.2007

Following year: 1.1.2008 – 31.12.2008

The adjustment for failure year YA 2007 will be: YA2006 – 1.7.2005 – 30.6.2006

YA2007 – 1.7.2006 – 31.12.2007 (6 months period added to the following period of 12 months)

YA 2008 – 1.1.2008 – 31.12.2008

Conclusion on Basis Periods

Basis periods may still be confusing to some. It is hard to remember all the rules. So, regular check on these notes will help. You have to check whether the normal accounting date is 31 December or not and if they fall in the following year or perhaps in the third basis year, or in the same year. Usually for a company intending to change accounting dates there is no threat of double tax. The tax advantage of changing accounting dates has disappeared more or less after the introduction of current year assessment and pay as you earn and the payment of estimated tax. Previously there was a distinct advantage to have accounting periods ending early in the year like 31 January or 28 February because of the preceding year basis. Instead of closing on 31 December if you close on 31 January you shift the tax collection 11 months into the following year. For individuals in business it seems the sensible thing to do is to follow the basis year, 1st January to 31st December. Whenever you commence operations close the accounts to 31st December. Life is much simpler this way.

7.7 Commencement of Business

The date of commencement of a business is a relevant question and remains a question of fact. It is therefore important to distinguish between the setting up of a business and the commencement of a business, as commencement of business would determine: -

- a) the basis period for the business source of income; and
- b) the amount of pre-commencement expenditure which does not qualify for tax deductions (other than certain preliminary expenses of small enterprise companies with paid-up capital of less than RM250,000, now increased to RM2.5 million.)

Certain guidelines may be employed to ascertain the date of commencement of business. Subject to the specific circumstances and facts of the case, the following examples may be indicative of the commencement of business. The act or activity constitutes part of a series of acts or activities that are actively carried out or undertaken in the course of the business

- **Acquisition of a business** - the date the existing business is acquired
- **Hotel** - the date the hotel is opened to the public
- **Manufacturer** - the date raw materials are purchased
- **Plantation** the date the seeds are sown or seedlings planted
- **Property developer** - the date the land is purchased
- **Construction** - the date the land is leveled

Single or Separate Business

The issue of single or separate business is also important to tax computation. Firstly outgoings and expenses are only allowed if it is incurred during that basis period by that person in the production of gross income from that source. Secondly capital allowances are only allowed against the same business source. The capital allowances and expenses cannot be allocated against other business sources at the discretion of the businessperson.

Therefore the facts and circumstances of each case will need to be analysed to determine if there is a separate business or it is the same business. Case law decisions also help in establishing whether there are separate businesses. In the case of business losses they can be set-off against other business income, but capital allowances can only be set-off against the same business source. An elaborate discussion of this issue is not within the purview of this module.

7.8 Capital or Revenue Receipts in business operations

Receipts, which are capital in nature, do not fall within the ambit of the Income Tax Act 1967. It is therefore important to distinguish whether a receipt is capital or revenue. Earlier in the chapter we discussed the difference between income and capital gains. Only income is taxable. Capital gains from the disposal or from the realisation of a capital asset are not taxable. In business operations there will arise many types of business receipts that require us to determine if they are taxable income receipt or non-taxable capital receipt. Case laws have helped to elucidate this often-difficult distinction between capital and revenue.

Here are some principles that have been established over the years: -

- a) Consideration received for the sale or for the destruction of the profit-making apparatus is capital in nature.
- b) Consideration received in lieu of trading profit or loss of income is revenue in nature
- c) Consideration received for the sale of fixed assets is a capital receipt.
- d) Consideration received for sterilisation of a capital asset is capital in nature.
- e) Consideration received in respect of a restrictive covenant or for the imposition of substantial restriction on the activities of a trader is capital receipt.

Some specific case laws are identified below which may be relied upon to distinguish whether the receipts are capital or revenue. These judicial precedents are summarised below: -

- a) Compensation received in respect of the fireclay left un-worked was held to be a capital as it was made **for the sterilisation of a capital asset - *The Glenboig Union Fireclay Co Ltd v CIR (12 TC 427)***.
- b) Consideration received for **the disclosure of secret processes** where no parts of it were retained was held to be **capital in nature *Evans Medical Supplies Ltd V Morairty (37 TC 540)***.
- c) Compensation received for **termination of an un-expired agreement** was held to be capital as it was for the loss of the company's **only major asset** which affected the structure of the organisation - ***Barr Crombie & Co Ltd v CIR (26 TC 406)***.
- d) Consideration received under **a restrictive covenant**, for example, an actor undertakes not to act in, produce or direct any film for any other person for an agreed period of time was held to be capital in nature - ***Higgs v Olivier (33 TC 136)***.
- e) Compensation received for any loss resulting from the alteration of an agreement **which relates to the framework of the business** was held to be capital in nature ***Sabine v Lookers Ltd (38 TC 120)***.

- f) Consideration received for the **cancellation of future rights** under the agreement [which are not ordinary commercial contract made in the course of business] which relates to the whole structure of the person's profit-making apparatus was held to be capital in nature - *Van den Bergh Ltd v Clark (19 TC 390)*.
- g) **Where part of it is retained** and the vendor is still able to make profit from the "asset" for example, "know-how", the receipt for sale of such "know-how" was held to be revenue in nature - *Jeffrey v Rolls-Royce Ltd (40 TC 443)*
- h) Compensation received for **cancellation of a trading contract**, which is in the **ordinary course of business**, was held to be revenue in nature - *Short Bros Ltd v CIR*
- i) Compensation received for **late delivery of an asset** where the damages received is for **loss of profit** was held to be revenue in nature - *Burmah Steam Ship Co Ltd v CIR TC 955*
 Note: Section 22(2)(b) provides that such receipt is taxable.
- j) Compensation received [in addition to repair cost] for a partly damaged asset was held to be revenue as that amount was for loss of use of an asset instead of disposal of an asset - *London & Thames Haven Oil Wharves Ltd v Attwool (43 TC 491)*
- k) Compensation received for **cancellation of agency contract** which was **incidental to the normal course of business** was held to be revenue in nature even if that contract might be modified, altered or discharged from time to time - *Kelsall Parson & Co v CIR (21 TC 608)*

7.9 Gross Income as per Income Tax Act 1967

The general provision as to Gross Income is covered under Section 22.

Section 22, ITA states:

"Subject to this Act, the gross income of a person from a source of his for the basis period for a Year of Assessment shall be the gross income from that source for that period ascertained in accordance with the following provisions of this chapter."

An important provision in this Section 22 is subsection (2). It states:

"Subject to this Act, the gross income of a person from a source of his for the basis period for a YA shall include any sums receivable or deemed to have been received for that basis period in relation to that source by way of-

- (a) **Insurance, indemnity, recoupment, recovery, reimbursement** or otherwise –
 - i. where such sums are in respect of the outgoings and expenses deductible in ascertaining the adjusted income of that person from that source; or
 - ii. under a contract of indemnity
- (b) compensation for loss of income from that source, and
- (c) a rebate under Section 6B

This section is encountered commonly as it refers to insurance recovery or indemnity. But it refers to revenue items. For example if a key-man policy is in respect of loss of profits or covering incidental or additional expenses any recovery from that policy is taxable based on this provision. But if the insurance recovery is in respect of a plant or machinery then the recovery is to replace a capital asset. Such recovery will not be taxable.

Compensation for loss of income is a revenue receipt. Anytime a business receives money as compensation for loss of income it will be taxable.

Rebate under Section 6B relates to commercial banks and their loans to small-scale companies. This rebate however is treated as gross income for the banking business. A rebate is deducted directly from the tax payable. There is therefore some benefit to the banks.

Section 24 discusses various types of gross income from business by relating it to basis periods.

Section 24 (1): relates to **trading debt**

- (a) in respect of stock-in-trade
- (b) in respect of services rendered in the course of carrying on a business
- (c) in respect of the use or enjoyment of any property dealt with at any time in the course of carrying on a business

Section 24 (2) relates to any stock in trade withdrawn for own use or withdrawn without any consideration being received. In these situations the market value of the stock withdrawn will be treated as gross income.

Section 24 (4) relates to dividend income treated as business income if the dividend earned is from the turning over of capital stock. This would be the case of banks and insurance companies that use their capital as stock in trade or a share dealing company.

Section 24(5) relates to interest income received by a company that uses its capital as stock in trade. Such companies deal in interest bearing securities or loans. Money lending companies and investment dealing companies will treat the interest earned as business income.

Section 24(6) relates to the export of articles, products, or produce and the use of market value as the gross income of that business for that period.

Section 30 relates to recovery of bad debts, which had been allowed in arriving at the adjusted income of the business. Any subsequent recovery is taxable as gross income of the business for that period. Recovery of excess qualifying mining expenditure and any waiver of debts are also included as gross income of that business for that period.

7.10 Gross Income in layman's terms

While the Act specifically spells out what constitutes gross income in certain situations, there is no direct reference to accounting income. In practice we have to start with the Net Income or Profit of the business as the Gross Income for tax purposes. The usual financial statements of a business will be the Income Statement and the Balance Sheet. These are the two statements that IRB will work with. However, in the future the Cash Flow statement will also be prominent. IRB requires a lot of explanations and so Notes to the accounts are an important part of the analysis.

Students must note the difference between Sales Revenue and Turnover, Gross Profit and Net Profit. The IRB computation will start with the Net Profit as the Gross Income of the business.

7.11 Adjusted Income

We are now ready for the next stage in business tax computation, the adjustment of the Gross Income to arrive at the Adjusted Income. Examiners and IRB pay a lot of attention to this area. The expenses claimed by accountants in the normal course of business vary a great deal with the Income Tax Act. There are specific provisions in the ITA 1967 that dwells on what are acceptable outgoings and expenses for a business. One of the principal adjustments is the adding back of depreciation for capital assets. If you remember Chapter 3 you will note that Gross income is adjusted to give Adjusted Income and then Capital Allowances are then given to arrive at Statutory Income. It is best to cover the two topics of Adjusted Income and Capital Allowances in different chapters.

7.12 Conclusion

The chapter has discussed different aspects of Business Taxation – Computation of Gross Income. Among the points discussed are: What constitutes Business Income, Badges of Trade, Capital or Revenue, Is the business income derived from Malaysia? Basis Periods and Basis Years for Business, Commencement of Business, Capital or Revenue Receipt in business operations, Gross Income as per Income Tax Act 1967, Gross Income in layman's terms and Adjusted Income. The different aspects have been explained to provide a comprehensive knowledge on business taxation.

Self Assessment

- Q1** Define business and identify a profession or vocation
- Q2** State at least five badges of trade
- Q3** State if the following receipts are capital or revenue
1. Consideration received for the cancellation of a basic trade agreement which affected the whole business
 2. Consideration received for a covenant not to compete
 3. Consideration received from a government compulsory acquisition of land belonging to a developer
- Q4** If you commence a business on 1/4/2006 and close the accounts on 30th June 2007, and 30th June thereafter, will IRB accept the accounts? If not how will IRB adjust your accounting periods for YA 2006 and YA2007?

Suggested Answers

- A1** Business is defined as including a profession, vocation and trade and every manufacture, adventure or concern in the nature of trade, but excludes employment.
- Profession – see explanation page 2, Chapter 7
Vocation – see explanation page 2/3 Chapter 7
- A2** Badges of trade:
1. Purpose or intention for a transaction
 2. Period or length of ownership
 3. Repetition or frequency of transactions
 4. Improvements and other supplementary work
 5. The way disposal was organized
- A3** Situation 1 – capital (affected the whole profit making apparatus of the business)
Situation 2 – capital (not received in the normal course of business)
Situation 3 – revenue (land is trading stock for a developer)
- A4** YA 2006 – 1/4/06 to 31/12/06
YA 2007 – 1/1/07 to 31/12/07
YA 2008 – 1/7/07 to 30/6/08

Chapter 8

Business Taxation - Computation of Adjusted Income

Chapter Outline:

- 8.1 Introduction
- 8.2 Income tax provisions
- 8.3 Layman's understanding of Section 33
- 8.4 Deductible Expenditure
 - 8.4.1 Business Deductions – Section 34
 - 8.4.2 Section 34 (6)
 - 8.4.3 Section 34 (7)
 - 8.4.4 Double Deduction of Expenses
 - 8.4.5 Section 35 – Stock in trade – Adjustment for stock reserves
 - 8.4.6 Deductions not allowed – Section 39
 - 8.4.7 Miscellaneous Deductions as per case law decisions
 - 8.4.8 Takaful Premiums
- 8.5 A Comprehensive Illustration on the Taxation of Business Income
- 8.6 Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- Compute the Adjusted Income of a business source
- State the main provisions of Section 33, ITA 1967
- Differentiate capital from revenue expenditure
- Identify the usual expenses allowed under the ITA 1967
- Understand case laws that explain the tax treatment of various expenditures like initial expenses and repairs
- Explain the tax treatment of bad debts
- Explain the tax treatment of interest expense and how and when interest expense is restricted
- Explain the main expenses not allowed under Section 39, ITA 1967.
- Explain the tax treatment of entertainment expenses as per the IRB Public Ruling
- Explain some of the important case law decisions on allowable and not allowable expenses
- Explain the tax treatment of key man life insurance premiums as per IRB Public Ruling
- Understand the process of computing Adjusted Income

8.1 Introduction

The present chapter is discussing the Business Taxation - Computation of Adjusted Income with the objectives of providing an understanding on Compute the Adjusted Income of a business source, State the main provisions of Section 33, ITA 1967, Differentiate capital from revenue expenditure Along with other aspects.

Business Taxation Computation of Adjusted Income -Deductions

8.2 Income Tax Provisions

There are specific provisions in the ITA 1967 that explains what allowable deductions are and what are not allowable deductions in arriving at the income that is taxable. In tax lingo we call it computing the adjusted income. The main provisions are Section 33 and Section 39. Let us explore Section 33 first.

Section 33 (1) states:

“Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses **wholly and exclusively incurred** during that period by that person in the production of gross income from that source, **including-**

- (a) subject to subsection (2), any sum payable for that period by way of **interest** upon any money borrowed by that person and –
 - (i) employed in that period in the production of gross income from that source; or
 - (ii) laid out on assets used or held in that period for the production of gross income from that source
- (b) **rent payable** for that period by that person in respect of any land or building or part thereof occupied by him in that period for the purpose of producing gross income from that source
- (c) **expenses incurred** during that period for **the repair of premises, plant, machinery or fixtures** employed in the production of gross income from that source or for the renewal, repair or alteration of any implement, utensil or article so employed, other than implements, utensils, articles (the expenditure on which would be qualifying plant expenditure for the purposes of Schedule 3) or any means of conveyance, **excluding the cost of reconstructing or rebuilding**
 - i. any premises, buildings, structures or works of a permanent nature;
 - ii. any plant or machinery; or
 - iii. any fixtures and
- (d) such other deductions as may be prescribed

8.3 Layman’s Understanding of Section 33

- Section 33 is the main provision as regards deductible outgoings and expenses. All outgoings and expenses must be wholly and exclusively incurred in the production of gross income. That person must incur it in that period for that source.
- This may seem quite ordinary but there are tremendous implications. The meaning of wholly and exclusively incurred has gone many times to courts for clarification. For example it is customary for accountants to make provisions for expected or contingent liabilities. Although prudent in accounting parlance it is not acceptable under Section 33. The expenses must be incurred. Therefore most provisions in the financial accounts are

disallowed in tax computations.

- In the case of *Strong v. Woodfield* it was established that it is not enough that the disbursement is made in the course of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits "
- In the case of *Bentleys, Stokes and Lowless v Beeson* the judge Romer LJ states that, "the expenses undertaken must be solely for the purpose of the business solely with the object of promoting the business or its profit earning capacity."
- In *Atherton v British Insulated & Helsby Cables Ltd* case the judge Viscount Cave LC observed, "...a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade." Commercial expediency is a valuable concept but IRB is bound to challenge any random claims.
- There is no clear definition as to outgoings and expenses in the Act but in Section 39, capital expenditure is excluded from deduction. Expenses and outgoings refer to revenue expenses. A revenue expense is something incurred on a regular basis, in the production of income and is distinguished from capital outlay. Even if the accountant capitalizes an expense it can be claimed as a revenue expense in arriving at the adjusted income.
- In the local case of *Exxon Chemical (Malaysia) Sdn Bhd v Ketua Pengarah HDN* the Court of Appeal judge Gopal Sri Ram JCA held that the monies set aside to meet retirement sum when the staff retires or resigns are accrued liabilities and should be allowed tax deduction in the year of accrual and not in the year of payment. In the opinion of the judge, expenses wholly and exclusively incurred include a sum, which the taxpayer is under an obligation to pay.
- The phrase „in the production of gross income“ does not mean that there must be income before the expenses are allowed. The taxpayer must show that the expenses were incurred for the purpose of earning income even if it meant income in the future years.

8.4 Deductible Expenditure

Sections 33, 34 and 35 provide for different type of expenses, which qualify for deductions whereas Section 39 specifies expenses, which are prohibited as a business deduction.

Expenses, which qualify for deductions, are that expenditure which is revenue in nature. Capital expenditure does not rank for deduction in arriving at the adjusted income.

The following tests may be applied to distinguish whether expenditure is revenue or capital in nature.

a) Initial Expenditure

Expenditure incurred in setting up a business into operation does not rank for deduction, for example, pre-commencement expenditure. However, preliminary expenditure would rank for deduction if the authorised capital of the company to be incorporated does not exceed RM2.5 million.

Certain expenditure incurred may be regarded as capital in nature for example expenditure incurred to turn a newly dilapidated ship into a useable state. In *Law Shipping Co Ltd. v IRC*, such expenditure was considered to be capital outlay.

However, a deferred repair on assets which were commercially viable and could

be used as profit-earning assets was held to be revenue expenditure - *Odeon Associated Theatres Ltd v Jones (48 TC 257)*.

b) **Fixed Capital or Circulating Capital**

Expenditure incurred to acquire a fixed capital or fixed asset is generally considered to be capital expenditure whereas expenditure incurred to acquire a circulating capital would generally rank for deduction.

Circulating capital is what the owner makes profit with by parting with it and letting it change masters. Fixed capital is what he turns to profit by keeping it in his possession.

The above principle may not always apply as certain expenditure, which relate to a fixed capital are considered to be revenue expenditure instead of capital expenditure. For example, expenditure incurred in preserving or maintaining capital assets are considered to be tax deductible.

c) **Bringing into Existence An Asset**

When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the long term benefit of a trade, there is very good reason for treating such expenditure to be capital instead of revenue in nature.

d) **Lump Sum payment**

Capital expenditure is generally considered to be expenditure incurred once and for all whereas revenue expenditure are those recurring every year. This may not be true as certain capital expenditure is made on instalment basis and certain revenue expenditure are made in one lump sum which includes prepayment.

The **following expenditures do not rank for deduction** under Section 33(1):

- 1) Capital expenditure.
- 2) Expenditure, which are for private or domestic purposes.
- 3) Expenditure, which is not wholly and exclusively, incurred in the production of gross income, that is, expenditure with dual purposes where business purpose is secondary.
- 4) Provision made in the accounts, reserve or warranty being provided in the accounts
- 5) Expenditure incurred for acquisition of a source of income.
- 6) Expenditure incurred which are not linked with the income-earning operation.
- 7) Expenditure incurred after the cessation of a source of income.

Compensation incurred, which is out of the carrying on of a business, was held to be tax deductible - *Herald & Weekly Times Ltd v FC of T (48 CLR 113)*

Expenditure incurred for **dual purposes** where the business purpose was secondary, no part of the expenditure would be deductible - *Newsom v Robertson (33 TC 452)*

Expenditure incurred in the production of gross income would rank for deduction even if no income has actually resulted if it can be demonstrated that its incurrence is so **closely linked with the income-earning operation** *Port Elizabeth Electric Trainway Co Ltd. v CIR*

Production of Income Evaluation Chart

To Produce Income	In the production of income	After the production of income
Expenses are regarded as capital in nature	Deductible expenditure	Non-deductible expenditure
X X XX	IIIIIIII	X X X X
	Date of Commencement	Date of Cessation
XXXX	Non allowable expenditure	
IIIIIIII	Allowable expenditure	

Example of Interest Expense

Money borrowed of RM400,000 [Interest Payable = RM40,000]			
Used for Working Capital	Used for Acquisition of Machinery	Used for Investment in Property	Used for Investment in Shares
RM100,000	RM120,000	RM140,000	RM40,000
Interest Payable of RM40,000 Shall be allowable against			
Business Income RM22,000	Rental Income RM14,000		Dividend Income RM4,000
$\frac{100,000 \times 40,000}{400,000}$ = RM10,000	$\frac{120,000 \times 40,000}{400,000}$ = RM12,000	$\frac{140,000 \times 40,000}{400,000}$ = RM14,000	$\frac{40,000 \times 40,000}{400,000}$ = RM4,000

In computing the adjusted income from a business source of income, the following **tax adjustment** shall be required:

Net Profit (Business)	AA
Add: Interest disallowed	18,000
	<hr/>
Adjusted Business Income	BB
	<hr/>

By disallowing interest of RM 18,000, we have indirectly claimed interest of RM 22,000 (RM 40,000 – RM 18,000) against the business source of income.

The interest disallowed of RM 18,000 shall be allowable against rental income and dividend income, that is RM 14,000 against rental income and RM 4,000 against dividend income.

Example of Repairs

Initial repairs and renewal of an entire asset was considered capital expenditure - *Jackson v Laskers Home Furnishers Ltd.*

In *O'Grady v Bullcroft Main Collieries Ltd.* a company carrying on the business of coal mining replaced a chimney, which had become unsafe with a new chimney erected on an adjacent site was held to be capital since the new chimney is an entirety. Today's understanding would be that the chimney would be **a part of the entirety**.

Renewal of a component part of an entire asset is tax deductible as they are considered to be revenue in nature - *Jones (Samuel) & Co Ltd. v CIR CS 1951*.

8.3.1 Business Deductions – Section 34

In ascertaining the adjusted income of a person from a business source, the following shall be deducted from the gross income of that person:

- a) Any **trade debts** which are reasonably estimated to be wholly **irrecoverable** or if **partly irrecoverable**, that amount which is estimated to be irrecoverable.

To rank for deduction the following **conditions** need to be satisfied:

- i) It must **be a trade debt**
- ii) The debts must have been **included in that person's gross income** of the previous year; and
- iii) The amount provided must be **irrecoverable** or estimated to be irrecoverable and must be proven to the satisfaction of the Inland Revenue Board.

The IRB has issued a **Public Ruling No. 1/2002** relating to **Deduction for Bad & Doubtful Debts and the Treatment of Recoveries**

- b) **Contribution** made to an **approved scheme** in respect of an employee is the lower of:
- i) the amount of contribution made; or
 - ii) **19%** of the employees' remuneration.

The above would only rank for deduction provided that the remuneration is tax deductible.

8.3.2 SECTION 34 (6)

- a) An amount equal to any payroll tax paid in respect of any remuneration paid by him to any person employed by him.
- b) An amount equal to any turnover tax paid in the relevant period.
- c) Where the gross income is derived from the working of a mine, such amount of mining allowance (including capital expenditure) under Schedule 2.
- d) **Replanting expenditure** incurred, provided that it is of the same crop, and that the gross income is derived from the working of a plantation/farm. (Replanting of a different crop would qualify for Schedule 3 Allowance).
- e) Expenditure incurred by the employer on the provision of any **equipment necessary to assist a disabled employee** in the performance of his duties of employment is deductible

Disabled person is any individual certified in writing to be a disabled person by the Department of **Social Welfare**

- f) Expenses incurred in respect of **translation** or publication in Bahasa Malaysia of cultural, literacy, professional, scientific or technical books shall be deemed deductible provided that the **Dewan Bahasa Dan Pustaka** approves it.
- g) Expenditure incurred on provision of **library facilities** to the public and contribution to public libraries of schools and higher education institution of up to RM 100,000.
- h) Provision of services, **public amenities**, contributions to a charity or community project approved by the Minister pertaining to education, health, housing, infrastructure, information and communication technology (acculturation projects at local community levels). No further deduction is available under Section 44 (6).
- i) Expenditure for the provision & **maintenance of a childcare centre** for the benefit of his employees. Excludes capital expenditure on
 - Land
 - Premises
 - Building structures or works of a permanent nature
 - Acquisition of rights in or over any property
- j) Expenditure incurred in establishing & managing a **musical or cultural group** approved by the Minister.
- k) Expenditure incurred for **sponsoring any arts or cultural activities** approved by Ministry of Culture, Arts & Tourism. The maximum deduction is RM 300,000 for approved performances held in Malaysia of which the deduction allowed for sponsoring foreign arts or cultural activities shall not exceed RM 200,000.
- l) **Scholarships** given to students undertaking a diploma / degree (including masters/doctorate) or equivalent course at higher educational institutions established / registered under Malaysian law regulating such establishment / registration authorized by any order under Section 5A of the Universities and

University Colleges Act 1971.

Conditions:

- Full time students
 - No means of his / her own
 - Income of parents / guardian does not exceed RM 5,000 p.m.
 - Only for payments relating to:
 - Course fees
 - Educational aids
 - Reasonable cost of living
- m) i) Expenditure incurred for the purpose of obtaining certification for recognized quality systems and standards (e.g. ISO) and halal certification evidenced by a certificate issued by a certification body as determined by the Minister; or
 ii) Obtaining accreditation for a laboratory or as a certification body, as evidenced by a certificate issued by the Department of Standards Malaysia:
- Provided that the expenditure incurred in the relevant period shall be deemed to be incurred by that company in the basis period for the year of assessment in which the certificate is issued;"
- n) Expenditure incurred in the provision of **practical training** in Malaysia in relation to his business to an individual who is a Malaysian resident but not an employee
- o) An amount equal to the expenditure incurred by a company in the relevant period for participating in **international standardization** activities approved by the Department of Standards Malaysia.

8.3.3 SECTION 34 (7)

Expenditure incurred on **scientific research expenditure** in relation to the business. **Research is defined as the systematic & intensive study directed towards fuller scientific knowledge or understanding of the subject studied.**

The research can be **undertaken directly by the taxpayer or on his behalf**. No approval from the minister is required to qualify for this deduction.

However it excludes capital expenditure in respect of:

- Plant & machinery
- Fixtures
- Land Premises
- Buildings structures or works of a permanent nature
- Alterations, additions or extensions there of
- Acquisition of rights in or over any property

8.3.4 Double Deduction of Expenses

Double deduction of expenses include:-

Type	Remarks
a) Interest payable on loan to small business	i) Employer is required to produce certificate of approval ii) Interest must be allowable under section 33 ITA 1967
b) Insurance premium paid for the import or export of cargo insured with any insurance company incorporated in Malaysia	i) Premium must be allowable under section 33 ITA 1967 ii) Premiums which are not allowable under ITA 1967 are excluded
c) Remuneration of employees who are physically or mentally disabled	i) Employer has to prove to the satisfaction of Director General ii) Remuneration must be allowable under Section 33 ITA 1967
d) Premium paid on export credit insurance taken with a company approved by the Minister of Finance/Premium paid on export taken with any local insurance company (w.e.f. Y/A 1995)	i) Premium must be allowable under Section 33 ITA 1967
e) Freight charges incurred for the export of rattan and wood –based product	i) The person claiming deduction must be engaged rattan and wood-based products (veneer and sawn timber are excluded)
f) Fee incurred by small scale companies on training its employees at NPC, SIRIM, MIT, MARDI, FRIM, CIIAST, PSDC, IKM, ITI, GMI or MTIB	i) The company must be a small scale company as defined Promotion of Investment Act 1986 ii) Company is required to produce receipt of payment and certificate from the relevant agency
g) Revenue expenditure in research	i) The research must be:- 1) Approved by the Minister or 2) Undertaken by person participating in an approved industrial programme
h) Cash contributions to approved research institutes or payments for use of services of approved research institutes or companies.	i) Only cash contributions qualify for double deduction
i) Overseas expenses incurred by hotel and tour operators for promotion of tourism	i) Hotel and tour operators must be registered with the Tourist Development Corporation of Malaysia
j) Expenditure incurred on approved training by :-	
1) Manufacturing company	i) A training programme approved by MIDA; or ii) A training programme conducted by training

- institute;
- iii) If the company has commenced business, the expenditure must be incurred in training its employees for the purposes of upgrading and developing the employees' craft, supervisory and technical skills or quality of its products.
 - iv) If the Company has not commenced business, the expenditure must be incurred in training its employees for the acquisition of craft, supervisory or technical skills which will contribute directly
- 2) Non-Manufacturing company
- i) A training programme approved by the Minister of Finance or any agency appointed by the Minister of Finance; or
 - ii) A training programme conducted by a training institute
- 3) Hotel or tour operating business company
- i) A training programme approved by the Minister of Culture, Arts & Tourism
 - ii) A training programme conducted by a training institute
 - iii) Hotel & tour operating business must be registered with TDC
- 4) Handicapped persons
- i) A training programme approved by Minister of Finance
 - ii) A training programme conducted by a training institute
 - iii) The training programme is for the purpose of enhancing his employment prospects
 - iv) The handicapped person must be registered with the Ministry of National Unity & Social Development
 - v) The person is not an employee of the company
- k) Approved outgoings and expenses incurred
- i) Product exported incurred must be qualifying products for the promotion of export from Malaysia which qualify for export allowance or abatement of statutory income for export
 - ii) Company must be resident in Malaysia
- l) Expenses incurred in international trade fairs held in Malaysia for the promotion of export.
- i) The trade fair must be an international trade fair approved by the Minister of International Trade & Industry (MITI)
 - ii) The company must be approved by MITI to participate in the international trade fair; and

- iii) The expenditure must be a kind allowable under S33 of the Act. The costs of exhibits are excluded.
- m) Income Tax (Deduction for Freight charges from Sabah or Sarawak to peninsular Malaysia) Rules 2000
- i) Ship freight charges incurred by manufacturers goods from Sabah / Sarawak to any port in peninsular Malaysia.
- n) Income tax (double deduction for Advertising Expenditure on Malaysia Brand name goods) Rules 2002
- i) The company is incorporated in Malaysia and at least 70% Malaysian owned
- ii) The company is the registered proprietor of the Malaysian brand name used in the advertisement
- iii) The Malaysian brand name goods are of export quality i.e. 20% of total sales in that YA is exported
- iv) The expenditure is incurred in Malaysia and allowable under S33 of the Act
- v) Qualifying advertising expenditure
- Advertisements in/on:
 - i. Internet – host website is located in Malaysia
 - Magazines & newspapers – printed in Malaysia
 - Local licensed tv stations
 - Advertisement boarding – approved by relevant authorities & located in Malaysia
 - The course of sponsoring an approved international sporting event – in Malaysia
 - Approved by minister responsible by sports
 - The course of sponsoring an approved international trade conference /exhibition held in Malaysia
 - Approved by the Malaysian external trade development corporation
 - Professional fees made to a company resident in Malaysia for advertising or promoting Malaysian brand name goods on behalf of the company which is the registered proprietor of the Malaysian name.

8.3.5 Section 35 – Stock in trade – Adjustment for stock reserve

Example

	Cost	Reserve	Book Value
	RM	RM	RM
Stock A	1,000	100	900
Stock B	2,000	100	1,900

Where a reserve has been provided in the accounts of 10% for Stock A and 5% for Stock B, the relevant adjustment required to revert back to cost shall be:

	% of Stock Reserve			X	Book Value
	-----				Net of Reserve
	Balance of 100%				
Stock A	10				
	----	x	RM900	=	RM100
	90				
Stock B	5				
	----	x	RM1,900	=	RM100
	95				

By adding back the above result computed, the stock figure should be reverted back to cost. Where valuation of stock is at market value, which is lower than cost, no tax adjustment is required.

8.3.6 Deductions not allowed – Section 39

In ascertaining the adjusted income of any person, no deduction from the gross income shall be allowed in respect of:

- Domestic or private expenses.
- Any disbursement or expenses not being money wholly and exclusively laid out or expended for the purpose of producing the gross income.
- Any capital withdrawn or any sum employed or intended to be employed as capital.
- Any amount made to any unapproved scheme.
- any capital expenditure incurred in relation to a business which would qualify for Schedules 2, 3 or 4 Allowances.(mining, agriculture, and prospecting expenditure)
- any payment (income in nature) made to a non-resident person where withholding tax provision under Sections 107A, 109 and 109B have not been complied with. However the gross payment will be allowable once the withholding taxes together with the penalty are paid.
- any sum by whatever name called made otherwise than to a State Government, a statutory authority for the use of license or permit to extract timber from a forest in Malaysia.
- any sum paid by way of rentals in respect of a motor vehicle other than a motor vehicle licensed or permitted by the appropriate authority for commercial transportation of goods or passengers such as lorry, truck, bus, mini-bus, van, station wagon or taxi cab, in excess of RM 50,000 or RM 100,000 if the vehicle has not been used for any purpose prior to the rental and the total cost is NOT more than RM 150,000.
- 50% of entertainment expenditure including entertainment allowance. This is disallowed as an expense in arriving at the adjusted income of a business of a person. The following shall continue to be allowable:

- i) Entertainment given to employees;
- ii) Entertainment provided by a business where the nature of the business is to provide entertainment;
- iii) Expenditure on promotional gifts or samples;
- iv) Promotional gifts within Malaysia consisting of items or articles incorporating conspicuous advertisement or logo of the business would qualify for deduction
- v) Expenditure on promotional gifts at trade fair or industrial exhibition held outside Malaysia for the promotion of exports;
- vi) Expenditure for cultural or sporting events open to members of the public, wholly to promote the business.
- vii) Provision of entertainment, which is related wholly to sales arising from the business of that person;

Entertainment is defined in Section 18 as:

- i) The provision of food, drink, recreation or hospitality of any kind; or
- ii) The provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in (a) above.
- j) The cost of leave passage given to employees by the employer.

8.3.7 Miscellaneous Deductions as per case law decisions

- a) Payment for termination of service contracts or onerous contracts is considered to be capital in nature. However, if it can be demonstrated that the payment is for the good of the business, for example, getting rid of an inefficient employee, then it is deductible - ***Mitchell v BW Noble Ltd. (1926) 11 TC 372.***
- b) Company's general meeting expenses are held not deductible as they did not form part of the profit earning expenditure - ***Syarikat KM Bhd v DGIR.***
- c) Payment for restrictive covenant payments are considered to be capital expenditures as decided in ***Associated Portland Cement Mfg Ltd. v Kerr (1946) 27 TC 103.*** Payment for fines or penalty are generally not deductible - ***Mayne Nickless Ltd. v FC of T 84 TC 4458.***
- d) Retrenchment payment may qualify for deduction if a company, which continues to operate, makes that payment. For example, closing a section or a branch of the company. If the whole company is closed down, then that payment would not be tax deductible as decided in a local case, ***Ampat Tin Dredging v DGIR (1982) 2 MLJ 46.***
- e) Payments made for buying off competition are considered to be capital expenditure as it would benefit the business entity, structure or organisation set up - ***Sun Newspaper Ltd. v FC of T (1938) 61 CLR 337.***

- f) Payments made to affect the total closure of a rival were held to be capital expenditure in ***Walker v Joint Credit Card Co Ltd. (1982) BTC 168.***
- g) Professional fees incurred for cost of tax appeals are not tax deductible - ***Smith's Potato Estates Ltd v Bolland (30 TC 267) and Allen Farquharson Bros (17 TC 59).***
- h) Cost incurred to acquire a fixed capital is capital expenditure. Expenditure incurred to maintain a fixed capital was held to be revenue in nature - ***Southern v Borax Consolidated Ltd (23 TC 547) and Morgan v Tate & Lyle (35 TC 367).***
- i) Contingent liabilities and anticipated losses are non-deductible - ***Peter Merchant Ltd v Stedeford (30 TC 496), Edward Collins & Sons Ltd v CIR (12 TC 773).*** Specific provision for doubtful debts is allowable under Section 34 instead of Section 33.
- j) Loss due to theft or embezzlement by the proprietor of the business or director of a company is not deductible. It is submitted that loss caused by embezzlement or defalcation by employees is tax deductible - ***Curtis v J & G Oldfield Ltd (9 TC 319) and Bamford v ATA Advertising Ltd (48 TC 359).***
- k) Exchange losses on loan were held to be a capital loss - ***Beauchamp v FW Woolworth Plc.***
- l) Compensation incurred as a result of negligence of the trader or his employees in the course of carrying on a business was held to be deductible - ***O mahu Shengle Co Ltd v C of T (1950).***
- m) Expenditure incurred during temporary cessation of business (where the source still continues, that is, the business has not permanently ceased) would be tax deductible - ***Queensland Meat Export Co Ltd v FC of T.***
- n) Revenue expenditure including those paid to family members would be tax deductible provided that it is not excessive - ***Copeman v William Flood & Sons Ltd (24 TC 53); Stott and Ingham v Treheame (9 TC 69).***

Please refer to IRB's Public Rulings related to Professional fees and expenses at the end of the chapter.

8.3.8 Takaful Premiums

Generally, insurance premium incurred on policies covering loss or damage through fire or other causes would rank for tax deduction where the expenditure is an ordinary business operating expenditure.

Annual premium of policies insuring damage to or loss of fixed asset including loss of business profit, may be allowable where the assets concerned are used for purposes of the business.

Where an employer took up a policy insuring against loss of profit upon the death, sickness or injury of an employee, the premium paid would be tax deductible where:-

- a) The sole relationship is that of employer and employee; and
- b) The insurance is intended to meet loss of profit resulting from the loss of services of

the employee.

Premium paid by a trader to insure his own life or life of a partner are not tax deductible.

In general, if receipts under a policy would be treated as income, the premium should be allowable and if the receipts would be treated as capital, the premium would not be allowable expenditure.

8.4 A Comprehensive Illustration on the Taxation of Business Income

Naga Sdn Bhd has been manufacturing rubber-dipped products for export since 1983. The detailed Profit and Loss Account for the year ended 30 June 2004 is as follows:

Naga Sdn Bhd Profit and Loss Account Year ended 30 June 2004			
	Note	RM'000	RM'000
Sales			10,000
Cost of Sales	1		6,000
Gross Profit			4,000
Expenditure			
Supply and distribution	2	100	
Marketing and selling	3	300	
General administration	4	820	
Intangible asset written off	5	30	
Interest income	6	(50)	
Technical fees	7	300	1,500
Net Profit before Taxation			2,500

Notes:

- 1) Included in the cost of sales are:

Depreciation of plant and machinery	RM 200,000
Warranty reserve* sales	0.4% of gross

* During the year the company paid RM 100,000 out of the warranty reserve for defective goods.

- 2) Included in the supply and distribution are:

Depreciation of fixed assets	RM 20,000
------------------------------	--------------

Marine insurance for the import of raw materials paid to a company incorporated in Malaysia 10,000. Export credit insurance insured with an approved company

12,000

3) Marketing and Selling

a) Included in the above is the cost of leave passage for the employees of the company, which amounted to RM 75,000.

b) Entertainment expenditure included are:

	RM
Reimbursement of entertainment expenses to marketing personnel (not wholly related wholly to sales)	40,000
Staff annual dinner	10,000
Promotional gift and samples of company's product	12,000
Entertaining clients and business associates (wholly related to sales)	5,000

c) A car costing RM 200,000 was leased at a monthly rate of RM 6,000 from a leasing company from September 2003.

4) General and Administration

Included in the above are the following:

a) Legal fees of RM20,000 incurred in removing a director from office as his continued presence was considered undesirable in the interest of the company.

b) Professional fees of RM10,000 paid to a firm of consultants for successfully appealing against the company's tax liabilities.

c) The managing director was paid the following:

	RM
Salary	160,000
Bonus	50,000

5) Intangible asset written off was in respect of goodwill (acquired 10 years ago)

6) Interest income was derived from a 15-month fixed deposit placed with a local licensed bank.

7) The withholding tax for the technical fees to a non-resident was made after the 3 months later with permission of the Director-General of Inland Revenue Department.

Required:

Starting with the net profit before taxation, compute the adjusted income of the business, explaining the adjustments you have made.

Naga Sdn Bhd
Computation of Adjusted Income
Year of Assessment 2004

	+ RM'000	- RM'000	Reference
Net profit before taxation	2,500	-	P/L
Interest		50	Section 4(c)
Cost of sales	140		Note
Supply and distribution -		2	Note 2
Marketing and selling	105		Note 3
General and administration	10		Note 4
Intangible assets written off	30		P/L A/c
Technical fees	NIL	-	Note 5
	2,785	52	
	52		
Adjusted Business Income	2,733		

Notes to the Tax Computation

1. <u>Cost of Sales</u>	P/L A/c	Disallowed	
Depreciation	200,000	200,000	1
Warranty reserve	40,000	40,000	2
Warranty paid	-	(100,000)	3
		140,000	

- 1 Instead, capital allowance is claimed to reduce the adjusted income.
- 2 Provision made does not rank for deduction as it was not incurred.
- 3 The RM100,000 incurred would rank for deduction to reduce the gross income.

2. Supplies and Distribution

	<u>Adjustment</u>	
Depreciation	20,000	
Import insurance	(10,000)	*Deduction Rule 1982
Export insurance	(12,000)	*Deduction Rule 1985
	<u>(2,000)</u>	

* Double deduction is claimed.

3. Marketing and Selling

	<u>Adjustment</u>	
Cost of leave passage	50,000	Sec 39(1)(m)
Entertainment [40,000 @ 50%]	20,000	Sec 39(1)(l)
Lease rental	10,000	Sec39(1)(k)*
	<u>105,000</u>	

4. General and Administration

	<u>Adjustment</u>	
Legal fees	NIL	<i>Mitchell v Noble</i>
Professional fees	10,000	<i>Allen v Farquharson</i>
Bonus	NIL	<i>Bros</i>
	<u>10,000</u>	

5. No adjustment as the time period of remitting the tax withheld was with the permission of the Tax Collector.

8.5 Conclusion

The chapter has discussed different aspects of Business Taxation - Computation of Adjusted Income. Among the points discussed are: Income tax provisions, Layman's understanding of Section 33, Deductible Expenditure and A Comprehensive Illustration on the Taxation of Business Income. The different aspects have been explained to provide a comprehensive knowledge on Computation of Adjusted Income.

Self Assessment

Q1 The following expenditure relates to LSB Sdn Bhd for the year ended 31 December 2007. Compute the amount to be adjusted against the net profit for the year in arriving at the adjusted business income:

- 1) Included in the cost of sales were:
 - a) Depreciation of RM 240,000
 - b) A reserve for warranty of 1% based on the turnover of RM 27.38 million in respect of manufactured goods. An amount of RM 152,800 was paid out as warranties during the year.
- 2) LSB paid to Risk Management Sdn Bhd, a locally incorporated insurance company, a premium of RM 155,000 for insurance on goods imported for use as raw materials and RM 80,000 against damage of goods in transit between the port of entry and its factory.
- 3) The foreign exchange loss (net) comprised of the following:-

	RM
Realised loss (on settlement of amounts due for stocks acquired)	48,000
Realised loss (repayment of loan)	60,000
Unrealised loss (on settlement of trade debts)	30,000
Unrealised gains (on amounts due for purchase of stocks)	(30,000)
	108,000
- 4) The conduct of the marketing director was detrimental to the business of the company. The company therefore required him to retire and agreed to pay him a compensation of RM 60,000 in annual instalments of RM 30,000 each. Only the first instalment paid in December 2007 was included in the profit and loss account of LSB.
- 5) Administrative expenses include compensation of RM 45,000 paid to a customer for late delivery of components. The following expenses were also included:-

	RM
Installation cost of new generator	30,000
Bad debt written off in respect of a loan made to a former director who is in financial difficulties	34,000
Contribution made by the company to meet the expenses incurred on launching of a social organisation in Kuala Lumpur. The executive director of the company is the pro-tem president of the organisation.	11,000

6) Professional Fees comprised:

	RM
Audit, tax and accounting fees	15,000
Feasibility study for a new project	25,000
Legal fees Re: Recovery of trade debts	8,000
Re: Breach of contract	11,000
Income tax appeal	9,000
Contribution to a political party	2,000
	<hr/>
	70,000
	<hr/>

7) The company incurred an amount of RM 300,000 in carrying out research on an approved project and the management decided that the expenditure was to be written-off over three (3) years.

8) The following expenditure incurred in renovating the main office was included: -

	RM
Fixed partitions for new executive offices	40,000
Moveable dividers for marketing and finance departments	60,000
	<hr/>
	100,000
	<hr/>

Also included was RM 10,000 in respect of entrance fee to a golf club for the managing director and a fine of RM 4,000 for evading Customs duty in respect of goods imported.

Suggested Answers

A1

LSB Sdn Bhd			
<u>Computation of Adjusted Income</u>			
<u>Year of Assessment 2007</u>			
	(-) RM'000	(+) RM'000	Remarks
Profit before taxation		NPBT	Profit & Loss Account
1) Cost of Sales Depreciation	-	240	-
Reserve of Warranty	-	273.8	Has not been incurred
Warranty Paid	142.8	-	Incurred, claim as a deduction
2) Freight and Insurance	155	-	Double deduction
3) Foreign Exchange	-	60	W1
4) Retirement Payment	30	-	RM 60,000 less RM30,000
5) Administrative Expenses			
New generator	-	30	Capital expenditure
Bad Debts	-	34	Non-trade debts
Contribution	-	11	Non-business expenditure
6) Professional Fee			
Audit, Tax & Accounting	-	NIL	Allowable as concession
Feasibility Studies	-	25	Capital expenditure
Income Tax Appeal	-	9	Does not satisfy the deduction test under S33 (1)
Contribution	-	2	-do-
7) Research & Development	500	-	Double deduction
8) Miscellaneous Expenses			
Partition & Dividers	-	100	Capital expenditure
Entrance Fee	-	10	Capital expenditure
Fines	-	4	Mayne & Nickles
	<u> A </u>	<u> B </u>	
<u>Adjusted Income</u>		(A) C	



**LEMBAGA HASIL DALAM NEGERI MALAYSIA
INLAND REVENUE BOARD**

PUBLIC RULING

**TAX TREATMENT OF LEGAL AND
PROFESSIONAL EXPENSES**

Translation from the original Bahasa Malaysia text

**PUBLIC RULING
NO. 6/2006**

DATE OF ISSUE : 6 JULY 2006



TAX TREATMENT OF LEGAL AND PROFESSIONAL EXPENSES

LEMBAGA HASIL DALAM NEGERI
MALAYSIA

Public Ruling No. 6/2006
Date of Issue : 6 Julai 2006

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DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

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**Director General of Inland Revenue,
Malaysia**



TAX TREATMENT OF LEGAL AND PROFESSIONAL EXPENSES

LEMBAGA HASIL DALAM NEGERI
MALAYSIA

Public Ruling No. 6/2006
Date of Issue: 5 July 2006

1. This Ruling explains:

- 1.1 the deductibility of legal and professional expenses; and
- 1.2 the non-deductibility of legal and professional expenses.

2. The related provisions for the deductibility and non-deductibility of legal and professional expenses are subsections 33(1) and 39(1) of the Income Tax Act 1967 (ITA).

3. The words used in this Ruling have the following meanings:

- 3.1 "Person" includes a company, a co-operative society, a club, an association, a Hindu joint family, a trust, and estate under administration, a partnership and an individual.
- 3.2 "Basis period" in relation to a person, a source of his and a year of assessment, means such basis period, if any, as is ascertained in accordance with section 21 or 21A of the ITA.
- 3.3 "Year of assessment" means a calendar year.

4. **General principle**

- 4.1 Generally, legal or professional expenses are deductible where these are incurred in the maintenance of trade rights or trade facilities, existing or alleged to exist and are not deductible, as being of a capital nature, where incurred for the purpose of acquiring new rights or facilities. The deductibility of expenses incurred to maintain alleged trade rights does not depend upon whether the action is successful or not.
- 4.2 Legal and professional expenses which are not wholly and exclusively incurred in the production of gross income or prohibited from deduction under subsection 39(1) of the ITA are not deductible.

5. **Deductible legal and professional expenses**

This Ruling addresses the specific situations when and how legal and professional expenses may be deducted as an expense under subsection 33(1) of the ITA from the gross income of a person from a source in ascertaining the adjusted income of the person from that source for the basis period for a year of assessment :

5.1 Debt collection

Legal and other expenses incurred by a person in the course of collecting trade debts from customers.

5.2 Renewal of loans

Legal expense incurred by a finance company in renewing existing loans.

5.3 Preparation of accounts

- (a) Ordinary expenses of keeping books and preparing financial records and accounts including charges for accountancy work.
- (b) Statutory audit fees expenditure [P.U.(A) 129 - Income Tax (Deduction For Audit Expenditure) Rules 2006]

5.4 Defending title to property

Legal expenses incurred in connection with defending a person's title to the ownership of an asset that is used in the business. The title to the ownership by the person remains the same and had been maintained with nothing added or taken away.

5.5 Legal expenses incurred by a landlord

Legal expenses including litigation costs incurred on renewal of a lease.

5.6 Defending an action connected with a trade or breach of trading contracts

- (a) Expenditure incurred by a person in resisting a claim that he has broken a trading contract is allowable unless the breach was deliberate and dishonest.

Examples:

- (i) Cost incurred by a money lender in defending an action in connection with a loan made to him by a company (loans are the trading stock of a money lender's business).
- (ii) Cost to a dairy farmer in successfully defending a charge of adulteration of milk.
- (b) Averting a threat to the goodwill of a business.
- (c) Preservation and / or protection of a capital asset that does not result in the creation of a new asset.

- (d) Where litigation ensues after a customer withholds payments wholly or in part on the grounds of inferior workmanship, sub-standard material, non-fulfilment of contract requirements or for other reasons, the legal action is regarded as an ordinary incident of trade.
- (e) Litigation against claims for libel arising from published documents in respect of a newspaper or publishing business.
- (f) Defending legal action taken against a professional in respect of negligence in undertaking work for a client.

5.7 Legal cost incurred in disputes over trading contracts when incurred for -

- (a) Enforcement of a contract for the supply to a litigant of goods which would be resold for profit.
- (b) The establishment of an agreement between the litigant and another under which the litigant is entitled to render services for specific remuneration.
- (c) Determination of fares fixed by a transport company for carrying passengers.
- (d) Attempting to recover sums which would have been taxable if received.
- (e) Claims for compensation for trading goods lost in transit.

5.8 Legal or professional expenses incurred by a developer or a dealer in property -

- (a) For obtaining end-financing facility for the benefit of house purchasers.
- (b) For valuation of land.
- (c) Legal fees paid for transfer of land titles, sub-division and conversion of land.
- (d) Survey fees.

5.9 Other legal expenses

- (a) Renewal of leases and licenses.
- (b) Claim for compensation for trading goods destroyed, defective or lost in transit.
- (c) Legal fees and agency fees incurred in connection with employment agreements as well as in connection with preparation of trading contracts or agreements.

6. Non-deductible legal and professional expenses

The following are examples of legal and professional expenses which will not qualify for deduction:

6.1 Debt collection

Legal and other expenses incurred by a person in the collection of non-trade debts and loans of a capital nature.

6.2 Renewal of loan

- (a) Legal expenses incurred by a trading or commercial company.
- (b) Legal expenses on renewal of a mortgage on premises.
- (c) Cost of raising additional capital whether by means of a loan or otherwise (this will also apply to a person carrying on a business of banking or money-lending).

6.3 Annual corporate filings and meeting expenses

- (a) Secretarial fees.
- (b) Annual general meeting expenses.

6.4 Income tax returns

- (a) Cost of filing of tax returns and tax computations.
- (b) Cost of appeal against income tax assessment i.e. to the Special Commissioners of Income Tax and the Courts.

6.5 Legal expense incurred by a landlord

When a property is let for the first time by the owner or lessor.

6.6 Cost of defence in a fraud case

The cost of defending criminal prosecution or in connection with unlawful acts in the operation of a business.

6.7 Legal expenses incurred to vary vehicle licences

A variation of vehicle licences from ordinary lorries to articulated vehicles.

6.8 Legal expenses incurred in connection with:

- (a) The formation, renewal, variation or dissolution of a partnership.
- (b) The transfer of a mortgage on business premises.
- (c) The grant of a lease of business premises unless in connection with the renewal of a lease.



**LEMBAGA HASIL DALAM NEGERI
MALAYSIA**

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- (d) The acquisition of capital assets or the sale or transfer of capital assets.
- (e) Securing an enduring advantage for a trade or business.
- (f) Obtaining a trading licence.
- (g) Increasing or reducing share capital or altering the Memorandum and Articles of Association of a company.
- (h) Floatation, registration, winding up or liquidation of a company.
- (i) Obtaining new leases, mortgages, loan or credit facilities.
- (j) Valuation charges relating to probate, company reconstruction and change of ownership.
- (k) Legal fees relating to income already earned eg. income tax appeals.
- (l) Costs of legal proceedings incurred in pursuing a claim for unlawful or unjust dismissal by an employee.

6.9 Legal and professional fees incurred by a property developer

- (a) For obtaining bank overdraft, term loan and bridging finance.
- (b) Fees for revaluation of land.

7. Effective Date

This Ruling is effective for the year of assessment 2006 and subsequent years of assessment.

**Director General
of Inland Revenue**



**LEMBAGA HASIL DALAM NEGERI
INLAND REVENUE BOARD**

PUBLIC RULING

ENTERTAINMENT EXPENSE

Translation from the original Bahasa Malaysia text.

PUBLIC RULING NO.3/2004

DATE OF ISSUE: 8 NOVEMBER 2004



ENTERTAINMENT EXPENSE

Public Ruling No. 3/2004

Date of Issue : 8 November 2004

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DIRECTOR GENERAL'S PUBLIC RULING

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**Director General of Inland Revenue,
Malaysia**



INLAND REVENUE BOARD
MALAYSIA

ENTERTAINMENT EXPENSE

Public Ruling No. 3/2004
Date of Issue : 8 November 2004

1. This Ruling explains the tax treatment of entertainment expense as a deduction against gross income from a business.
2. The related provisions are section 18, subsection 33(1), paragraphs 39(1)(l) and (m) of the **Income Tax Act, 1967** (the Act).
3. The words used in this Ruling have the following meanings:
 - 3.1 "Entertainment" includes:
 - (i) the provision of food, drink, recreation or hospitality of any kind; or
 - (ii) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in paragraph (i) above,

by a person or an employee of his in connection with a trade or business carried on by that person.
 - 3.2 "Entertainment related wholly to sales" means the entertainment which is directly related to sales provided to customers, dealers and distributors excluding suppliers.
 - 3.3 "Recreation and hospitality" would include:
 - (i) a trip to a theme park or a recreation centre;
 - (ii) a stay at a holiday resort;
 - (iii) tickets to a show or theatre; and
 - (iv) gifts and give-aways.
4. **General provision for deductibility**

Generally, an expense that is wholly and exclusively incurred in the production of income is allowable as a deduction against gross income under subsection 33(1) of the Act. Expenses that are included in subsection 39(1) of the Act are disallowed as a deduction against gross income.
5. **Provision for deductibility specifically for entertainment expense**

In respect of expenses that come within the definition of "entertainment" under section 18 of the Act which are wholly and exclusively incurred in the production of income under subsection 33(1) of the Act, a sum equal to fifty per cent (50%) of such expenditure would be disallowed under paragraph 39(1)(l) of the Act except for the



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categories of entertainment expenses specified in proviso (i) to (vii) of paragraph 39(1) of the Act.

6. Proviso to paragraph 39(1)(i) of the Act

The following categories of entertainment expenses included in proviso (i) to (vii) of paragraph 39(1)(i) of the Act would be wholly allowable. The categories of entertainment expenses with examples are as follows:

6.1 The provision of entertainment to employees

Expenditure on food, drink and recreation provided to employees except where such expenditure is incidental to the provision of entertainment for others. Examples of such entertainment expenses are expenses on free meals and refreshment, annual dinners, outings, family day or club membership for employees. Where the cost of outings, family day trips includes cost of travel, food and accommodation, only the amount relating to food and accommodation is deductible. The cost of travel is not a deductible expense as it is specifically disallowed under paragraph 39(1)(m) of the Act.

Example 1

Active Sdn Bhd entertains its suppliers on 15 December 2004 and the cost is RM3,000. Some employees of Active Sdn Bhd are also present.

As the entertainment is principally for the suppliers of Active Sdn Bhd, an amount of fifty per cent (50%) is disallowed and the balance is allowable.

Example 2

Mestijaya Sdn Bhd entertains its employees at an annual dinner on 10 December 2004. Some suppliers are also invited to the dinner. The cost of the dinner is RM10,000.

As the entertainment to the suppliers of Mestijaya Sdn Bhd is only incidental to the provision of entertainment to employees, the full amount incurred RM10,000 is allowable.

Example 3

To foster family values among its employees, Warna Sdn Bhd provided a family day trip for its employees to Langkawi. The total cost incurred amounted to RM70,000 comprising cost of travel totalling RM40,000 and cost of food, drinks and accommodation which amounted to RM30,000.

Warna Sdn Bhd is allowed a deduction for the cost of food, drinks and accommodation spent on its employees amounting to RM30,000. Warna Sdn Bhd is not allowed any deduction for the cost of travel of RM40,000.

6.2 The provision of entertainment for payment in the ordinary course of business

Expenditure on entertainment provided by a person to clients or customers for payment in the normal course of the business and where the nature of the business is to provide such entertainment for payment. Examples of such entertainment are:

- (i) Provision of cultural shows by restaurants or hotels at their premises to entertain their customers.
- (ii) Meals provided by airlines or other transportation business to its passengers.

Expenses on entertainment provided by a person free of charge to clients or customers of the business which are not in the ordinary course of carrying on the person's business would not be deductible.

Example 4

Syarikat Top Auto Service carrying on a car servicing business provides light refreshments such as tea, coffee, sandwiches to its customers while waiting for their cars to be serviced. The customers are not charged for the light refreshments provided.

The entertainment expenses incurred on the light refreshments by Syarikat Top Auto Service would not be deductible as it is not in the ordinary course of the car servicing business to provide such entertainment. However this expenditure would qualify for deduction under proviso (vii) of paragraph 39(1)(l) of the Act.

6.3 The provision of promotional gifts at trade fairs or trade or industrial exhibitions outside Malaysia

Expenditure incurred on promotional gifts at trade fairs or trade exhibitions or industrial exhibitions held outside Malaysia for the purpose of promoting exports from Malaysia. Examples of such entertainment expenses are expenditure incurred on samples of products of the business, small souvenirs, bags and travel tickets provided as gifts to customers or visitors at a trade fair or trade or industrial exhibitions held outside Malaysia.

6.4 The provision of promotional samples of products of the business



Expenditure incurred on promotional samples of products of the business for the purposes of advertising that product for example:

- (i) A complimentary drink or meal provided by a restaurant.
- (ii) Free samples of drinks manufactured by the business given to schools or for functions.
- (iii) Free samples of products manufactured/distributed by the business or free samples of new products.

6.5 The provision of entertainment for cultural or sporting events open to members of the public wholly to promote the business

Expenditure incurred on providing entertainment for cultural or sporting events which are open to members of the public for the purpose of promoting the business. Examples of such entertainment are:

- (i) Cultural events which relate to the promotion of the arts such as painting, sculpture, music, drama and dance. (National Day Parade is not considered a cultural event).
- (ii) Sporting events, for example, badminton tournaments, golf tournaments, motor racing or swimming events.

In the provision of cultural or sporting events, the organiser may pay fees to the artistes or sportsmen, pay cost of passage, accommodation, food or recreation or t-shirt for artistes or sportsmen. This proviso includes sponsorship of a cultural or sporting event. These events should be open to members of the public. If the event is open to members only, it cannot be considered as being open to the public.

6.6 The provision of promotional gifts within Malaysia of articles incorporating the logo of the business

Expenditure on promotional gifts within Malaysia consisting of articles incorporating a conspicuous advertisement or logo of the business. The deduction allowed in respect of promotional gifts is to be restricted to articles which are not products of the business on condition that the articles incorporate a conspicuous advertisement or logo of the business. The logo could either be affixed or embossed on the promotional products. Logo of the business refers to the company's logo or the logo of its products.



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So long as the promotional gifts provided are made available on a non-discriminatory basis to the public at large, they will qualify for deductions (as opposed to expensive gifts given to selected persons or when there is an absence of any business relationship the transaction done between the giver and recipient may not justify the gift and is not available to other members of the public).

6.7 The provision of entertainment related wholly to sales arising from the business

Expenditure on provision of entertainment which is related wholly to sales arising from the business. The following are examples of such expenditure:

- (i) Food and drinks for the launching of a new product.
- (ii) Redemption vouchers given for purchases made.
- (iii) Discount vouchers, shopping vouchers, concert or movie tickets, meal or gift vouchers and cash vouchers.
- (iv) Free gifts for purchases exceeding a certain amount.
- (v) Redemption of gifts based on a scheme of accumulated points.
- (vi) "Free" maintenance/service charges or contribution to sinking fund by property developers.
- (vii) Lucky draw prizes to customers.
- (viii) Expenditure on trips given as an incentive to dealers for achieving the sales target.
- (ix) Expenditure of the type shown in Example 4.

7. Expenses disallowed under paragraph 39(1)(l) of the Act

Entertainment expenses which are wholly and exclusively incurred in the production of income under subsection 33(1) of the Act and which do not fall into any of the categories of expenses enumerated in the proviso to paragraph 39(1)(l) of the Act would only qualify for fifty per cent (50%) deduction. Such expenses would include the following :



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-
- (i) the expenses incurred in connection with specific business transactions;
 - (ii) existing clients or suppliers are entertained; and
 - (iii) allowances paid to employees for the purpose of defraying expenses incurred by the employees in the provision of entertainment.
8. Taxpayers are required to keep records in respect of the entertainment expense and the categories into which the entertainment expense can be identified with.
9. The following example illustrates the treatment of entertainment expense:

Example 5:

Sejahtera Sdn Bhd incurred RM100,000 on entertainment for the basis period for year of assessment 2004. Details of the entertainment expenses that are wholly and exclusively incurred in the production of income are as follows:

	RM
Entertainment allowance to employees	10,000
Entertainment to suppliers	5,000
Sponsorship of a cultural show at a sporting event open to members of the public	50,000
Gifts to customers for purchases above RM100	15,000
Launching of a new product	<u>20,000</u>
	<u>100,000</u>

The computation of allowable entertainment expense is as follows:

	<i>Incurred</i>	<i>Allowed</i>	<i>Disallowed</i>
	<i>RM</i>	<i>RM</i>	<i>RM</i>
<i>Entertainment allowance to employees</i>	<i>10,000</i>	<i>5,000</i>	<i>5,000 *</i>
<i>Entertainment to suppliers</i>	<i>5,000</i>	<i>2,500</i>	<i>2,500 *</i>
<i>Sponsorship of a cultural show at a sporting event</i>	<i>50,000</i>	<i>50,000</i>	
<i>Gifts to customers for purchases above RM100</i>	<i>15,000</i>	<i>15,000</i>	
<i>Launching of a new product</i>	<i>20,000</i>	<u><i>20,000</i></u>	
		<u><i>92,500</i></u>	<u><i>7,500</i></u>

Note *:

RM7,500.00 (50% of RM15,000.00 incurred) is to be disallowed under subsection 39(1)(l) of the Act.



ENTERTAINMENT EXPENSE

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Date of Issue : 8 November 2004

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10. This Ruling is effective for the year of assessment 2004 and subsequent years of assessment.

**Director General
of Inland Revenue**



**LEMBAGA HASIL DALAM NEGERI
INLAND REVENUE BOARD**

PUBLIC RULING

**DOUBLE DEDUCTION INCENTIVE
ON RESEARCH EXPENDITURE**

Translation from the original Bahasa Malaysia text.

PUBLIC RULING NO. 5/2004

DATE OF ISSUE: 30 December 2004



**DOUBLE DEDUCTION
INCENTIVE ON RESEARCH
EXPENDITURE**

**INLAND REVENUE BOARD
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**Public Ruling No. 5 /2004
Date of Issue: 30 December 2004**

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**DOUBLE DEDUCTION
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DIRECTOR GENERAL'S PUBLIC RULING

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**Director General of Inland Revenue,
Malaysia**



**DOUBLE DEDUCTION
INCENTIVE ON RESEARCH
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**Public Ruling No. 5 /2004
Date of Issue: 30 December 2004**

1. This Ruling explains:
 - 1.1 particular activities that qualify as research;
 - 1.2 the expenditure that qualifies for double deduction; and
 - 1.3 the general procedure for the application for the double deduction incentive in respect of research expenditure.
2. The related provision is section 34A of the Income Tax Act 1967 (the Act).
3. The words used in this Ruling have the following meanings:
 - 3.1 "Time-sheet" means a record of actual time spent on a particular research project by an employee who is not involved in research on a full-time basis.
 - 3.2 "In-house research" means research carried out in Malaysia by a person within his business for the purpose of using the results of the research for furthering his own business.
 - 3.3 "Science" is the systematic study of the nature and behaviour of the material and physical universe, and "technology" is the practical application of science, especially in industry and commerce. The process by which new scientific and technological information is discovered, gathered and used involving theoretical conjecture, observation, experiment, measurement and deduction, is referred to as research.
 - 3.4 "New technology" in relation to information technology means new capability accomplished through research, excluding purchase of rights or licence.
4. Only revenue expenditure on research directly incurred by a person resident in Malaysia would be eligible for a claim for double deduction. These expenses must be incurred specifically in undertaking in-house research by that person in relation to his business. The said research must be approved by the Minister of Finance. The Minister has, however, delegated such powers to the Director General of Inland Revenue (DGIR).
5. In the case of scientific research which does not qualify for approval by DGIR under section 34A, claim for expenses on that scientific research may be given consideration under subsection 34(7) of the Act. The conditions that must be complied with to be eligible for the deduction under this subsection are as follows:
 - (i) the research expenditure must be of a revenue nature; and
 - (ii) the research is related to the business and directly undertaken by the person or on his behalf.
6. **Definition of Research**
 - 6.1 For the purpose of this Ruling, the DGIR has adopted the following definitions:



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6.1.1 *Definition of research generally*

“Research” means any systematic or intensive study undertaken in the field of science or technology with the object of using the results of the study for the production or improvement of materials, devices, products, produce or processes.

6.1.2 *Definition of Research for Information Technology (IT) & Software*

“Research in IT and Software” covers any research activity that involves the development of a new technology or enhancement of existing technology through the incorporation of new elements that involve or are expected to result in some advancement of the product, process, device, service, knowledge or understanding relating to IT and its components (hardware, software, etc.).

7. Research activities in sectors other than information technology (IT) & software

The following are included as research activities:

- 7.1 experimental or other work aimed at the discovery of new knowledge or the advancement of existing knowledge;
- 7.2 the search for applications of research findings or other knowledge;
- 7.3 research to devise new methods of testing (excluding routine testing and standardisation);
- 7.4 the formulation and design of possible new or improved product or process alternatives;
- 7.5 the design, construction and testing of prototypes and models;

Example 1

A prototype is an original model constructed to have all the technical characteristics of the anticipated new product. The design, construction and testing of prototypes would fall within research. Once modification (that is necessary to reflect the test findings) to the prototype and further testing have been satisfactorily completed, then the research phase would have been completed.

- 7.6 the design, construction and operation of a pilot plant that is of a scale not economically feasible for commercial production;
- 7.7 the design and construction of a pilot plant prior to commercial production;

Example 2

A pilot plant forms part of the research phase for as long as it is used to evaluate hypothesis, develop new product formulae, establish new product specifications,

design special equipment and structures and prepare operating instructions or manuals on the process. Once this experimental phase is over, a pilot plant may begin to operate as a commercial production unit, at which point it no longer represents a research activity; and

- 7.8 the design of tools, jigs, moulds and dies involving new technology.

[The above research activities should have the objective of using the results of the study for the production or improvement of materials, devices, products, produce or processes.]

8. Research activities in information technology (IT) & software

8.1 Research in IT and software includes:

- (i) the spectrum of activities of research from the conceptual stage to the “proof-of-concept” stage of the project;
- (ii) software research, which may include software design, methodology, computer systems for example computer language, compiler, operating systems and algorithms; or
- (iii) the development or use of software within a larger research project.

8.2 Coverage of software research includes:

- (i) *Theoretical Computer Science*

Generally, technological or scientific advances in this area produce new theorems and algorithms.

- (ii) *Operating Systems*

Technological advances consist of -

- a. a technological improvement in resource and interface management;
- b. a new operating system; or
- c. the conversion of an operating system to a significantly different hardware environment.

[Some examples of operating systems available in the market are: Linux, Windows, Oracle and Unix].

- (iii) *Programming Language*

Technological advances include:

- a. new languages;
- b. significant extension of an existing language; and
- c. new or significantly different language translators.

[Some examples of programming languages available in the market are: C++, COBOL, PASCAL, Visual Basic and JAVA].



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(iv) *Applications*

Technological advances may occur when a development represents a significant technological step forward (e.g. new combinations of established computer programme components or known programming principles), provided that this integration requires the resolution of technological uncertainties.

(v) *Data Management*

Technological advances include the development of:

- a. algorithms to achieve significantly better basic operations (e.g. data retrieval);
- b. new or enhanced query language for databases that significantly increases the power of search or manipulation capabilities; and
- c. new object representations or data structures.

Significant increase in paragraph b. above means significant increase in terms of response time, efficiency, flexibility, accuracy of data or enhancement in query command language.

(vi) *Software Engineering*

Advances in the methodology required to construct computer programmes with greater flexibility, efficiency, reliability and ease of maintenance.

(vii) *Artificial Intelligence (AI)*

Scientific and technological advances which are made in such domains as machine vision, robotics, interference, knowledge representation, expert systems, theorem proving, understanding of natural language, automatic language translation, logic programming and future generation systems. Most areas of AI do not yet have an established practice; however, the attempt to resolve a technological uncertainty must be demonstrated as a basis for establishing the eligibility of expenditure. Frequently, in this area, the existence of any kind of solution will reflect this indeterminacy.

9. Non-research activities in sectors other than information technology (IT) & software

There are activities that may be closely associated with research but are not research. The following are examples of activities that would be non-research activities:

- 9.1 activities which involve changes in aesthetic values like features, colour planning or artwork to promote the sale of products;
- 9.2 pre-production work prior to commercial production;



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- 9.3 routine product, process or service development, not involving a significantly innovative scientific or technological advance;

Example 3

Routine analysis and testing by subjecting a product to different conditions to suit the local environment. (The product is available overseas and it is meant to be produced and marketed locally eventually).

- 9.4 routine systematic programme of work to update an existing product, process or service by the application or introduction of well established techniques or equipment;
- 9.5 engineering follow-through in an early phase of commercial production;
- 9.6 quality control during commercial production, including routine testing of products or processes;
- 9.7 troubleshooting in connection with breakdowns during commercial production;
- 9.8 routine efforts to refine, enrich or otherwise improve upon the qualities of an existing product or process;

Example 4

The process of chlorinating water and passing it through a normal distillation system so as to enrich / improve upon the quality of water used in the production of dental toothpaste.

- 9.9 adaptation of an existing capability to a particular requirement or customer's need as part of a continuing commercial activity;
- 9.10 seasonal or other periodic design changes to existing products or processes;
- 9.11 routine design of tools, jigs, moulds and dies;

Example 5

Design and drawing work for the preparation, execution and maintenance of production standardisation (i.e. jigs and tools) does not constitute research.

- 9.12 testing analysis either of equipment or product; or on the suitability of materials for the purposes of quality or quantity control;
- 9.13 activities, including design and construction engineering, related to construction, relocation, rearrangement, or startup of facilities or equipment, other than facilities or equipment used solely for a particular research project;
- 9.14 activities which only involve product-testing to ensure conformity of its properties to the required standards for purposes of compulsory registration of the product, as required by any law in Malaysia (such as for agricultural chemicals and pharmaceutical products); and

9.15 legal and administrative work in connection with patent applications, records and litigation and the sale or licensing of patents.

10. Non-research activities in information technology and software

Non-research activities in IT and software includes:

- 10.1 product development using IT and its components and commercialisation of the output;
- 10.2 routine computer programming, systems maintenance, application of software or enhancement of existing application system; and
- 10.3 software related activities such as:
 - (i) supporting existing system;
 - (ii) converting and / or translating computer languages;
 - (iii) adding user functionality to application programmes;
 - (iv) debugging of systems;
 - (v) adaptation of existing software; and
 - (vi) preparation of user documentation.

Example 6

Adaptation or application of existing software such as Lotus Smartsuite or Microsoft Office in developing a stock-inventory system or management support system.

Example 7

Development of a software system such as banking or management system based on the requirement of the customer by using known application software and without any new technological findings.

11. General non-research activities

Research must be distinguished from a wide range of related activities. The following are examples of activities that are not research in nature:

- 11.1 general education and training;
- 11.2 scientific and technical information services;
- 11.3 general purpose data collection or efficiency surveys;
- 11.4 market research and evaluation;
- 11.5 calibration of standards and routine testing and analysis of materials, components, products and processes;
- 11.6 routine computer maintenance or software development;
- 11.7 setting-up of manufacturing line or equipment;



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- 11.8 routine soil / fertiliser analysis or testing;
- 11.9 fabrication or modification of machinery / equipment; and
- 11.10 general commercial activities will not be considered as research. These include:
 - (i) the range of commercial and financial steps necessary for innovation and development and marketing of a new product, process or service such as a business plan, cost benefit analysis, management or policy studies;
 - (ii) the production and distribution of goods and services;
 - (iii) administrative and other supporting services (such as secretarial, clerical, book-keeping or security); and
 - (iv) general support services (such as transportation, storage, up-keeping, cleaning, repair and maintenance).

12. Criteria for eligibility of research project / activity

In order to obtain approval for a research project / activity the following criteria should be fulfilled:

- 12.1 The research project / activity undertaken by a person must satisfy the definition of research as spelt out above.
- 12.2 The research activity must be geared towards the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use.
- 12.3 Research activity is distinguished by its non-routine nature and the novelty of what is being created. If successful, it will result in the extension of scientific or technical advancement / knowledge (although it is recognised that research will not always be successful).
- 12.4 In the case of a software development project, its completion must be dependent on the development of a scientific and / or technological advancement. The aim of the project must be the resolution of a scientific or technological uncertainty on a systematic basis.
- 12.5 The research undertaken must be in accordance with the needs of the country and must be beneficial to the Malaysian economy such as training of Malaysians for technology transfer and undertaking research activities in Malaysia.

13. Research expenditure which qualifies for double deduction

To qualify for double deduction, the research expenditure must be for an approved project(s) and must be incurred in the basis period. The accounts for the expenditure incurred for each project must be kept separately.

The following expenditure qualifies for a double deduction:



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13.1 *Raw materials used in research*

- (i) Raw materials used directly in a research project excluding the purchase of fixed assets used in the research. For each project, the name, amount used and cost of each raw material used must be kept, along with information about its relevance to the projects. If raw materials are taken from the stock, the cost attributable can be separately identified and measured reliably.
- (ii) Cost of moulds, dies and soft tools (life span not exceeding one year) which cannot be reused. These moulds, dies and soft tools should not be eligible for capital allowance claim. In the case where tools are reused for production the cost in respect of the research project should be apportioned by comparing the period of utilisation to develop prototype units with the period of utilisation to manufacture production units.

[Cost of materials used for production or used for administrative purposes do not qualify for double deduction].

In cases where the moulds, dies, and soft tools used to develop the prototype were incurred in one basis period and the said tools were reused for the manufacture of production units in the next basis period(s), then the claim for double deduction made in the first mentioned basis period need to be revised accordingly. If such revision results in additional tax payable for the first-mentioned year of assessment, penalty would not be imposed for cases where the claim has been made in good faith.

13.2 *Manpower in a research project*

- (i) Only expenditure on the basic salary of an employee directly involved in the research project (research employee) is eligible for double deduction. Expenditure such as EPF, SOCSO, bonus, medical fees and benefits-in-kind will not qualify for double deduction. If an employee is not involved in a research project on a full time basis, expenditure claimed should be apportioned according to the actual time spent by that employee on that research project. The basis of apportionment must be substantiated by keeping a time-sheet.
- (ii) Salaries of employees involved in the research attending courses / seminars directly relevant to the research project may be considered for the claim [see also paragraph 13.4(ii) on travelling cost attending courses / seminars].
- (iii) Employees involved in the research are those providing technical input, feedback, guidance or direction on the research project.

13.3 *Technical services*

13.3.1 The following technical services payments are included:



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- (i) Consultancy fees paid to a particular research organisation or individual for obtaining information / advice pertaining to the research being undertaken.
- (ii) Payment to particular organisations for the use of testing equipment such as those available in SIRIM, FRIM and the universities.
- (iii) Payment to a particular organisation or individual for analytical services and data evaluation processing.

13.3.2 If the payment for technical services undertaken outside Malaysia is more than 70% of the total allowable expenditure, the payment will not qualify for double deduction. However, the balance of the allowable expenditure (if it is an ordinary allowable expenditure incurred locally such as the purchase of raw materials, manpower and transportation) will qualify for double deduction.

13.3.3 The expenditure for the technical services which are obtained from overseas and undertaken in Malaysia will qualify for double deduction.

13.3.4 If payment is made to a non-resident as in the case of employing a foreign researcher / consultant, deduction and payment of withholding tax, where applicable, must be made.

13.3.5 Information should be kept in respect of:

- (i) the name and address of the researcher / consultant /organisation whose technical services are obtained;
- (ii) purpose or relevance of the technical services in the said research project; and
- (iii) the amount paid.

13.4 *Travelling cost*

(i) *Visiting research stations*

Travelling cost incurred by research employees related to visiting research stations solely for the purpose of conducting research work. Allowable expenditure includes travelling costs and daily allowances (includes the cost of food and lodging). The daily allowance is restricted to RM400.00 per person or the actual cost incurred, whichever is lower.

(ii) *Attending courses / seminars*

Cost of travelling locally or overseas by research employees related to attending courses / seminars relevant to research projects. These courses / seminars must be solely for the purpose of obtaining the latest or up-to-date scientific information which is directly relevant to the project. Allowable expenditure includes travelling costs and daily allowances (including the cost of food and lodging) and course/seminar fee. The daily allowance is restricted to RM400.00 per person or the actual cost incurred, whichever is lower.

[Expenditure such as travelling costs to visit vendors, meetings with suppliers /clients, attending exhibitions / shows, market surveys and other such expenditure not related to research do not qualify for double deduction].

13.5 *Transportation cost*

Cost of transporting raw materials used directly in the research. However, expenditure such as cost of transporting fixed asset, end-products, postage for administrative purposes or others not related to research do not qualify for the double deduction. In the case where the research uses the same type of raw materials as that used in manufacturing an existing product and the raw materials are purchased in bulk and have been delivered at different times with different transport cost, then the cost of transportation for a basis period would be apportioned according to the total quantity of raw materials used for research over total quantity of raw materials purchased during the same basis period.

13.6 *Maintenance cost*

Maintenance costs for motor vehicles, buildings, equipment and machinery used directly in a research project qualify for double deduction. However, expenditure not related directly to research do not qualify for double deduction. Maintenance costs on motorcars used by research employees / consultants, capital expenditure incurred on plant and machinery (including installation costs), fixtures, land, premises, buildings, structure or works of a permanent nature and alterations, additions or extensions to the said items are some examples of expenditure which are not related directly to research. Therefore, such expenses do not qualify for double deduction.

13.7 *Rental*

- (i) Rental of motor vehicles, buildings, equipment and machinery used directly in a research project qualify for double deduction. However, expenditure not related directly to research do not qualify for double deduction. Expenditure



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such as rental of premises for administrative purposes, rental of motorcars for research employees / consultants (including petrol, insurance and road tax) and rental of machinery for production are not expenditure related directly to research and as such do not qualify for double deduction.

- (ii) In cases where the buildings or machinery are also being used for other purposes apart from research, apportionment of the expenditure must be made based on usage related to research for example floor space used for the research or by taking the period of utilisation of machinery to develop prototype units compared with the period of utilisation for other non- research activities.

14. Other expenditure

- 14.1 Claims for double deduction can also be made on other revenue expenditure incurred directly for research such as water and electricity, telephone, fax, courier, stationery, photostating of research reports or schematic design, ink / toner used to print reports, lab coats and slides or photographs. Other expenditure such as books or magazines, insurance and all taxes such as service or road tax do not qualify for double deduction.
- 14.2 Detailed information should be kept on the types of expenditure and their relevance to the research project. In cases where no separate meters for water and electricity are set up for research, apportionment of the said expenditure must be made based on percentage used for research.

[Capital expenditure incurred on plant and machinery, fixtures, land, premises, buildings, structures or works of a permanent nature (including installations) or alterations, additions or extensions thereof or in the acquisition of any rights in or over any property (including royalty) do not qualify for double deduction.]

15. Application for approval for research projects / activities

15.1 Granting of approval

Commencing from year of assessment 2005, the DGIR will only give approval for a research project. This approval does not include approval for research expenditure incurred. This practice differs from the practice for year of assessment 2004 and prior years where approval was given not only for each research project but also for research expenditure incurred.

15.2 Application form

The application by a person to obtain approval for a research project must be made for each year of assessment on the application form Borang 1 (Sek 34A ACP 1967) and submitted with relevant supporting documents to the Technical Division, Inland Revenue Board, six (6) months **before** the financial year-end of the business. Applicants are required to adhere to all conditions imposed and



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furnish correct information as required in the said form. Late applications will be considered on a case to case basis. The DGIR will then issue a letter of approval or rejection, as the case may be, to the applicant. Approvals given will be subjected to the terms stated in the letter.

15.3 *New research projects*

Application for approval of any new research project must be submitted together with the proposal reports in the application form. In cases where an application has been submitted and a new research project commenced after the application in paragraph 15.2, the applicant has to submit an additional application for the relevant project using the application form within one (1) month after the close of the financial year-end of the applicant.

Where a proposed project submitted for approval was delayed or did not take off, the person should notify IRB.

15.4 *Multiple research projects*

Detailed information must be provided for each research project. In cases where numerous research projects are undertaken concurrently under a specific research programme, the programme and the overall objective must be specified.

15.5 *Research projects for related companies*

As a concession, a holding company which undertakes research project / activity at its research centre on behalf of companies within its group may submit an application for approval of research project / activity on behalf of its subsidiary or associate companies. However, the details for each subsidiary or associate company should be separately and clearly stated.

16. Claim for double deduction on research expenditure

16.1 Upon receiving the approval of the research project, the applicant will claim the double deduction for expenditure incurred in the relevant income tax return form.

16.2 *Supplementary worksheet*

The applicant is also required to prepare two copies of the supplementary worksheet Borang 2 (Sek 34A ACP 1967). The original copy (with supporting documents) must be kept by the applicant for audit purposes. The second copy is to be sent simultaneously to the Technical Division, IRB for record upon submission of the relevant income tax return form.

16.3 *Research expenditure for related companies*

In cases where research is undertaken by a research centre for subsidiary or associate companies, allowable expenditure incurred in relation to a project undertaken on behalf of subsidiary or associate companies shall be allocated to each company. The subsidiary or associate companies may claim double deduction based on the allocation of expenditure made by the research centre. Research fees paid to related research centre / company will not be allowed a double deduction. No double deduction can be claimed by the research centre.

17. Period of research project

An applicant can claim only those expenditure incurred during the period from the commencement to the completion of the approved project. Commencement of a project means the date the specific research activity commences. Completion of a research project means the date whereby testing of a prototype product has been completed or the principles of a new production process have been established. In the case where the duration of the project spreads over two or more basis periods, the expenditure incurred can only be claimed in respect of the amount incurred in each respective basis periods (see also paragraph 18 on period of approval for ongoing project).

Example 8

Company A Sdn. Bhd. undertakes a research project in the year of assessment 2005. The financial year-end of the company is 31.12.2005. The project is to develop a new product. The research activity commences on 1.1.2005 and immediately carries out experiment and testing which is intensive and systematic in the field of science. The final testing of prototype finishes on 30.6.2005. Production starts on 1.7.2005.

The project meets the definition of research and hence is eligible to claim double deduction for expenditure incurred during the period 1.1.2005 to 30.6.2005.

Example 9

Company B Sdn. Bhd. commences a research project on 1.6.2005 under the title of „Executive desktop“. The project is completed on 31.5.2006. The financial year end of the company is 31.12.2005. The research activities involve the development of a new software for the export market. The company provides a detailed development schedule plan, the research methodology employed including the raw materials utilised and the resource persons involved.

The project meets the definition of research in Software & IT and, hence, is eligible for double deduction claim on the expenditure incurred during the period 1.6.2005 to 31.12.2005 (for the year of assessment 2005) and the period 1.1.2006 to 31.5.2006 (for the year of assessment 2006).



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18. Period of approval for ongoing project

For a research project which requires 5 or more years to be completed, the DGIR can approve the research period for up to three (3) years. Where a research project / activity has been approved by the DGIR for three (3) years and that period has not expired, the applicant can directly claim the double deduction in the income tax return form for each relevant year of assessment without reapplying for the particular approved research project / activity. Applicants are then required to state in the supplementary worksheet the period and reference of the approval. After the expiry of the period of approval, new application should be made to obtain further approval for the project.

19. Abandonment of project

Where an approved project is delayed, abandoned or ceased within the period of approval, the person should notify the DGIR. In the case of cessation or abandonment of the project, the approval is deemed withdrawn with effect from the date of cessation or abandonment.

20. Amount claimed in the tax computation

The amount of deduction shall be twice the amount of expenditure, not being capital expenditure incurred in the basis period. If the research expenditure has been charged in the profit and loss account, a further deduction of the expenditure will be allowed. However, if the research expenditure incurred is capitalised in the balance sheet, a deduction of twice the amount of the expenditure will be allowed.

21. Keeping of sufficient records

21.1 A person must maintain sufficient records of all activities pertaining to any research project including records of the research activity, records of the time spent (man-hours) by each research employee on each project and relevant documents supporting the expenditure claimed. Separate sets of records must be maintained for different projects. In addition, research expenditure records must be maintained independently from the overall production costing. For this purpose, a research unit should be set up to undertake such activities.

21.2 Documentation of step-by-step methodology, testing, investigation and results for each phase of the research project must be maintained. Preferred documentation would include logbooks or diaries maintained by each research employee which record the day-to-day research activities performed, raw materials used and man-hours spent for each research project.

22. Appeals

Written appeals in respect of rejected applications must be made to the DGIR within 30 days from the date of the rejection letter.



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23. Penalty for incorrect information

Applicants are advised to furnish correct information as required in the prescribed form. If the information is incorrect or false, the DGIR reserves the right to withdraw the approval granted. In addition, DGIR will take action as provided for under sections 113, 114 and 114(1A) of the Act.

24. This Ruling is effective for year of assessment 2005 and subsequent years of assessment. This Ruling replaces the "Guidelines on Application for Double Deduction for Research and Development Expenditure under Section 34A of the Income Tax Act 1967" dated November 2000.

**Director General
of Inland Revenue**

Kepada:

**KETUA EKSEKUTIF/KETUA PENGARAH,
LEMBAGA HASIL DALAM NEGERI, MALAYSIA,
BAHAGIAN TEKNIKAL,
BLOK 9, TINGKAT 12,
KOMPLEKS PEJABAT KERAJAAN,
JALAN DUTA,
50758 KUALA LUMPUR.**

**Permohonan Untuk Projek Penyelidikan Yang Diluluskan
Di Bawah Seksyen 34A Akta Cukai Pendapatan 1967**
Application For An Approved Research Project
Under Section 34A of the Income Tax Act 1967

Nama pemohon

Name of Applicant:

Nombor rujukan LHDN. 01/35/(S)/42/51/286- (jika ada)

Reference number LHDN.01/35/(S)/42/51/286- (if any):

Nombor rujukan cukai pendapatan

Income tax reference number:

Cawangan Lembaga Hasil Dalam Negeri

Branch of Inland Revenue Board:

Tahun taksiran

Year of assessment:

Tempoh asas

Basis period:

Permohonan untuk:

Application for:

Tandakan (/) di ruang yang berkaitan

Tick (/) which ever is relevant:

☐

Projek penyelidikan baru
New research project

☐

Melanjutkan projek penyelidikan yang telah diluluskan
An extension of an approved research project

BAHAGIAN A: BUTIR-BUTIR PEMOHON

PART A: PARTICULARS OF APPLICANT

1. **Nama pemohon** / Name of applicant:
2. **Alamat** / Address: **Pejabat/ Office** **Kilang/ Factory**
.....
.....
.....
.....
No. telefon/ Tel No.
No. faks/ Fax No.
3. **Tarikh penubuhan (bagi syarikat)**
Date of incorporation (for a company):

Tarikh permulaan perniagaan
Date of commencement of business:
4. **Struktur ekuiti (bagi syarikat)/ Equity structure (for a company)**

Milikan rakyat Malaysia
Owned by Malaysian:%

Milikan rakyat asing (sebutkan negaranya)/
Owned by foreigners (specify the country):%
5. **Aktiviti utama pemohon/ Principal activity of applicant:**
.....
6. **Jenis produk yang dikeluarkan/ Types of products produced:**
.....
7. **Nilai jualan bagi tahun taksiran sebelum**
Sales turnover for the preceding year of assessment
.....

8. Galakan yang telah diluluskan di bawah Akta Penggalakan Pelaburan 1986/ Akta Cukai Pendapatan 1967

Incentives approved under the Promotion of Investment Act 1986/ Income Tax Act 1967

Jenis galakan/ Type of incentive:

Tarikh kelulusan/ Date of approval:

Tempoh kelulusan/ Period of approval:

Produk yang dikeluarkan/ Product produced:

.....

BAHAGIAN B: PROJEK PENYELIDIKAN YANG DIPOHON UNTUK MENDAPATKAN KELULUSAN

PART B: RESEARCH PROJECT FOR APPROVAL

1. Senaraikan projek yang dipohon untuk mendapatkan kelulusan

List the research projects for approval

Tajuk projek Title of project	Tarikh mula Date of commencement	Tarikh dijangka siap Expected date of completion

2. Senaraikan projek penyelidikan yang telah diluluskan potongan dua kali oleh Kementerian Kewangan/Lembaga Hasil Dalam Negeri dalam tiga (3) tahun yang lepas dan jumlah perbelanjaan yang dituntut

List the research projects approved by the Ministry of Finance/Inland Revenue Board in the last three (3) years and the amount of expenditure claimed for double deduction

Tajuk projek Title of project	Tarikh kelulusan Date of approval	Tempoh kelulusan Period of approval	Jumlah perbelanjaan Total expenditure

BAHAGIAN C: BUTIR -BUTIR MENGENAI PROJEK PENYELIDIKAN
PART C: PARTICULARS OF THE RESEARCH PROJECTS

Bagi setiap projek yang disenaraikan dalam Perenggan 1. Bahagian B, kemukakan maklumat berikut:

For every project listed in Paragraph 1. of Part B, submit the following information:

1. Tajuk projek:

Title of the project:

2. Objektif projek penyelidikan:

Objectives of the research project:

3. Latar belakang penyelidikan dengan terperinci (sila nyatakan sebab bagi pelaksanaan penyelidikan tersebut daripada perspektif saintifik/teknologi)

Detailed background of the research (please state reasons for undertaking such research from the scientific / technological perspective)

.....
.....

4. Lokasi di mana penyelidikan akan dijalankan

Location where research is to be carried out

.....

Sekiranya sebahagian daripada penyelidikan tersebut akan dikontrakkan atau dilaksanakan secara usaha sama dengan syarikat/organisasi lain, nyatakan nama, alamat dan negara asal syarikat/organisasi berkenaan dan maklumat mengenai penyelidikan tersebut

If any part of the research is to be contracted out or undertaken as a joint-venture project with another company/organisation, state the name, address and the country of origin of the company/organisation and the details of the research

.....
.....

Jika penyelidikan akan dijalankan di luar negeri, nyatakan sebab-sebabnya

If the research is to be undertaken overseas, state the reasons for it

.....
.....

5. **Kaedah:**

Methodology:

Berikan maklumat terperinci mengenai aktiviti penyelidikan yang akan dijalankan dan kaedah /teknik yang diguna pakai

Give detailed information of the research activity to be carried out and the method /technique to be used

Jadual aktiviti penyelidikan yang akan dijalankan Schedule of research activities to be carried out		Kaedah dan teknik Method and technique
Tarikh(bulan) Date(month)	Aktiviti Activities	

6. **Ujian yang dijalankan:**

Tests to be carried out:

Senaraikan ujian/percubaan yang akan dijalankan serta peralatan/perkakas yang akan digunakan untuk tujuan tersebut

List the tests/ trials to be conducted and the equipment/ tools to be used for this purpose

Jadual ujian yang akan dijalankan Schedule of tests to be carried out		Peralatan/ perkakas yang akan digunakan Equipment/ tools to be used
Tarikh (bulan) Date (month)	Ujian Tests	

7. Hasil yang dijangka daripada penyelidikan:

Expected result of the research

A. Projek penyelidikan baru

New research project

Terangkan dengan jelas dan terperinci tentang hasil penyelidikan yang dijangkakan dapat diperolehi (boleh disokong dengan foto/ sampel/ prototaip/ lakaran skematik atau lain-lain)

Explain clearly and in detail the expected result of the research (can be supported with photographs/ sample/ prototype/ schematic design or others)

.....

; atau/ or

B. Bagi melanjutkan projek penyelidikan telah diluluskan

For an extension of an approved research project

Terangkan kemajuan dan pencapaian yang diperolehi oleh projek penyelidikan tersebut dengan memberi penekanan tentang sejauh mana objektif penyelidikan tersebut telah dicapai. Penerangan hendaklah disokong dengan foto-foto yang relevan

Explain the progress and achievement made in the project, emphasising on how much of the objectives of the research have been met. The explanation must be supported by relevant photographs

8. Tenaga manusia dalam projek penyelidikan

Manpower in the research project

Nama pegawai/staf	Warga-negara	Jawatan yang dipegang	Kelayakan & pengalaman	Tanggung-jawab kerja	Peratusan pembahagian masa untuk penyelidikan
Name of officer/staf	Citizenship	Position held	Qualification & experience	Job responsibility	Percentage of time allocated for research

9. Anggaran perbelanjaan ke atas projek penyelidikan

Estimate of expenditure on research

Butiran Items	Tahun 1 Year 1	Tahun 2 Year 2	Tahun 3 Year 3
Bahan-bahan Materials			
Kos tenaga manusia Manpower cost			
Perkhidmatan teknikal Technical services			
Kos perjalanan Travelling cost			
Kos pengangkutan Transportation cost			
Kos penyelenggaraan Maintenance cost			
Sewaan peralatan/bangunan Rental of equipment/ building			
Lain-lain Others			
Jumlah Total			

Catatan:

Note:

- 1) Sekiranya terdapat lebih daripada satu projek penyelidikan yang akan dijalankan, Bahagian C borang ini hendaklah dilengkapi secara berasingan bagi setiap projek.
If more than one research project are being carried out, Part C of this form is to be completed separately for each of the research project.
- 2) Sila gunakan helaian yang berasingan jika ruang yang disediakan di dalam borang ini tidak mencukupi.
Please use separate sheets if the space provided in this form is insufficient.

BAHAGIAN D: PENGAKUAN

PART D: DECLARATION

Pengakuan oleh pemohon:

Declaration by applicant:

Saya dengan ini:

I hereby:

- (i) **mengesahkan dan mengaku bahawa semua butiran yang diberikan dalam permohonan ini adalah benar dan betul;**
certify and declare that all the particulars furnished in this application are true and correct;
- (ii) **mengesahkan dan mengaku bahawa projek/aktiviti yang mana permohonan ini dibuat adalah projek/aktiviti penyelidikan;**
certify and declare that the project/activity for which this application is made is a research project/activity; and
- (iii) **memberi kebenaran kepada pegawai Lembaga Hasil Dalam Negeri dan mana-mana pakar yang dibawa bersamanya untuk memeriksa di premis perniagaan atau di lokasi di mana penyelidikan dijalankan, dokumen yang berhubung dengan projek/ aktiviti penyelidikan dan perbelanjaan yang dituntut ke atasnya.**
give permission to officers of the Inland Revenue Board and any accompanying experts to examine documents relating to research project/ activity and expenditure claimed thereof at the business premises or at locations where the research is undertaken.

.....
Tandatangan/Signature

.....
Nama/ Name

.....
Jawatan/Designation

Tarikh/ Date:

Cop syarikat/ Company's seal:

HELAIAN KERJA
SUPPLEMENTARY WORKSHEET

Salinan asal borang ini hendaklah dilengkapi dan disimpan bersama-sama dokumen asal oleh pihak yang menuntut bagi tujuan audit.

The original copy of this form must be completed and kept together with the original document by the claimant for audit purposes.

Salinan kedua borang ini hendaklah dikemukakan kepada Bahagian Teknikal, Lembaga Hasil Dalam Negeri seperti di alamat berikut:

The second copy of this form must be submitted to the Technical Division of the Inland Revenue Board as per address below:

**KETUA EKSEKUTIF/KETUA PENGARAH,
LEMBAGA HASIL DALAM NEGERI, MALAYSIA,
BAHAGIAN TEKNIKAL,
BLOK 9, TINGKAT 12,
KOMPLEKS PEJABAT KERAJAAN,
JALAN DUTA,
50758 KUALA LUMPUR.**

(salinan asal/ salinan kedua)
(original copy/ second copy)

**TUNTUTAN POTONGAN DUA KALI BAGI PERBELANJAAN PENYELIDIKAN
DI BAWAH SEKSYEN 34A AKTA CUKAI PENDAPATAN 1967**
CLAIM FOR DOUBLE DEDUCTION ON RESEARCH EXPENDITURE
UNDER SECTION 34A OF THE INCOME TAX ACT 1967

TAHUN TAKSIRAN/ YEAR OF ASSESSMENT:
TEMPOH ASAS/ BASIS PERIOD:

1. **Nama pihak yang menuntut:**
Name of claimant:
2. **Nombor rujukan LHDN. 01/35/(S)/42/51/286- (jika ada):**
Reference number LHDN. 01/35/(S)/42/51/286- (if any):
3. **Nombor rujukan cukai pendapatan:**
Income tax reference number:
4. **Cawangan Lembaga Hasil Dalam Negeri:**
Branch of Inland Revenue Board:

5. **Senaraikan nama projek penyelidikan yang telah mendapat kelulusan Kementerian Kewangan/ Lembaga Hasil Dalam Negeri dan amaun yang dituntut untuk potongan dua kali dalam jadual di bawah ini:**

List the research project that has been granted approval by the Ministry of Finance/ Inland Revenue Board and the amount claimed for double deduction in the table below:

Tajuk projek Title of the project	Tarikh kelulusan Date of approval	Tempoh kelulusan Period of approval	Amaun perbelanjaan yang dituntut (RM) Amount of expenditure claimed (RM)

6. **Bagi setiap projek yang telah mendapat kelulusan Kementerian Kewangan/ Lembaga Hasil Dalam Negeri seperti di perenggan 5 di atas, sila berikan maklumat berikut:**

For each project which has been granted approval by the Ministry of Finance/ Inland Revenue Board as in paragraph 5 above, please furnish the following information:

BAHAGIAN A: Perbelanjaan penyelidikan yang dilakukan

PART A: Research expenditure incurred

Tajuk Projek:

Title of the project:

1. Bahan-bahan:

Materials

Tarikh perbelanjaan dilakukan Date of expenditure incurred	Nama bahan Name of material	Cara digunakan dalam penyelidikan How it is used in the research	Kuantiti digunakan dalam penyelidikan Quantity used in research	Amaun perbelanjaan dituntut Amount of expenditure claimed
JUMLAH/TOTAL				

2. **Tenaga manusia dalam projek:**

Manpower in research project:

Nama pegawai / staf Name of officer/ staff	Warga negara Citizenship	Jawatan dipegang Position held	Kelayakan & pengalaman Qualification & experience	Tanggung jawab kerja dalam penyelidikan Job responsibility in research	Gaji asas (RM) Basic salary (RM)	Peratusan bahagian masa kerja utk Penyelidikan Percentage of time allocated for research	Gaji sebenar dituntut (RM) Actual salary claimed (RM)
JUMLAH TOTAL							

Bagi tenaga manusia yang tidak melibatkan diri secara sepenuh masa dalam penyelidikan, Helaian Masa (Lampiran 1) hendaklah disediakan

For manpower not involved in research on a full time basis, a Time Sheet (Appendix 1) must be prepared

3. **Perkhidmatan teknikal (contoh: ujian, analisa data, dll):**

Technical services (examples: tests, data analysis, etc.)

Tarikh perbelanjaan dilakukan Date of expenditure incurred	Nama & alamat agensi/ individu yang memberi khidmat teknikal Name & address of agency/ individual which/ who provides the technical service	Jenis perkhidmatan teknikal yang diperolehi Type of technical services obtained	Aplikasi khidmat teknikal dalam penyelidikan Application of the technical service in research	Amaun perbelanjaan dituntut (RM) Amount of expenditure claimed (RM)
JUMLAH TOTAL				

4. **Kos perjalanan dan elaun harian:**

Travelling cost and daily allowance

4.1 **Kos perjalanan yang berkaitan dengan lawatan ke tapak penyelidikan:**

Travelling cost related to visiting research stations:

Tarikh & jangka masa lawatan	Lokasi	Pegawai yang membuat lawatan	Aktiviti yang dijalankan di tapak penyelidikan	Perbelanjaan perjalanan yang dituntut (RM)	Elaun harian yang dituntut (RM)
Date & duration of visit	Location	Name of officer who visited the research station	Activity carried out at the research station	Travelling Cost claimed (RM)	Daily allowance claimed (RM)
JUMLAH TOTAL					

4.2 **Perjalanan yang berkaitan dengan menghadiri kursus/ seminar:**

Travelling related to attending courses/ seminars

Tarikh & jangka masa kursus/ Seminar	Tajuk & kandungan kursus/ seminar	Nama pegawai yg. hadir kursus/ seminar	Nama penganjur dan tempat di adakan	Aplikasi dalam penyelidikan	Kos perjalanan (RM)	Fi kursus (RM)	Elaun harian (RM)
Date & duration of course/ seminar	Title & course content of the course/ seminar	Name of the officer who attended the course/ seminar	Name of the organiser and the venue of the course/ seminar	Application in research	Travelling cost (RM)	Course fees (RM)	Daily allowance (RM)
JUMLAH TOTAL							

5. **Kos pengangkutan bahan-bahan yang digunakan dalam penyelidikan**

Cost of transportation of materials used in the reasearch

Tarikh Date	Destinasi Destination		Nama bahan Name of material	Aplikasi dalam penyelidikan Appication in research	Kuantiti dibeli Quantity purchased	Peratusan untuk kegunaan penyelidikan Percentage used in research	Amaun perbelanjaan yang dituntut (RM) Amount of expenditure claimed (RM)
JUMLAH TOTAL							

6. **Kos penyelenggaraan**

Maintenance cost

6.1 **Kos langsung bagi penyelenggaraan kenderaan yang digunakan dalam penyelidikan**

Direct cost of maintenance of vehicle used in the research

Tarikh Date	Jenis kenderaan & nombor pendaftaran Type of vehicle & registration number	Peratusan digunakan untuk penyelidikan Percentage used for research	Jenis penyelenggaraan yang dibuat Type of maintenance carried out	Amaun perbelanjaan yang dituntut (RM) Amount of expenditure claimed (RM)
JUMLAH TOTAL				

6.2 Kos langsung bagi penyelenggaraan bangunan yang digunakan dalam penyelidikan

Direct cost of maintenance of building used in the research

Tarikh	Alamat bangunan	Peratusan digunakan dlm penyelidikan (mengikut ruang lantai)	Jenis penyelenggaraan yang dibuat	Amaun perbelanjaan yang dituntut (RM)
Date	Address of the building	Percentage used in research (by floor space)	Type of maintenance carried out	Amount of expenditure claimed (RM)
JUMLAH TOTAL				

6.3 Kos langsung bagi penyelenggaraan peralatan/jentera yang digunakan dalam penyelidikan

Direct cost of maintenance of equipment/machinery used in the research

Tarikh	Jenis peralatan/jentera	Cara digunakan dalam penyelidikan	Jenis penyelenggaraan yang dibuat	Amaun perbelanjaan yang dituntut (RM)
Date	Type of equipment/machinery	How it is used in the research	Type of maintenance carried out	Amount of expenditure claimed (RM)
JUMLAH TOTAL				

7. Sewa bangunan, peralatan/jentera, kenderaan bermotor yang digunakan dalam penyelidikan

Rental of building, equipment/machinery, motor vehicle used in the research

Alamat bangunan; Jenis peralatan/ jentera; Jenis kenderaan bermotor & nombor pendaftarannya Address of the building; Type of equipment/ machinery; Type of motor vehicle & its registration number	Nama & alamat pemberi sewa Name & address of the lessor	Aplikasinya dalam penyelidikan Its application in the research	Sewa sebulan (RM) Rental per month	Peratusan digunakan dalam penyelidikan Percentage used for research	Amaun perbelanjaan yang dituntut (RM) Amount of expenditure claimed (RM)
JUMLAH TOTAL					

8. Perbelanjaan lain

Other expenditure

Tarikh Date	Diskripsi Description	Aplikasi dalam penyelidikan Its application in the reasearch	Amaun perbelanjaan yang dituntut (RM) Amount of expenditure claimed (RM)
JUMLAH TOTAL			

BAHAGIAN B: **Bagi projek penyelidikan yang dijalankan untuk tempoh melebihi satu (1) tahun**
 PART B For research project undertaken for a period of more than one (1) year

Tajuk projek Title of the project	Tarikh Mula Commencement date	Tarikh dijangka siap Expected date of completion	Jumlah tuntutan tahun-tahun sebelum (RM) Total claim for previous years (RM)	Tuntutan dalam tahun semasa (RM) Claim for the current year (RM)	Jumlah (RM) Total (RM)

Catatan/Note:

- 1) Perbelanjaan yang dituntut hendaklah dilakukan dalam tempoh asas yang berkaitan.**
Expenditure claimed must be incurred in the relevant basis period.
- 2) Sila gunakan helaian berasingan sekiranya ruangan dalam borang ini tidak mencukupi.**
Please use separate sheets if the space provided in this form is insufficient.

BAHAGIAN C: Pengakuan oleh pihak yang menuntut
 PART C: Declaration by the claimant:

Saya dengan ini:

I hereby:

- mengesahkan dan mengaku bahawa semua butiran yang diberikan dalam borang ini adalah benar dan betul; dan**
certify and declare that all the particulars furnished in this form are true and correct; and
- memberi kebenaran kepada pegawai Lembaga Hasil Dalam Negeri dan mana-mana pakar yang dibawa bersama-samanya untuk memeriksa di premis perniagaan atau di**

lokasi di mana penyelidikan dijalankan, dokumen-dokumen berhubung dengan projek/aktiviti penyelidikan dan perbelanjaan yang dituntut ke atasnya.

Give permission to officers of Inland Revenue Board and any accompanying experts to examine at the business premises or at the location where the research is being undertaken, documents relating to research activity/ project and the expenditure claimed thereof.

.....
Tandatangan/
Signature

.....
Nama/
Name

.....
Jawatan/
Designation

Tarikh/Date:.....

Cop syarikat/ Company's seal:

SAMPEL HELAIAN MASA
SAMPLE OF TIME -SHEET

TAJUK PROJEK/TITLE OF PROJECT:

NAMA/NAME:

BULAN/MONTH:

JAWATAN KAKITANGAN/STAFF DESIGNATION:

TAHUN/YEAR:

NO. KAKITANGAN/STAFF NO.:

Aktiviti Activity	ISN MON	SEL TUE	RAB U WED	KHA THU	JUM FRI	SAB SAT	AHAD SUN	ISN MON	SEL TUE	RAB U WED	KHA THU	JUM FRI	SAB SAT	AHAD SUN	ISN MON	SEL TUE	RAB U WED	KHA THU	JUM FRI	SAB SAT	AHAD SUN	ISN MON	SEL TUE	RAB U WED	KHA THU	JUM FRI	SAB SAT	AHAD SUN	ISN MON	SEL TUE
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30
Jumlah Masa Total Time																														

DISEDIAKAN OLEH/PREPARED BY:

DILULUSKAN OLEH/APPROVED BY:

TANDATANGAN/SIGNATURE:

JAWATAN/DESIGNATION:

TARIKH/DATE:

TANDATANGAN/SIGNATURE:

TARIKH/DATE:



LEMBAGA HASIL DALAM NEGERI
INLAND REVENUE BOARD

PUBLIC RULING

**TAX TREATMENT OF
LEAVE PASSAGE**

Translation from the original Bahasa Malaysia text.

PUBLIC RULING NO.1/2003

DATE OF ISSUE: 5 August 2003



TAX TREATMENT OF LEAVE PASSAGE

INLAND REVENUE BOARD
MALAYSIA

Public Ruling No. 1/2003
Date of Issue: 5 August 2003

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DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

**Director General of Inland Revenue,
Malaysia**



TAX TREATMENT OF LEAVE PASSAGE

INLAND REVENUE BOARD
MALAYSIA

Public Ruling No. 1/2003
Date of Issue: 5 August 2003

-
1. This Ruling explains the tax treatment of:
 - (i) leave passage provided for the employee by or on behalf of his employer as a benefit or amenity taxable under gains or profits from an employment; and
 - (ii) expenditure incurred on leave passage provided to the employee by the employer in ascertaining the adjusted income of the employer.
 2. The related provisions are subparagraph 13(1)(b)(ii) and paragraph 39(1)(m) of the **Income Tax Act, 1967** [hereinafter referred to as the *Act*].
 3. The words used in this Ruling have the following meanings:
 - 3.1 "Members of his immediate family" means his wife or wives and his children or her husband and her children.
 - 3.2 "Child" means a legitimate child or step-child of an individual or his wife or a child proved to the satisfaction of the Director General to have been adopted by the individual or his wife in accordance with any law.
 - 3.3 "Leave passage cost" means cost of fares.
 - 3.4 "Employer", in relation to an employment, means-
 - (a) where the relationship of master and servant subsists, the master;
 - (b) where that relationship does not subsist, the person who pays or is responsible for paying any remuneration to the employee who has the employment, notwithstanding that that person and the employee may be the same person acting in different capacities.
 - 3.5 "Employee", in relation to an employment, means-
 - (a) where the relationship of master and servant subsists, the servant;
 - (b) where that relationship does not subsist, the holder of the appointment or office which constitutes the employment.
 - 3.6 "Employment" means-
 - (a) employment in which the relationship of master and servant subsists;
 - (b) any appointment or office, whether public or not and whether or nor that relationship subsists, for which remuneration is payable.



TAX TREATMENT OF LEAVE PASSAGE

INLAND REVENUE BOARD
MALAYSIA

Public Ruling No. 1/2003
Date of Issue: 5 August 2003

-
- 3.7 "Leave passage" means travelling during a period of absence or vacation from duty or employment.
- 3.8 "Local leave passage" means travelling within Malaysia.
- 3.9 "Overseas leave passage" means travelling between Malaysia and any place outside Malaysia.
4. Generally, any benefit or amenity provided for the employee by or on behalf of his employer would be subject to tax as gains or profits from an employment.
5. Subparagraph 13(1)(b)(ii) of the Act provides that not all benefits in the form of leave passage will be included as assessable income of the employee.
6. Any expenditure incurred by an employer in the provision of a benefit or amenity for his employee consisting of a leave passage within or outside Malaysia is not allowed as a deduction in ascertaining his adjusted income [paragraph 39(1)(m) of the Act].
7. This Ruling gives general guidelines on:
- 7.1 conditions where a benefit or amenity in the form of leave passage does not constitute assessable employment income;
 - 7.2 situations or circumstances where a benefit or amenity in the form of leave passage can be treated as gains or profits from an employment and charged to income tax under paragraph 13(1)(b) of the Act; and
 - 7.3 the treatment of leave passage expenditure whether within or outside Malaysia incurred by the employer for the benefit of his employee as a non-allowable deduction under the provisions of the Act.
8. **Leave passage benefit not assessable as an employment income**
- A benefit in the form of leave passage is not assessable as an employment income under the following conditions:
- (i) leave passages for travel within Malaysia not exceeding three times in any calendar year; or
 - (ii) one leave passage for travel between Malaysia and any place outside Malaysia in any calendar year, limited to a maximum value of three thousand ringgit.

The leave passage benefit, however, is confined only to the employee and members of his immediate family.

Example 1

Encik Abdullah is entitled to a yearly leave passage benefit amounting to RM5,000.00 under the terms of his employment agreement. In January 2003, he travelled to



TAX TREATMENT OF LEAVE PASSAGE

INLAND REVENUE BOARD
MALAYSIA

Public Ruling No. 1/2003
Date of Issue: 5 August 2003

Mauritius and the total leave passage cost claimed by Encik Abdullah was RM2,500.00.

Encik Abdullah is exempted from tax on leave passage benefit amounting to RM2,500.00 in the year 2003 for the year of assessment 2003.

Example 2

Encik Ng is entitled to a yearly leave passage benefit of RM5,000.00 from his employer. He made use of that benefit to go on a trip to Pulau Pinang with his wife and two young children during the festive season school holidays in January 2003. The whole family also went on a holiday to Singapore in March 2003. His employer paid him a total local leave passage cost of RM500.00 and overseas leave passage cost of RM1,500.00 for the trips.

Encik Ng is exempted from tax for both the local and overseas leave passage benefit amounting to RM2,000.00 in the year 2003 for the year of assessment 2003 .

Example 3

Puan Salmah is entitled to a yearly local leave passage benefit of RM6,000.00 according to the terms of her employment agreement. In the year 2003, Puan Salmah went on three separate holiday trips with her husband and six children to Kuching, Kota Kinabalu and Melaka and she claimed local leave passage cost of RM5,500.00 from her employer.

Puan Salmah is exempted from tax for the three local leave passage benefit amounting to RM5,500.00 in the year 2003 for the year of assessment 2003.

9. **Leave passage benefit assessable as an employment income**

Leave passage benefit, received by the employee from the employer, which does not fall within paragraph 8 above is subject to tax under paragraph 13(1)(b) of the Act as gains or profits from an employment.

Example 4

Using the above Example 1 in paragraph 8, Encik Abdullah and his wife went on another overseas holiday trip in the year 2003 to Indonesia for which he made a claim for leave passage cost of RM1,500.00 from his employer.

Encik Abdullah is assessable to tax on overseas leave passage cost amounting to RM1,500.00 in the year 2003 for the year of assessment 2003. (Note: If there are two or more overseas leave passages in the same year, then the higher cost of the leave passage is exempted limited to a maximum value of RM3,000.00).

Example 5



TAX TREATMENT OF LEAVE PASSAGE

INLAND REVENUE BOARD
MALAYSIA

Public Ruling No. 1/2003
Date of Issue: 5 August 2003

Encik Chelliah is entitled to a yearly overseas leave passage benefit of RM4,000.00 from his employer. He made use of that benefit to go on holiday to Australia accompanied by his father in the year 2003. His overseas leave passage cost amounted to RM2,000.00 per person and his employer paid him a total overseas leave passage cost of RM4,000.00 for the trip.

Encik Chelliah is exempted from tax on overseas leave passage benefit amounting to RM2,000.00 expended on himself in the year 2003 for the year of assessment 2003. He would however be taxed on the remaining leave passage benefit expended on his father.

Example 6

Puan Rina is entitled to a yearly overseas leave passage benefit of RM10,000.00 and local leave passage benefit of RM5,000.00 according to the terms of her employment agreement. In the year 2003, Puan Rina went on an overseas holiday trip with her husband to Italy and made a claim for overseas leave passage cost of RM7,500.00. She also went on four local holiday trips to Pulau Langkawi, Pulau Tioman, Pulau Pangkor and Pulau Redang with her husband and three children in the year 2003 and made a claim for local leave passage cost of RM500.00 for each trip.

Puan Rina is exempted from tax on the overseas leave passage benefit of RM3,000.00 in the year 2003 for the year of assessment 2003 but would be taxed on the remaining amount of RM4,500.00. She is also exempted from tax for up to three local leave passage benefit amounting to RM1,500.00 in the year 2003 for the year of assessment 2003 but would be taxed on the remaining local leave passage benefit. (Note: If there are four or more local leave passages in the same year, then the three most expensive passages are exempt).

10. Leave passage expenditure incurred by the employer for his employee

10.1 Any expenditure incurred in the provision of a benefit or amenity by the employer to his employee consisting of a leave passage within or outside Malaysia is not deductible in arriving at the adjusted income of his business as it is specifically disallowed under paragraph 39(1)(m) of the Act.

10.2 Where leave passage cost given by the employer to the employee includes cost of food, accommodation or other incidental expenses, only the amount relating to fares is treated as leave passage cost.

10.3 The cost of food and accommodation is deductible as entertainment expenses in arriving at the adjusted income of the employer's business. The amount deductible is restricted to the amount spent on his employees only.

Example 7



TAX TREATMENT OF LEAVE PASSAGE

INLAND REVENUE BOARD
MALAYSIA

Public Ruling No. 1/2003
Date of Issue: 5 August 2003

Encik Robin's employer paid him an overseas leave passage cost for travel to Australia under a packaged tour in the year 2003. The air fare for the trip amounted to RM2,000.00 whereas accommodation amounted to RM1,000.00.

Encik Robin's employer is not allowed any deduction on the cost of air fare amounting to RM2,000.00 but is allowed a deduction for the accommodation cost of RM1,000.00 for the year of assessment 2003. Encik Robin, on the other hand, is exempted from tax on the overseas leave passage cost of RM2,000.00.

11. Leave passage benefit where provided to partners or sole proprietors will not qualify for tax exemption. The condition whereby the leave passage benefit is confined to the employee is not fulfilled since the relationship between a partner and the partnership or a sole proprietor to himself is unlike the employer and employee relationship.
12. In the case of a partnership or a sole proprietorship, the expenditure incurred on leave passage cost to the partner or to the sole proprietor will not qualify for deduction being regarded to be private in nature. Thus, no part of the expenditure claimed is allowed in computing the partner's share of the partnership income or the sole proprietor's adjusted income of his business.
13. This Ruling is effective for year of assessment 2003 and subsequent years of assessment.

**Director General
of Inland Revenue**



“KEY-MAN” INSURANCE

INLAND REVENUE BOARD
MALAYSIA

Public Ruling No: 2/2003
Issue Date: 30 December 2003

1. This Ruling explains:
 - (i) the deductibility of premium expense paid for a “key-man” insurance policy; and
 - (ii) the taxability of insurance proceeds received on “key-man” insurance.
2. The related provisions for the deductibility of premium expense and the taxability of insurance proceeds are sections 33 and 22 of the **Income Tax Act, 1967** (the *Act*).
3. The words used in this Ruling have the following meanings:
 - 3.1 “Controlled company” has the same meaning as in section 139 of the *Act*.
 - 3.2 “Whole life”, “endowment”, “term life” and “accident” policy in relation to insurance have the same meanings as in the insurance business.
4. **“Key-man” insurance**
 - 4.1 Generally, a premium paid on an insurance, which is intended wholly and exclusively to recover moneys that would replace a loss of profits on the happening of the event insured against, would be allowable as a deduction against the gross income of a business.
 - 4.2 Death, critical illness, sickness, accident or injury of an employee or a director may result in a loss of business income for the employer or company. Insurance may be taken on the life of an employee or a director who is a “key” person to cover the risk of loss of business income. This type of insurance is known as “key-man” or “key-person” insurance.
 - 4.3 The right to the insurance proceeds of a “key-man” insurance **must** remain with the employer or company and the proceeds must **not** be payable to the “key-person” or his family.
5. **Deductibility of premium expense**
 - 5.1 The premium on the policy is allowable if the insurance has no element of investment and the insurance is taken on the life of a “key-person” whose absence would result in a reduction in the profits of the employer or the company.



INLAND REVENUE BOARD
MALAYSIA

“KEY-MAN” INSURANCE

Public Ruling No: 2/2003
Issue Date: 30 December 2003

5.2 Policies that have no element of investment are term life and accident policies. These policies expire at the end of the insured period and there is no return on the premium paid if the insured person lives or is not injured. The premium payable on a term life policy or an accident policy of a “key-man” insurance is allowable as a deduction against gross income from a business.

5.3 A whole life policy and an endowment policy have elements of investment and are therefore regarded as capital assets of a company. Both policies have cash values that can be redeemed after being in force for several years. For an endowment policy there is a lump sum payable upon maturity of the policy. The premium payable on a whole life or an endowment policy is not allowable in arriving at the adjusted income from a business of a company.

Example 1

A company purchased a “key-man” endowment policy on the life of the managing director with the company as the beneficiary. The annual premium payable is RM20,000 and the sum assured is RM500,000. Under the direction of the managing director, the company’s profits have increased 20% each year for the last five years.

Although the company is the beneficiary of the insurance policy and the managing director is a “key-person” in the company, the annual premium payable is not allowable as the company has acquired an asset. On maturity of the policy, the company will receive RM500,000 plus bonuses declared by the insurance company.

6. Taxability of insurance proceeds

The proceeds receivable on a term life policy or an accident policy is taxable on the employer or the company as the sum is receivable in respect of an insurance premium that has been allowed previously. On the other hand, the proceeds receivable in connection with a whole life or an endowment policy is not taxable as the insurance premium has not been allowed.

Example 2

A company acquired a “key-man” term life policy on the life of the managing director with an annual premium payable of RM30,000. It also acquired a “key-man” whole life policy on the life of the sales manager with an annual premium payable of RM20,000. The premium of RM30,000 had been allowed and the premium of RM20,000 had been disallowed in the tax computation. Both the managing director and the sales manager were killed in an accident and the company received cash payments of RM2,000,000 and RM500,000 in respect of the term life and whole life policies.



INLAND REVENUE BOARD
MALAYSIA

“KEY-MAN” INSURANCE

Public Ruling No: 2/2003
Issue Date: 30 December 2003

The sum of RM2,000,000 received by the company is taxable on the company as it is received in respect of a policy where the premium had been allowed previously while the sum of RM500,000 will not be taxable as the premium had not been allowed previously.

7. In the case of a controlled company, premium paid for a “key-man” insurance policy on the life of a director or an employee who owns shares in the company is not an allowable deduction as there are other motives for the purchase of the insurance policy. Other than providing a cover for the risk of loss of business income, it is also for the advantage of the director or employee in their capacity as shareholders of the company. Similarly, premium paid on “key-man” insurance policy on the life of a partner or sole-proprietor is not allowable.
8. This Ruling shall be effective for the year of assessment 2004 and subsequent years of assessment.

**Director General
of Inland Revenue**

Issue: A



INLAND REVENUE BOARD
MALAYSIA

“KEY-MAN” INSURANCE

Public Ruling No: 2/2003
Issue Date: 30 December 2003



INLAND REVENUE BOARD MALAYSIA

TAX TREATMENT OF LEAVE PASSAGE

**ADDENDUM TO
PUBLIC RULING NO. 1/2003**

Translation from the original Bahasa Malaysia text

DATE OF ISSUE: 23 AUGUST 2007

Issue: A



INLAND REVENUE BOARD
MALAYSIA

“KEY-MAN” INSURANCE

Public Ruling No: 2/2003
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INLAND REVENUE BOARD
MALAYSIA

TAX TREATMENT OF LEAVE PASSAGE

Addendum to Public Ruling No. 1/2003
Date of Issue: 23 August 2007

DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling as provided for under section 138A of the Income Tax Act 1967 is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

**Director General Inland Revenue,
Malaysia**



INLAND REVENUE BOARD
MALAYSIA

“KEY-MAN” INSURANCE

Public Ruling No: 2/2003
Issue Date: 30 December 2003

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INLAND REVENUE BOARD
MALAYSIA

TAX TREATMENT OF LEAVE PASSAGE

Addendum to Public Ruling No. 1/2003
Date of Issue: 23 August 2007

TAX TREATMENT OF LEAVE PASSAGE ADDENDUM TO PUBLIC RULING NO. 1/2003

1. This Addendum provides clarification on the change in tax treatment of the following:-
 - a. benefit of meals and accommodation provided by an employer to an employee pursuant to local leave passages - subsubparagraph 13(1)(b)(ii)(A), Income Tax Act (ITA) 1967; and
 - b. deduction for expenditure incurred by an employer on local leave passages provided to an employee - proviso (viii) of paragraph 39(1)(l), ITA 1967.
2. **Benefit of meals and accommodation provided pursuant to local leave passages - subsubparagraph 13(1)(b)(ii)(A), ITA 1967**

Previously, benefit provided to an employee in the form of local leave passages not exceeding three times in any calendar year is excluded from being part of his employment income. The amount of benefit excluded is confined only to the cost of leave passage fares. With effect from year of assessment 2007, the amount of local leave passage benefit excluded has been extended to include cost of meals and accommodation given pursuant to the local leave passages. This amendment is provided under subsubparagraph 13(1)(b)(ii)(A), ITA 1967.

Example 1

Puan Ani is entitled to a yearly local leave passage benefit of RM6,000 according to the terms of her employment. She went on a holiday trip to Kuching with her husband and three children in February 2007. She claimed for the cost of leave passage fares, meals and accommodation amounting to RM3,000 from her employer.

Puan Ani is exempted from tax on the total cost of leave passage fares, meals and accommodation amounting to RM3,000.



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Addendum to Public Ruling No. 1/2003
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3. Deduction for expenditure incurred by an employer on local leave passages - proviso (viii) of paragraph 39(1)(l), ITA 1967

- 3.1 Prior to year of assessment 2007, any expenditure incurred by an employer on the provision of local and overseas leave passages to an employee is not deductible as it is specifically disallowed under paragraph 39(1)(m), ITA 1967.
- 3.2 With effect from year of assessment 2007, leave passage expenditure incurred by an employer to facilitate a yearly event within Malaysia which involves the employer, employee and immediate family members of that employee is categorised as entertainment expense specified under proviso (viii) of paragraph 39(1)(l), ITA 1967. This expenditure is thus, wholly allowable by virtue of that proviso from year of assessment 2007.

Example 2

Meriah Sdn Bhd organised a family day trip to Pulau Redang for its employees in November 2007. The total cost incurred is RM60,000 comprising cost of travel fares amounting to RM40,000 and cost of meals and accommodation amounting to RM20,000.

Meriah Sdn Bhd is allowed a deduction for the cost of travel fares amounting to RM40,000 by virtue of proviso (viii) of paragraph 39(1)(l), ITA 1967. The cost of meals and accommodation spent on its employees amounting to RM20,000 is also allowed a deduction under proviso (i) of subparagraph 39(1)(l), ITA 1967.

4. This Addendum forms part of the Public Ruling No. 1/2003 and is effective from year of assessment 2007.

Director General
Inland Revenue Board Malaysia



INLAND REVENUE BOARD
MALAYSIA

“KEY-MAN” INSURANCE

Public Ruling No: 2/2003
Issue Date: 30 December 2003

Issue: A

Chapter 9

Business Taxation - Computation of Statutory Income

Chapter Outline:

- 9.1 Introduction (Introduction to Capital Allowance)
- 9.2 Qualifying Capital Expenditure
- 9.3 The first year of assessment that one can claim Capital Allowance
- 9.4 Schedule 3 – two basic types of allowance
- 9.5 Rate of Allowance
- 9.6 Example of Capital Allowance for plant and machinery
- 9.7 Disposal of Asset
- 9.8 Example of Capital Allowance for Motor Vehicles
 - 9.8.1 Motor Vehicles limited to a maximum of RM 50,000 capital allowance
 - 9.8.2 Motor Vehicles that qualify for a maximum of RM 100,000 capital allowance
 - 9.8.3 Hire-purchase vehicles
 - 9.8.4 Example of hire-purchase capital allowance computation
- 9.9 Industrial Building Allowance (IBA)
 - 9.9.1 What is an Industrial Building?
 - 9.9.2 A factory is further defined in a Paragraph 64 as
 - 9.9.3 Qualifying Building Expenditure
 - 9.9.4 Initial Allowance
 - 9.9.5 Annual Allowance
 - 9.9.6 Special Rates and Conditions
 - 9.9.7 Example

- 9.10 Agriculture Allowance
 - 9.10.1 Qualifying Agriculture Expenditure
 - 9.10.2 Rates of Agriculture Allowance
 - 9.10.3 Example
 - 9.10.4 Agriculture Changes
- 9.11 Putting it all together
- 9.12 Summary of Points to note
 - 9.12.1 Comprehensive Example 1
 - 9.12.2 Comprehensive Example 2
- 9.13 Further Notes
- 9.14 Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- Explain what Statutory Income is and what happens in-between Adjusted Income and Statutory Income
- Explain what are Capital Allowances and why are they given
- State how to arrive at the Qualifying Capital Expenditure for the three different categories of assets
- Understand Initial Allowances
- Understand the three different annual Capital Allowance rates for furniture/office equipment, plant and machinery, motor vehicles and heavy equipment

Explain the Capital Allowance rules for motor cars and the restriction on Capital Allowances due

- Explain how the Capital Allowance rules work in a hire-purchase situation

State the nature of Capital Allowances due for Industrial Buildings and what buildings qualify for Industrial Building Allowance

- State the nature of Capital Allowances due for Agriculture activities
- Understand what happens when an asset is disposed off and the computation of Balancing Allowances and Balancing Charge

Business Taxation

Computation of Statutory Income

Capital Allowances

9.1 Introduction to Capital Allowances

Only a business source is entitled to capital allowances. Employment and rent, to name a few other sources is not eligible for capital allowances. Capital allowances are given in place of depreciation for capital expenditure incurred. Accounting principles concerning depreciation are varied and therefore the Income Tax Act follows its own schedule as a standard for allowing capital allowances. Capital allowances rules and procedures are contained in Schedule 3.

9.2 Qualifying Capital Expenditure

The first issue is to determine what qualifies as qualifying capital expenditure. Capital expenditure has been explored in the earlier two chapters. It is principally expenditure that is not considered revenue allowable against income in the Profit and Loss Account. Capital expenditure must be incurred for the purpose of the business and they are usually expenditure on assets, which are used in more than one accounting period. It is a long-term asset. Not all capital expenditure qualifies for capital allowances.

Qualifying Capital expenditure is classified into the following categories: -

1. Qualifying Plant expenditure
2. Qualifying Building expenditure
3. Qualifying Agriculture expenditure
4. Qualifying Forest expenditure
5. Qualifying building expenditure on Licensed private hospital, maternity home and nursing home
6. Qualifying building expenditure on buildings used for research or training
7. Qualifying building expenditure on buildings used for warehouse
8. Qualifying plant expenditure on plant and machinery used for research
9. Qualifying building expenditure on buildings used in an approved service project
10. Qualifying building expenditure incurred on a hotel
11. Qualifying building expenditure incurred on an airport
12. Qualifying building expenditure incurred on a Motor racing circuit

The principal two categories are (1) plant and machinery and (2) buildings. Agriculture expenditure has become more prominent as a result of government promotion of the agriculture sector. It is interesting that hotels and nursing homes are also considered industrial buildings.

9.3 The first year of assessment that one can claim Capital Allowances

It is important to observe the very first year capital allowances can be claimed. Capital allowances follow a strict rule of qualifying and entitlement for each year of assessment. Therefore, the qualifying capital expenditure is allocated to the relevant years of assessment based

on basis periods and capital expenditure incurred. An important rule is that capital allowances can only be claimed if the asset is in use in the business and the asset is owned at the end of the basis period. It is also available only to owners of the asset as at the end of the basis period.

9.4 Schedule 3 – two basic types of allowances

There are two basic types of allowances:

- 1) **Initial Allowance** and
- 2) **Annual Allowance**

Initial Allowance is given in the first year of assessment the expenditure is incurred. The year of assessment will follow the basis period.

The **Annual Allowance** will then be given for each year of assessment from the first year of assessment to the final year of assessment for which there is remaining **residual value**. However, if the asset is disposed off or sold in a year of assessment, there will be no more capital allowances due and the difference in value between the residual value and the disposal value will be taken into consideration either as a balancing charge or a balancing allowance.

9.5 Rates of Allowances

Initial Allowance: For qualifying plant and machinery the initial allowance is 20%. For Industrial buildings the initial allowance is 10%.

Annual Allowance: For qualifying plant and machinery the annual allowance has three categories:

1. for furniture and fittings and office equipment the annual allowance rate is 10%.
 2. for plant and machinery the annual allowance rate is 14%
 3. for heavy equipment and motor vehicles the annual allowance rate is 20%.
- For Industrial buildings the annual allowance rate is 3%.

9.6 Example of Capital Allowances for plant and machinery

The financial year of a company is 1st July 2006 to 30th of June 2007. In December 2006 it incurred capital expenditure on a machine for RM 20,000. The capital allowances will be calculated as follows:

Year of assessment 2007		
Qualifying Plant Expenditure		RM 20,000
Initial allowance 20%	4,000	
Annual allowance 14%	<u>2,800</u>	<u>6,800</u>
<u>Residual value (YA 2007)</u>		<u>13,200</u>
Year of assessment 2008		
Annual allowance 14% (original cost)		2,800
<u>Residual value (YA 2008)</u>		<u>10,400</u>
Year of assessment 2009		
Annual allowance (14%)		2,800
<u>Residual value (2009)</u>		<u>7,600</u>

It will be observed that annual allowances will be given for each year of assessment until the residual value is zero. For every new purchase of asset there will be an initial and an annual allowance. The initial allowance is the same at 20% but the annual allowance varies into the three rates as described above.

9.7 Disposal of Asset

When an asset is disposed off in a particular year of assessment there will be a consequence. Let us take the previous example. The residual value as at year of assessment 2009 was RM 7,600. Let us assume that the asset was disposed off in the basis period for year of assessment 2010 for RM 10,000. In this case the disposal value is more than the residual value by RM 2,400. In this case there will be a balancing charge raised by IRB of RM 2,400. This balancing charge is added to the Adjusted Income of the business. If on the other hand the asset was disposed off for RM 6,000, there is a difference between the disposal value and residual value of RM 1,600. This difference will be allowed as a balancing allowance and will be deducted from the Adjusted Income of the business.

Residual value (YA 2009)	7,600
YA 2010 Disposal value	<u>10,000</u>
Balancing Charge	2,400
Will be added to Adjusted Income	
Or,	
Residual value (2009)	7,600
YA 2010 Disposal value	<u>6,000</u>
Balancing Allowance	1,600
Will be deducted from Adjusted Income	

9.8 Example of Capital Allowances for Motor Vehicles

Motor vehicles present a little complication. The qualifying capital expenditure is restricted to either RM 50,000 or RM 100,000. However, vehicles used in commercial transportation of people or cargo such as vans, taxis, lorries and trucks are not restricted. They are based on actual capital expenditure incurred.

9.7.1 Motor Vehicles limited to a maximum of RM 50,000 capital allowances

1. Vehicles that are used or second-hand
2. Vehicles that cost more than RM 150,000

9.7.2 Motor Vehicles that qualify for a maximum of RM 100,000 capital allowances

1. New vehicles that cost less than RM 150,000.

9.7.3 Hire-purchase vehicles

Vehicles bought under hire-purchase presents some complications. Only capital expenditure incurred in each year of assessment is entitled to the allowances. Steps in computing the capital allowances:

1. Figure out the relevant basis period and the first year of assessment that the business is entitled to capital allowances.
2. Determine the qualifying capital expenditure for the first year of assessment. Usually this will be the Down payment paid and the capital portion of the instalments paid in the relevant year of assessment. The loan amount represents the capital portion.

Therefore a quick step is to divide the loan amount by the number of months to determine the capital portion of each instalment. Then the capital portion per instalment times the number of instalments in that basis period is used to calculate the capital expenditure for the particular year of assessment.

3. The interest portion is allowed as a normal revenue expense in the profit and Loss account. The total interest cost divided by the number of months will give the monthly interest portion.
Initial allowance is given each year for new capital expenditure incurred each year.
4. The annual allowances will continue to be given for the capital expenditure incurred each year until fully absorbed. It is best to keep each year's capital expenditure separate, so that initial and annual allowances are given appropriately.

9.7.4 Example of hire-purchase capital allowance computation

Let us say you buy a car for RM 120,000 under hire purchase. The interest rate is 4% and the term is 5 years. You make a down payment of RM 20,000. As a company your financial year-end is 30th of June. You make the purchase in January 2007, and the first instalment is in February 2007. Compute the capital allowances due for YA 2007, 2008 and 2009.

Steps in the process

1. Determine the st year of assessment the company is entitled to capital allowances and the maximum capital allowances due. This would be year of assessment 2007 as the capital expenditure was incurred within the basis period for YA 2007 and the maximum capital allowances due is RM 100,000 (new and below RM 150,000).
2. Determine the capital expenditure incurred for the basis period for YA2007. This would include the down payment of RM 20,000 and the capital portion of the instalments in the basis period for YA2007. This would be the loan amount of RM 100,000/60 months = RM 1,667. The number of instalments is 5 (February to June). Therefore the total capital expenditure is RM 20,000 plus 5 * 1,667 = RM 28,335.
3. Compute the capital allowances for YA2007 and the continuing capital allowances for the rest of the years until fully allowed on the capital expenditure incurred in YA2007.

YA2007	Qualifying Plant Expenditure	RM 28,335
	Initial Allowance 20%	5,667
	Annual allowance 20%	<u>5,667</u> <u>11,334</u>
	Residual Expenditure	17,001
YA2008	Annual allowance 20%	<u>5,667</u>
	Residual Expenditure	11,334
YA2009	Annual allowance	5,667
	Residual Expenditure	<u>5,667</u>
YA2010	Annual allowance	5,667
	Residual Expenditure	0

4. Compute the capital allowances on new capital expenditure incurred in the YA2008. The new capital expenditure is the 12 instalments in YA2008. Therefore total qualifying plant expenditure for YA2008 is 12 * 1,667 = 20,004.

YA2008 QPE	20,004
Initial allowance 20%	4,001
Annual allowance 20%	<u>4,001</u>
Residual expenditure	12,002
YA2009 Annual allowance	<u>4,001</u>
Residual expenditure	8,001
YA2010 Annual allowance	<u>4,001</u>
Residual expenditure	4,001
YA2011 Annual allowance	<u>4,001</u>
Residual expenditure	0

5. Compute the capital allowances on new capital expenditure incurred in the YA2009. The new capital expenditure is the 12 instalments in YA2009. Therefore total qualifying plant expenditure for YA2009 is $12 \times 1,667 = 20,004$

YA2009 QPE	20,004
Initial allowance 20%	4,001
Annual allowance 20%	<u>4,001</u>
Residual expenditure	12,002
YA2010 Annual allowance	<u>4,001</u>
Residual expenditure	8,001
YA2011 Annual allowance	<u>4,001</u>
Residual expenditure	4,001
YA2012 Annual allowance	<u>4,001</u>
Residual expenditure	0

6. To answer the question how much capital allowances were given for YA2007, 2008 and 2009 you have to add the capital allowances in the three respective years

YA2007 Total	11,334
YA2008 Total	5,667 + 8,002
YA2009 Total	5,667 + 4,001 + 8,002

7. The interest portion will be calculated on a simple interest basis. The rate of 4% is applied on RM 100,000 for the five years. Therefore the total interest charge is $100,000 \times 4\% \times 5 = 20,000$. The interest portion per month will be $20,000/60$ months = RM 333 per month. For YA2007 the interest expense that can be claimed in the Profit and Loss Account will be $5 \times 333 = 1,667$. For YA2008 it will $12 \times 333 = \text{RM } 3,996$.
8. The maximum capital allowances allowed is RM 100,000. Therefore the RM 100,000 capital expenditure will be reached in YA2011. In YA2011 out of the RM 20,004 new capital expenditure, RM 8,351 will be disallowed, as it would have crossed the RM 100,000 restriction limit.
9. Students have to realise that there will be no restriction in the case of commercial vehicles.

10. When there is a disposal and there has been a restriction to the capital expenditure, the disposal value is adjusted in the same ratio as the total qualifying expenditure allowed versus the total capital expenditure incurred. Assuming the vehicle is sold in the year of assessment 2012 for RM 40,000. In the computation of balancing charge or allowance the disposal value taken is $40,000 \times 100,000/120,000 = 33,333$. The residual value will be the sum of all the residual values as at the year of assessment prior to the disposal of the vehicle.

9.8 Industrial Building Allowances (IBA)

This is an allowance given in place of depreciation in respect of qualifying expenditure incurred on a building, which, must qualify as an industrial building. Governed by Schedule 3 of the Income Tax Act, it is treated in exactly the same way as Capital Allowance for Plant and Machinery and Agricultural Allowance although the manner of calculating the relevant amounts differs.

9.8.1 What is an Industrial Building?

Paragraphs 63 – 67 explain the various kinds of buildings that are viewed as Industrial buildings and these include buildings that are:

- a. Used as a factory;
- b. Used as a dock, wharf, jetty or similar building;
 - . Used as a warehouse where the business is that of letting storage space to the public;
- d. The business is that of a water, electricity or telecommunication undertaking;
- e. Used in connection with the working of a farm. (Such buildings will be given agricultural allowance rather than industrial building allowance);
- f. Used in connection with a mine. (The relevant buildings would qualify for mining allowance instead of industrial allowance).

9.8.2 A factory is further defined in Paragraph 64 as:

- a. A mill, workshop or other building for the housing of plant and machinery used in the manufacture or subjection of goods to any process or the generation of power used for such manufacture or processing.
- b. A building (within the same curtilage as the factory building) used for storing raw materials, fuels or stores.
- c. Canteen, rest room, recreation room and similar amenities used by employees in business where there is already a factory.
- d. Living quarters for employees.

From the above, **the following points must be borne in mind:**

- d. The activity of the business must be manufacturing or processing. Thus retail businesses or showrooms would not qualify. Similarly, motor service stations and workshops would not be eligible.
- e. "Within the same curtilage" means in the same area or in the same compound as the factory.
- f. Buildings that are for the benefit of directors, shareholders and administrative staff would not qualify for allowance. Those occupying or utilizing such buildings must be manufacturing or processing personnel (Paragraph 65 (1)).
- g. Where the non-qualifying portion of an industrial building is less than 10% of the total expenditure, industrial building allowance is available on the full qualifying expenditure. If more than 10%, the allowance is apportioned accordingly. (Paragraph 66).

9.8.3 Qualifying Building Expenditure

Examples of qualifying building expenditure are as follows :

- a. Site preparation – cutting, excavating, tunnelling, levelling, piling
- b. Architect's fees
- c. Cost of plans
- d. Building approval costs
- e. Site clearing, demolition of existing buildings
- f. Construction costs
- g. Drainage, instillation of utilities
- h. Installation of fittings

It must be observed that the cost of the land on which the industrial building itself stands is not qualifying expenditure. What can be included is the expenditure incurred in preparing the land for construction and the actual construction expenses. In addition, any expenditure incurred in renovation or altering the relevant building will also qualify for industrial building allowance.

Where the building is purchased, the stamp duty, legal fees, conversion fees and other incidental expenses can be included.

9.8.4 Initial Allowance

The initial allowance is generally 10% except in the case of a building constructed for employees' accommodation where the rate would be 40% (Paragraph 42 (1)).

The conditions for granting initial allowance are:

- a. The building was in use as an industrial building
- b. The relevant person owned the building at the end of the basis period.

9.8.5 Annual Allowance

Previously, there were different rates for industrial buildings depending on whether they were constructed or purchased. However, with effect from Year of Assessment 2002, the rates were made the same and their calculation, in the case of purchased buildings, were simplified. The annual allowance rate is 3% of the qualifying expenditure or purchase price. The previous basis for purchased buildings, called the „permitted fraction“, is still applicable if that method produces a higher allowance than that on the 3% basis.

9.8.6 Special Rates and Conditions

Certain special rates for selected buildings or other assets have been introduced, as follows:

- a. **Public Roads:** 3/50 of qualifying expenditure
- b. **Building for accommodation in the manufacturing industry :** 10% per annum (for both constructed and purchased buildings). No initial allowance is available.
- . **Child care facilities and schools :** 10% per annum and no initial allowance

9.8.7 Example

Expenses Incurred: 2003		Industrial Building Allowance			
Cost of land	2,400,000	Qualifying Expenditure			4,270,000
Levelling	300,000	YA 2003	IA (10%)	427,000	
Building plans	40,000		AA (3%)	<u>128,100</u>	555,100
Architect's fees	70,000				3,714,900
Utilities	160,000	YA 2004	Annual Allowance		128,100
Construction	<u>3,700,000</u>				3,586,800
TOTAL	6,670,000	YA 2005	Annual Allowance		128,100
					3,458,700

9.9 Agriculture Allowance

This is another allowance granted by Schedule 3 of the Income Tax Act and is in respect of all "agricultural activities". "Agriculture" has been defined to mean "any form of cultivation of crops, animal farming, aquaculture, inland fishing, and any other agricultural or pastoral pursuit". It must be remembered that „planting“ expenses being „new or initial“ in nature would not be deductions allowable under Section 34 of the Act. Instead, they would qualify for Agriculture Allowances.

9.9.1 Qualifying Agriculture Expenditure

Paragraph 7 of Schedule 3 lists the qualifying agricultural expenditure to be capital expenditure on :

- Clearing and preparation of land for agriculture
- Planting of crops on land cleared for agriculture
- Construction on a farm of a road or bridge
- Construction on a farm of buildings like smoke houses or estate office used for the purposes of the agriculture business
- Buildings for the welfare or accommodation of employees
- Any capital expenditure approved by the Minister
- W.e.f. Year of Assessment 2004, any qualifying expenditure prescribed by the Minister

9.9.2 Rates of Agriculture Allowance

Type of Expenditure	% Rate	Paragraph
Clearing land	50	23
Planting crops	50	23
Construction of roads/bridges	50	23
Buildings for staff welfare	20	22(a)
Other buildings	10	22(b)

From the above it will be realized that Initial Allowances are not applicable where agriculture allowances are concerned. Only Annual Allowances will be granted, for 2, 5 or 10 years as the case may be.

Just as in other Schedule 3 allowances, the conditions for granting agriculture allowances are

- a. The asset was owned by the relevant person at the end of the basis period
- b. The asset was used for the purposes of the business

9.9.3 Example

In the year 2002, Green World Bhd, incurred the following expenditure on its estate:			
a. Clearing land		RM 1,680,000	
b. Planting crops		RM 2,430,000	
c. Building for workers' accommodation		RM 460,000	
Agriculture Allowance			
	<u>Clearingland</u>	<u>Plantingcrops</u>	<u>Livingquarters</u>
Q. Expd.	<u>1,680,000</u>	<u>2,430,000</u>	<u>460,000</u>
YA 2002	840,000	1,215,000	92,000
YA 2003	840,000	1,215,000	92,000
YA 2004	Nil	Nil	92,000
YA 2005	Nil	Nil	92,000
YA 2006	Nil	Nil	92,000

9.9.4 Agriculture Charges

Such charges would arise under either of the following occurring :

- a. The receipt of grants or subsidies. The government usually gives these and the quantum would depend on production or the area under cultivation.
- b. The disposal of an asset on which agriculture allowance had been granted. The disposal price does not matter at all; the mere fact that the asset has been disposed of will lead to all the agriculture allowances previously given being withdrawn through the agriculture charge.

Needless to say, the sale or disposal of the entire estate could also result in agriculture charges being applicable. Previously, agriculture charges would arise if disposal were within 10 years of the expenditure being incurred. However, from Year of Assessment 2004, the relevant period has been reduced to 6 years to coincide with Section 91(1) – the authority to raise assessments or additional assessments within 6 years.

Example:

On 22 June 1998, Akshi Estate Sdn Bhd constructed a smoke house costing RM 220,000 and staff quarters costing RM 380,000. The smoke house was demolished on 18 August 2004 and the "scrap material" sold for RM 24,000. The staff quarters were demolished on 26 September 2003 and the waste material sold RM 58,000.

	Smoke House	Staff Quarters
Qualifying expenditure	220,000	380,000
Expenditure incurred on	22 June 1998	22 June 1998
Disposal date	18 August 2004	26 September 2003
Agriculture Allowances given	132,000	380,000
Agriculture charge	Nil	380,000

In computing the agricultural charge, the sale proceeds are not taken into account. As long as the asset is disposed off within 6 years, an agriculture charge would apply.

9.10 Putting it all together

Capital Allowances, Losses & Income Tax Computations

The treatment of Capital Allowances and Losses in an Income Tax Computation follows a set sequence and ultimately results in Chargeable Income. A simplified sequence from Gross Income to Chargeable Income would be as follows :

COMPUTATION SEQUENCE

	Gross Income from Business		xxxxx
Add	Non-allowable items	xxxx	
Deduct	Non-assessable items	<u>xxxx</u>	<u>xxxx</u>
	Adjusted Income		xxxxx
Add	Balancing Charge		<u>xxxx</u>
			xxxxx
Deduct	Capital Allowance		xxxx
	Statutory Income		xxxxx
Add	Statutory Income from other business sources		<u>xxxxx</u>
			xxxxx
Deduct	Losses brought forward [Sec. 43(2)]		<u>xxxx</u>
			xxxxx
Add	Income from non-business sources		<u>xxxxx</u>
	Aggregate Income		xxxxx
Deduct	Basis Year Losses [Sec. 44(2)]		<u>xxxx</u>
			xxxxx
Deduct	Donations		<u>xxxx</u>
	Total Income		xxxxx
Deduct	Personal relief		<u>xxxx</u>
	Chargeable Income		<u>xxxxx</u>
	Tax charged		BBBBB
Deduct	Rebates		<u>BBBB</u>
			BBBBB
Deduct	Section 110 set off		<u>BBBB</u>
	TAX PAYABLE/REPAYABLE		BBBBB

9.11 Summary of Points to note

- Capital Allowances can be deducted only if there is adjusted income derived from the source in which the relevant assets were used. **Adjusted Income less Capital Allowance results in Statutory Income.**

- b. Where there is no or insufficient adjusted income, the (excess) capital allowance must be carried forward to the following year of assessment to be set-off against Adjusted income from the same source. It cannot be deducted from Adjusted Income of another business source. The amount carried forward will be added to the capital allowance available for the following year and deducted from the adjusted income. See Example..

Example

Business A		Business B	
Adjusted Income	90,400	Adjusted Income	47,300
Capital Allowance	20,700	Capital Allowance	55,900
Statutory Income	69,700	Statutory Income	Nil
		Capital Allowance c/f to next year to be set-off against Business B income	8,600

Losses brought forward [Sec. 43(2)] can be set off only against income from business sources. The loss brought forward is set off against the aggregate of statutory income from business sources. This means that where there is statutory income from more than one business source, such income must be aggregated (added up) and then the brought forward loss, is set off against this total. If there is insufficient business income to fully absorb such losses b/f, the losses must be carried forward again. Section 43(2) loss is only allowed at this specific step or place.

- d Basis year losses [Sec. 44(2)] can be set off against income from all sources. The statutory income from all sources (business and non business) is aggregated (after losses brought forward have been accounted for) and the basis year loss is deducted from this Aggregate Income. If any part of the basis year losses is not absorbed, it is carried forward, and becomes a Section 43(2) b/f loss as in Paragraph c above.
- e. Donations are deducted from Aggregate Income to arrive at Total Income. However, donations must be deducted after basis year losses have been accounted for. If there is not enough income to fully absorb the donation, any “excess” donation cannot be carried forward and is lost. It is only “approved donations” that are allowable.

9.11.1 Comprehensive Example 1

Ramli's summary of income for 2004 is as follows :			
1. Business A: Adjusted Income	47,400	3. Business C: Adjusted Income	13,700
Capital Allowance	13,200	Capital Allowance	16,800
2. Business B: Adjusted Loss	(11,600)	4. Adjusted Rent	26,300
Capital Allowance	2,800		
		Donation	4,000
INCOME TAX COMPUTATION			
1. Business A (Adjusted Income)		47,400	
Deduct: Capital Allowance		<u>13,200</u>	

Statutory income			34,200
2. Business B (Adjusted Income)	Loss (11,600)	NIL	
Capital Allowance c/f		2,800	
Statutory Income			NIL
3. Business C (Adjusted Income)		13,700	
Deduct: Capital Allowance		<u>16,800</u>	
Capital Allowance c/f		(3,100)	
Statutory Income			NIL
4. Rent			26,300
AGGREGATE INCOME			60,500
Deduct : Basis Year Loss			(11,600)
			48,900
Deduct : Donation			<u>4,000</u>
TOTAL INCOME			44,900

9.11.2 Comprehensive Example 2:

Daniel's summary of income for 2003 and 2004 is as follows:			
2003			
1. Business A : Adjusted Income	21,000	2. Business B: Adjusted Loss	(78,600)
Capital Allowance	6,200	Capital Allowance	14,800
3. Employment	48,000	Donation	3,600
2004			
1. Business A: Adjusted Income	11,700	2. Business B: Adjusted Loss	(9,800)
Capital Allowance	4,100	Capital Allowance	8,500
3. Employment	48,000	Donation	2,800
INCOME TAX COMPUTATION : YA 2003			
1. Business A: Adjusted Income		21,000	
Deduct : Capital Allowance		<u>6,200</u>	
Statutory Income			14,800
2. Business B: Adjusted Income	Loss	(78,600)	NIL
Capital Allowance c/f		14,800	
Statutory Income			NIL
3. Employment			<u>48,000</u>
AGGREGATE INCOME			62,800
Deduct: Basis Year Loss			(78,600)
TOTAL INCOME			Nil
Loss carried forward	(15,800)		
INCOME TAX COMPUTATION : YA 2004			
1. Business A Adjusted Income		11,700	
Deduct : Capital Allowance		<u>4,100</u>	
Statutory Income			7,400
2. Business B Adjusted Income	Loss	(9,800)	NIL
Capital Allowance b/f	14,800		
Capital Allowance 2004	<u>8,500</u>		
Capital Allowance c/f	23,300		
AGGREGATE of BUSINESS INCOME			7,400

Deduct : Loss b/f			<u>15,800</u>
Loss c/f to next year	(8,400)		Nil
3. Employment			48,000
AGGREGATE INCOME			48,000
Deduct: Basis Year Loss			9,800
			38,200
Deduct: Donation			2,800
TOTAL INCOME			35,400

9.12 Further Notes

If capital allowances brought forward are available to a person but the relevant source has ceased, such allowances will be „lost“ since there would not be any more adjusted income against which the capital allowances could be set off.

Example

Year of Assessment 2004	
Adjusted Income	54,000
Deduct: Capital Allowance	67,000
Statutory Income	Nil
	Sources ceases
Capital Allowance c/f 13,000	
The capital allowance of 13,000 cannot be utilized in future as the relevant source has ceased	

- 9.12.1** The position would be quite similar where losses carried forward are concerned. Should the person no longer have any business source, the losses brought forward cannot be utilized even if the person derives income from non-business sources. This is because losses brought forward can be set off against income from business sources only.

Example

Year of Assessment 2004	
Loss brought forward	23,000
1. Dividend	17,000
2. Rent	21,000
AGGREGATE/TOTAL INCOME	38,000
The loss brought forward cannot be used, as there is no business income against which it can be set off. Should the person later commence a new business, any income from this source can then utilize the losses b/f.	

9.13 Conclusion

The chapter has discussed different aspects of Business Taxation - Computation of Statutory Income. Among the points discussed are: Introduction to Capital Allowance, Qualifying Capital Expenditure, The first year of assessment that one can claim Capital Allowance, Schedule 3 – two basic types of allowance, Rate of Allowance, Example of Capital Allowance for plant and machinery, Disposal of Asset, Example of Capital Allowance for Motor Vehicles, Industrial Building Allowance (IBA), Agriculture Allowance, Putting it all together. The different aspects have been explained to provide a comprehensive knowledge on computation of statutory income.

Self Assessment

Q1 Information is provided as follows:

Year-end Balance Sheet 31.12.2007

Assets

Plant and Mach.	84,150
Motor Vehicles	144,769
Computer	50,000
	278,919
Less: Depreciation	45,876
	226,043

(a) The written-down value of assets as at 31.12.2006 is:

Plant and Machinery	: RM 75,150
Motor Vehicles	: RM 144,769

(b) The (tax) residual expenditure after Y/A 2006 and cost are :

Plant and Machinery	: (14%) RM 72,500
Cost: RM 145,000	
Motor Vehicles (6)	: (20%) RM 124,800
Cost: RM 260,000	

(c) On 7.4.2007, a computer costing RM 38,000 was bought on hire-purchase. A deposit of RM 8,000 was paid with interest of RM 12,000 due on the balance, through 48 instalments payable at the end of each relevant month, starting in May of the year 2007. HP interest has been capitalised. Annual allowance rate for computers is 40%.

Suggested Answer

A1 First step is to identify new and old assets and collate information available.

Assets: as at 31.12.2006

Asset	Cost	Written Down Value 2006	Residual Expenditure	Capital Allowance Rate
Plant/Machinery	145,000	75,150	72,500	14%
Motor vehicles	260,000	144,769	124,800	20%

Assets: as at 31.12.2007

Asset	Cost	Written Down Value 2006	Residual Expenditure	Capital Allowance Rate
Plant/Machinery	145,000 + 9,000	84,150 (see workings)	58,140	14%
Motor vehicles	260,000	144,769	99,840	20%
Computer	38,000	?	?	40%

Plant/machinery

Old Plant/Machinery

Cost: 145,000

Residual expenditure b/f: 72,500

Annual allowance (14% of cost) = 20,300

Residual exp c/f: 52,200

New Plant/Machinery

Cost: 9,000

Initial Allowance: (20%) = 1,800

Annual Allowance: (14%) = 1,260

Residual exp. c/f: 5,940

Motor Vehicles

Cost: 260,000

Residual exp. b/f: 124,800

Annual allowance: (20% of cost) = 24,960

Residual exp. c/f: 99,840

Computers

Qualifying cost does not include Hire

Purchase interest cost

Therefore Qualifying expenditure would be

Down Payment of 8,000 and capital cost of each instalment

Number of instalments in YA 2007 = May to Dec. = 8 months

Capital cost of each instalment: 30,000 / 48 = 625

Therefore for YA 2007

Qualifying Plant expenditure = 8,000 + 5,000 = 13,000

Initial Allowance (20% of cost) = 2,600

Annual allowance (40% of cost) = 5,200

Total allowance due for YA 2007 = 7,800

Residual Exp. = 5,200.

Note: In the following year the old qualifying expenditure of 13,000 will receive the annual allowance and the new instalments will receive both the Initial allowance and the annual allowance.

Chapter 10

Taxation of Individuals

Chapter Outline:

- 10.1 Introduction
- 10.2 Aggregate of Husband's and Wife Income (Section 45)
- 10.3 Format For Individual Tax Computation
- 10.4 Contract of Service or Contract for Service
- 10.5 Computation of Chargeable Income for an individual
- 10.6 Personal Relief
 - 10.6.1 Section 45A. Deduction for Husband
 - 10.6.2 Section 46. Deduction for Individual and Hindu joint family
 - 10.6.3 Section 47. Deduction for wife or former wife
 - 10.6.4 Section 48. Deduction for children
 - 10.6.5 Section 49. Deduction for insurance planning
- 10.7 Personal relief
- 10.8 Conclusion

Chapter Objectives

Students must be able to

- View the final picture of putting all the income together and computing the Chargeable Income
- Understand how husband and wife's income is aggregated at the Total Income stage
- Appreciate the advantage of Separate assessment
- Differentiate a contract of service and contract for service tax treatment
- Enumerate all the personal relief available to an individual and his /her family
- Understand the tax rebates available to resident individuals
- Use the tax rates in Schedule 1 and compute the tax payable

10.1 Introduction

Where an individual is married, his wife's income is assessed under her name unless she elects for combined assessment. Separate assessment is more advantageous as both receive personal relief and the income splitting will result in lower taxes because of scale rates of taxation.

10.2 Aggregate of Husband's and Wife's Income (Section 45)

Where an individual and his wife were living together and did not cease to live together or to be husband and wife of each other, then his wife may elect in writing before 1st April in the year of assessment or any subsequent date, that **her total income shall be aggregated with the total income (if any) of her husband.**

Where a wife is **non-resident** for the basis year of a year of assessment, she may elect for combined assessment only if she is a **citizen**

10.3 Format for Individual Tax Computation

STATUTORY INCOME	Husband	Wife	Reference
Business I	A	-	Note
Business II	B	C	Note
Partnership	E	-	Note 2
Aggregate Statutory Business Income	<u>F</u>	G	
Less: Unabsorbed Loss B/F - Section 43(2)	H	I	Note 3
Net Aggregate Statutory Business Income	<u>J</u>	K	
Employment	-	L	Note 4
Dividend (Gross)	M	N	Note 5
Interest	Nil	Nil	Sec 5(1) & 109C
Rent	O	P	Note 6
Pension - Optional	Q	R	Note 7
Remittance	S	T	Note 8
Aggregate Income	<u>U</u>	V	
Less: Adjusted Loss	W	W1	Sec 44(2)
Approved Donation	X	-Y1	Sec 44(6)
Total Income	<u>Z</u>	<u>AA</u>	Note 9
Less: Deduction	AB	AC	Note 10
Chargeable Income	<u>AD</u>	<u>AE</u>	

Where Section 45(2) [combined assessment] is elected (only applies where the individual's wife is either a resident or a citizen), the chargeable income of the individual shall be:-

Total Income of Husband	Z
Total Income of Wife	AA
Aggregate Total Income of Husband & Wife	AF
Less: Deductions under Sections 46 to 49	AG
CHARGEABLE INCOME	AH

Notes

1. The Statutory Business Income:

Adjusted Income, if any	a*
Add: Balancing Charges	b
	<hr/>
	c
Less: Schedule 3 Allowances	(d)
	<hr/>
STATUTORY INCOME	<hr/> <hr/>

*This should be Nil should there be an adjusted loss instead of an income. Adjusted loss is used to reduce the Aggregate Income in arriving at the Total Income of a person.

2. The Statutory Income from a partnership is: -

Divisible Income/(Loss)	f
Salary, Allowances, Interest on capital	g
	<hr/>
Adjusted Income/(Loss)	h*
Less: Capital Allowances	(i)
	<hr/>
STATUTORY INCOME	<hr/> <hr/>

- Should there be an adjusted loss, there is a set-off from the Aggregate Income. The amount of capital allowances of "i" will be carried forward.

3. The unabsorbed business loss is allowed against the Aggregate of Statutory Income from Business, and not just the Statutory Income of that particular business source.

4. Employment Income**Section 13(1)(a)**

Salary, Bonus, Fees, etc

a

Section 13(1)(b)

Benefits in Kind

b

Section 13(1)(c)Value of assessable accommodation 30% of 13(1)(a) or Defined Value (unfurnished accommodation) whichever is lower **Section**

c

13(1)(d)

Unapproved Fund - Employer's Portion

d

Section 13(1)(e)

Compensation (after Schedule 6 exemption)

e

GROSS EMPLOYMENT INCOME

f

Less: Subscription

g

Rental Paid (restricted to c)

h

Claims against allowances received

i

(j)

STATUTORY INCOME

k

1. In case of accommodation provided in a hotel, it shall be 3% of Section 13(1)(a).

5. Dividend

Gross Dividend (Net Dividend x 100/73)

a

Less: Section 33(1) Deductions, for example Interest

(b)

STATUTORY INCOME

c

Note: This feature will disappear from YA2008 when the single tier company tax system is introduced and dividends are not taxed on individuals.

6. Rent

This refers to the adjusted income of each property. Adjusted Loss of property A cannot be used to set-off against Adjusted Income of property B, unless they are grouped under the same category of usage according to the IRB Public Rulings or based on existing case laws.

7 Pension

Pension may be exempted if the conditions under Schedule 6 are satisfied.

8. Remittance

This is no longer taxable on individuals.

9. Separate Taxation

The wife's income is assessed in her name and would not be aggregated with the total income of her husband unless an election under Section 45(2) is made.

10.4 Contract of Service or Contract for Services

Where a person receives income from a contract entered into, the income can be a contract of service or a contract for services.

Where it is a contract of service, the income shall be assessable as an employment source of income. If the contract is one for services rendered, then the income shall be assessed as a business source of income. In this respect self-employed people would fall into the category of business providing services. Agents sign a contract for services. Therefore they should register themselves as a business.

The following may be used as a broad guideline as to whether the contract is one of services (employment) or for services (business):

- a) Master and Servant relationship.
- b) Extent of control by the employer as to how the work is to be performed and the manner it is to be done.
- c) Defined hours of work.
- d) Provision of own tools and equipment in the performance of work would indicate the contract is one for services rather than of services.
- e) Restriction to contract with other parties may indicate it is a contract of services rather than for services.

While with a tied agency system there can be reasons to regard it as a contract of service to one company, there are however, more facts that support it as a business. For example a purely commission based income and the agent choosing who he sees and what level of activity he chooses.

10.5 Computation of Chargeable Income for an individual

Personal Relief is deducted from total income to arrive at an individual's chargeable income for the basis year for a year of assessment. Personal relief is only available to individuals who are resident in Malaysia. We will examine personal relief in detail below.

10.6 Personal Relief

10.5.1 Section 45A. Deduction for husband

It has usually been a relief for wife of RM 3,000. Today a wife can get a deduction or relief for husband of the same amount of RM 3,000. IRB practices neutral gender. The IRB recognizes a situation of housewife or househusband. The relief is RM 3,000 for the husband plus a further relief of RM 3,500 if he is disabled. Only one wife can claim husband relief.

10.5.2 Section 46. Deduction for individual and Hindu joint family

Under this section the following relief or deductions are available.

1. Relief in respect of self (taxpayer) and dependents of **RM 8,000**
 - a) Medical expenses on parents – **RM 5,000** maximum. Must be evidenced by receipt by a medical practitioner.
 - b) Basic supporting equipment for disabled person, spouse, child or parent maximum **RM 5,000**

- c) A further relief of **RM 6,000** for disabled taxpayer
- d) Fees expended on course of study up to tertiary level in any institution or professional body in Malaysia recognized by the government or the minister for the purpose of acquiring law, accounting, Islamic financing, technical, vocational, industrial, scientific or technological skills or qualifications. Amount limited to **RM 5,000**.
- e) An amount limited to **RM 5,000** for medical expenses expended on himself, wife or child for serious diseases. Must be evidenced by receipt and certification by medical practitioner.
- f) Complete Medical examination expenses of up to **RM 500** for self, spouse or child but this is part of the expenses allowed under the serious illness category mentioned in (6) above, that is limited to RM 5,000.
- g) An amount limited to **RM 1,000** in respect of expenses for the purchase of books, journals, magazines and other similar publications for the purpose of enhancing knowledge for his own use, spouse or child. Must be evidenced by receipts.

Section 46(2) defines child and serious diseases, which includes Aids, Parkinson's disease, cancer, renal failure, leukaemia and other similar diseases.

Section 46(3) states that expenditure of the husband or the wife will be treated as expended by either one.

Section 46A was a deduction for **interest on a residential mortgage**. Deduction for interest expense on residential property is mentioned in the mini budget 2009, with effect from year 2009. The tax relief on interest is up to RM10,000.

10.5.3 Section 47. Deduction for wife or former wife

Under this section relief for wife is given. The relief is RM 3,000 and a further relief of RM 3,500 is given if she is a disabled person. Alimony payments to former wives qualify for relief but it is within the maximum limit allowed under this section of RM 3,000 for a wife. If the wife is assessed separately there will be no wife relief given under this section. However, if there is no Total Income to be aggregated with the husband's then the relief for wife of RM 3,000 can be given. .

In short where separate assessment is involved no wife or husband relief is given.

10.5.4 Section 48. Deduction for children

Where an individual is resident for the basis year he will be entitled to child relief.

The categories:

1st category is for children who are unmarried and below the age of 18.

2nd category is for children, unmarried who are receiving full time instruction at any university, college, school or other similar educational establishment

3rd category is for children, unmarried who are serving under articles or indentures with a view to qualifying in a trade or profession including a part-time education in that trade or profession

4th category is for an unmarried child who is physically or mentally disabled.

The relief is as follows:

1st category **RM 1,000** for each child

4th category **RM 5,000** for each child

2nd and 3rd category the allowance is increased to four times the relief entitlement, i.e. RM 4,000 instead of RM 1,000. They meet the over 18 and tertiary education conditions. In the case of a disabled child receiving full time instruction and above 18 there is an

additional relief of RM 4,000 to the RM 5,000, making it a total of RM 9,000. In the case of overseas education the relief is only available for degree level courses (including Master's and doctorates).

Under **Section 48(4)** where two or more individuals are entitled to claim child relief there will be allowed for each claimant a reduced deduction of fifty percent of the whole deduction. Therefore if a child is maintained by husband, wife and a former husband there will be allowed 50% of child relief for each one of them, giving a total of more than 100%.

Under **Section 48(5)**, if any child has Total Income that exceeds the deduction available to an individual parent then the deduction would not be allowed.

Section 48(9) In this section "child", in relation to an individual or his wife, means a legitimate child or stepchild of his or his wife, or a child proved to the satisfaction of the Director General to have been adopted by the individual or his wife in accordance with any law.

10.5.5 Section 49. Deduction for insurance premiums

Deductions for insurance premiums fall under this section. The individual must be resident for that basis year for a year of assessment to claim the relief.

The categories of insurance premiums or payments that qualify are as follows:

Section 49 (1) (a) Premium paid for any insurance or deferred annuity. The insurance and takaful with regards to the premium or contribution have the same treatment. According to Section 18 "insurance" includes a takaful scheme pursuant to the IFSA 2013 [Act 759]. Under the same section "premiums", in relation to insurance, includes contributions or instalments payable under a takaful scheme pursuant to the IFSA 2013.

Section 49 (1) (b) .As an employee or as self-employed person, contributions made to the Employees Provident Fund or any approved scheme.

Section 49 (1) (c) Contributions to a widows and orphans pensions or an approved scheme.

The total for all payments and contributions under Section 49(1) is an aggregate limit of **RM 6,000**.

Under **Section 49(1B)**, premium for insurance on education or for medical benefits is allowed up to a limit of **RM 3,000**

Under **Section 49(1C)**, premiums paid for insurance policy (deferred annuities) purchased through the Employee Provident Fund up to a total deduction of **RM 1,000**

Section 49(2) states that the **contributions must be obligatory** under a contract of employment or under rules of the approved scheme. Therefore contributions by employer's that exceed the required 12% contribution under the EPF Act must be contracted for.

Section 49(3) qualifies the type of insurance that is claimable. It must be:

- a. be on the **individual's life**
- b. be on the **life of a wife** of the individual or the life of the husband of the individual
- on **the joint lives** of the individual, and a wife or wives of his or in the case of a female on the life of the individual and her husband, or the individual, husband and one of the wives and the insurance or deferred annuity is for securing on death either a capital sum or a deferred annuity or both or an insurance or deferred annuity contracted for with a government or public body.

For the **insurance policy on education or medical** the contract can be on **himself, his wife or child** or in the case of the wife on **herself, her husband or child**.

Section 50 states that payments made by husband or wife can be treated as paid by each other only if they do not cease to live together.

Section 51 states that these **deductions must be claimed** for in each year of assessment

Illustrations on Personal Relief

ILLUSTRATION 1

Francis is married and provides you with the following income for the basis year 2007.

		Employment Income:
Self		RM 19,000
Wife		RM 13,000
EPF contributed by		
Self	RM 1,710	
Wife	RM 1,170	

Francis incurred RM 6,500 medical expenses for his parent.

Compute the Chargeable Income for Francis and his wife for the Year of Assessment 2007 assuming that election under Section 45(2) is not made.

Francis Income Tax Computation Year of Assessment 2007

	Self RM	Wife RM
Statutory Income		
Employment	19,000	13,000
Total Income	19,000	13,000
Less:		
Personal Deductions		
Personal relief	8,000	8,000
Medical expenses [Max]	5,000	-
EPF	1,710	1,170
	14,710	9,170
Chargeable Income	4,290	3,830

ILLUSTRATION 2

Frank, a disabled bachelor, received rental income (statutory income) of RM 24,000 for the basis year 2007. He purchased a medical supporting equipment of RM 6,500 during the year.

Compute the Chargeable Income for Y/A 2007.

Frank
Tax Computation
Year of Assessment 2007

		RM
Rental		24,000
		<hr/>
Total Income		24,000
Personal Relief	8,000	
Disabled Person	5,000	
Basic supporting equipment (max)	5,000*	
	<hr/>	
		18,000
		<hr/>
Chargeable Income		<u>6,000</u>

ILLUSTRATION 3

Farid and his wife Fatimah were married in the basis year 2001. They were legally divorced on 1 July 2007. They received the following incomes for the basis year 2007.

Employment Income

Farid	RM 30,000
Fatimah	RM 20,000

Compute the Chargeable Income for Farid and his wife for the Year of Assessment 2007.

FARID
Income Tax Computation
Year of Assessment 2003

Statutory Income	RM	RM
Employment		30,000
Total Income		30,000
Less: Personal Deductions		
Personal relief	8,000	
Wife relief	3,000	
EPF (assume 11%)	3,300	14,300
Chargeable Income		15,700

FATIMAH
Income Tax Computation
Year of Assessment 2003

Statutory Income	RM
Employment	20,000
Total Income	20,000
Less: Personal Deductions	
Personal relief	8,000
EPF (assume 11%)	2,200
Chargeable Income	9,800

ILLUSTRATION 4

Chong paid to his former wife whom he divorced in 2006 an alimony payment of RM 8,000 during the year ended 31 December 2007. He received the following incomes during the basis year 2007. Chong has not remarried since the separation from his former wife. .

Business - Adjusted Income	RM 70,000
Interest (Net of Tax)	RM 1,000
Dividend (Gross)	RM 4,000

Chong's ex-wife has no other income except the alimony she received from him. Compute the Chargeable Income for Chong for the YA2007.

CHONG
Income Tax Computation
Year of Assessment 2007

Statutory Income	RM	RM
Business		70,000
Interest		NIL
Dividend		4,000
Total Income		74,000
Less: Personal Deductions		
Personal relief	8,000	
Alimony payment of RM 8,000		
Restricted to	3,000	11,000
Chargeable Income		63,000

*Alimony payment and / or wife relief combined must not exceed RM 3,000

ILLUSTRATION 5

Mr Teh is married and provides the following information for the basis year 2007.

a)	Income	RM
i)	Employment	20,000
ii)	Interest	exempted
iii)	Rent	20,000
b)	Payments	
i)	Eldest son, aged 33, unmarried, studying at the University of Melbourne since 1996	RM 6,000
ii)	Third child, aged 24, unmarried, studying at the University of Birmingham since 1 March 2003	RM 8,000

The particulars of Mr Teh's other children are:

- a) Second child, unmarried, aged 27, studying at the University of Singapore since 10/10/2000
- b) Fourth child, aged 20 is disabled
- c) Fifth child aged 19, unmarried, an article clerk
Received salary of RM 5,800 for the basis year 2007
- d) Sixth child aged 15, unmarried, staying at home
- e) Seventh child aged 12, unmarried, studying in Maxwell School.

Determine the child relief that Mr Teh can claim and also compute his Chargeable Income for the Year of Assessment 2007.

Mr Teh
Income Tax Computation
Year of Assessment 2007

Statutory Income	RM	RM
Employment		20,000
Interest		exempted
Rent		<u>20,000</u>
Total Income		40,000
Less: Personal		
Deductions Personal relief	8,000	
Wife relief	3,000	
Child relief (note)	19,000	
EPF (assume 11%)	2,200	32,200
Chargeable Income		7,800

Note: Child relief is arrived as follows:

<u>Child No</u>	<u>Relief Given</u> <u>Y/A 2007</u>
	RM
1	4,000
2	4,000
3	4,000
4	5,000
5	NIL
6	1,000
7	<u>1,000</u>
	<u>19,000</u>

ILLUSTRATION 6

Ali has the following income for the basis year 2007.

a)	Employment Income	RM 20,000
	Less: EPF contribution	RM 2,200
	Amount received by Ali	RM 17,800
b)	Interest (net)	RM 3,900
c)	Rent	RM 6,000

He is unmarried for the basis year 2007 and has paid the following life insurance premiums:

- a) RM 3,000 for Policy A
- b) RM 1,200 for Policy B

Ali made contributions to an unapproved fund of RM 400 during the basis year 2007.

Compute his Chargeable Income for Y/A 2007.

ALI

Income Tax Computation **Year of Assessment 2007**

Statutory Income	RM	RM
Employment		20,000
Interest		NIL
Rent		6,000
Total Income		26,000
Less: Personal Deductions		
Personal relief	8,000	
EPF and Life Insurance	<u>5,000</u>	<u>13,000</u>
Chargeable Income		<u>13,000</u>

Workings:

i)	Life Insurance relief	
	Premium Paid	RM
a)	Policy A	3,000
b)	Policy B	1,200
ii)	EPF contribution	2,200
iii)	Unapproved contribution	NIL
		6,400
	Restricted to	<u>5,000</u>

ILLUSTRATION 7

Ahmad is married with two children age 14 and 16 for the basis year 2007. Details of income and expenditure/relief for 2007 are as follows:

	Ahmad	Fatimah (Wife)
	RM	RM
Total Income	40,000	2,000
EPF and Life Insurance	6,000	4,000

Assuming that Fatimah elects for joint assessment under Section 45(2).

	RM	RM
Total Income		42,000
Personal Relief	8,000	
Wife Relief	3,000	
Child Relief	2,000	
EPF & Life Insurance	<u>5,000</u>	<u>18,000</u>
Chargeable Income		<u>24,000</u>

ILLUSTRATION 8

Alex takes home a monthly salary of RM 2,670, after an 11% deduction for EPF. He has taken the following insurance policies:

Person insured	Premium p.a.	Medical	Education
	Life		
a) Alex	950		
b) Alex & Son	140		
c) Wife	200	2,074	
d) Alex, wife & son	250	556	
e) Daughter			500

He also paid a premium of RM 1,250 on an approved EPF annuity scheme.

Solution

Alex would be able to claim the following relief:

	Restricted Claim (RM)
EPF $\frac{2,670}{89} \times 11 \times 12$	= 3,960
Policies	
a) 950	950
b) 140	NIL (not qualifying)
c) $200 + 2,074 = 2,274$	2,164 (life 90 + medical 2,074)
d) $250 + 556 = 806$	556 (only medical qualifies)
e) 500	370 (130 has exceeded the limit)
EPF annuity scheme	<u>1,000</u>
	<u>9,000</u>

10.7 Tax Rebate

An individual resident for the basis year for a year of assessment will be granted a rebate of the following amounts:

a) Individual	350
b) Spouse	350

The above rebates are only available to tax payers having a chargeable income not exceeding RM 35,000.

In the case of a separate assessment, each party is entitled to claim a tax rebate of RM 350 provided that their individual chargeable income does not exceed RM 35,000. However, if the husband qualifies for wife relief, he also qualifies to claim a RM 350 rebate in respect of the spouse.

For joint assessment, the assessed party is entitled to claim a tax rebate of RM 350 in respect of itself and a further tax rebate of RM 350 in respect of the spouse provided that the chargeable income of the assessed party does not exceed RM 35,000

In the case of *zakat fitrah* and Islamic dues, a rebate shall be granted for a year of assessment for payment, which is obligatory and is paid during the basis year for a year of assessment. The amount paid has to be evidenced by a receipt issued by an appropriate religious authority in order to be considered for a rebate.

Example

Henry's chargeable Income for Y/A 2007 is RM 20,000. He is married and his wife opts for joint assessment. The amount of rebate he is entitled to for Y/A 2007 shall be:

	RM	RM
Income tax at scale rates		475
Less: Rebates		
Individual	350	
Wife	<u>350</u>	(700)
Income tax charged		<u>Nil</u>

Note

1. The tax will not be Nil if Henry's wife's income is assessed separately. The tax payable will be RM 125.
2. The amount allowable is restricted to income tax charged. Any amount unutilised will not be carried forward or given as a refund.
3. If Henry's chargeable income for Y/A 2007 is RM 40,000 and his wife's chargeable income for Y/A 2007 is RM 8,000, the amount of rebate shall be as follows:

	Henry	Wife
Income Tax at scale rates	2,175	115
Less: Rebate	NIL *	(350)
Income tax charged	2,175	Nil
Less: Section 110 set-off	(NA)	(NA)
Section 132/133	(NA)	(NA)
Relief		
Tax Payable/(Repayable)	2,175l	(Nil)

* No rebate is given if the chargeable income exceeded RM 35,000.

CASE STUDY 1

Joseph retired from ABC Sdn Bhd on July 31, 2007 at the age of 50 due to ill health after having worked with the company for 15 1/2 years. He received a gratuity of RM 77,500 which he used to start a bookshop business on September 1, 2007. His wife teaches at a kindergarten.

They have two children, Gerald who is studying accountancy since 1999 at the University of Malaysia Sarawak on scholarship which pays for his fees and living expenses, and Grace Age 16, studying at a secondary school in Singapore.

Joseph has provided the following additional information in respect of the year ended December 31, 2007.

	Joseph RM	Wife RM
Salary	28,000	18,000
EPF -Employer's portion	3,360	2,160
Employee's portion	2,800	1,800
Insurance premium paid	3,600	2,800
Children's maintenance expenses		
- Grace	15,000	-
- Gerald	3,000	-
Gross dividend income		
- Malaysia	20,000	-
- Singapore (not remitted)	-	25,000

Interest from Malaysian Banks (Net of tax)	2,375	4,750
Donations to approved institutions		
- Cash	200	600
- Furniture	1,000	-
Medical expenses incurred in respect of		
- Joseph & his family	1,200	-
- Joseph's parents	5,800	-
- Mrs. Joseph's parents	-	3,000

Joseph purchased basic supporting equipment for his father, a disabled person. The amount incurred by Joseph on March 1, 2007 amounted to RM 4,600.

His wife does not elect for combined assessment under Section 45(2).

The profit and loss account of Joseph's bookshop business for the period from September 1, 2007 to December 31, 2007 is as follows:-

	RM	RM
Sales of books and stationery		20,000
Less: Expenses		
Allowable	(23,900)	
Non-allowable	(900)	
	<u> </u>	(24,800)
Loss for the Period		(4,800)
		=====
Capital Allowances on Fixed Assets		1,200

Required

Compute the tax payable, if any, by Joseph and his wife for the year of assessment 2007.

Suggested answer

JOSEPH TAX COMPUTATION YEAR OF ASSESSMENT 2004

	Self RM	Wife RM
Statutory Income		
Business (W1)	Nil	-
Employment (W2)	28,000	18,000
Interest - S109C + Proviso S5 (1)	Nil	Nil
Dividend	20,000	Not Taxable
Aggregate Income	48,000	18,000
S44 (2) Loss [W1]	(3,900)	-
S44 (6) Donation	(200)	(600)
Total Income	43,900	17,400

Personal Relief	8,000	8,000
Medical Expenses [Max RM 5,000]	5,000	3,000
Basic Supporting Equipment [Max RM 5,000]	4,600	-
Child Relief (W3)	3,800	-
EPF & Life Insurance	6,000	4,600
	27,400	15,600
Chargeable Income	16,500	1,800

Notes:**W1 BUSINESS**

Net Loss per Accounts	(4,800)
Add: Non-allowable expenditure	<u>900</u>
Adjusted Loss	<u>(3,900)</u>
Capital Allowances C/F	1,200

W2 EMPLOYMENT

	Joseph	Wife
Salary	28,000	18,000
Gratuity	Exempted	-
	28,000	18,000

W3 CHILD RELIEF

Gerald	4 x 1,000 restricted to 3,000	3,000
Grace		800
		3,800

Tax computation

	Joseph	Wife
Income Tax on first	RM 10,000	2,500
	RM 175	Ni
Balance of		
RM 6,500 @ 3%	195	-
	400.00	Ni
Tax Rebate	350.00	-
	50.00	Nil
S110 Set-Off [27% x RM 20,000]	5,400.00	-
Tax Repayable	<u>(5,350.00)</u>	Nil

10.7 Conclusion

The chapter has discussed different aspects of Taxation of Individuals. Among the points discussed are: Aggregate of Husband's and Wife Income (Section 45), Format For Individual Tax Computation, Contract of Service or Contract for Service, Computation of Chargeable Income for an individual, Personal Relief and Personal relief. The different aspects have been explained to provide a comprehensive knowledge on taxation of individuals.

Self Assessment

- Q1** Calculate the total personal relief available to Encik Zamani and Pun Zakiah in the following scenario.

En. Zamani is a supervisor with the FTMS College Group earning RM 2,500 per month with personal EPF of 11%. He is living with his second wife Zakiah and his eight children plus Zakiah's two children from a previous marriage. In his spare time he attends a mechanic apprentice course costing RM 350 p.m. at ITM with the hope of earning some extra money since his divorce from his first wife has been finalised and he has to pay alimony of RM 250 p.m. from 1st March 2007. Zakiah, who is blind in one eye & registered as a disabled person with the Department of Social Welfare, has opted that her salary as a telephone operator be assessed separately for YA 2007. Her EPF was RM 2,050 for 2007.

In September 2007, Zamani injured himself very badly and lost the use of his left leg. He registered as a disabled person with the Department of Social Welfare so that he would receive a monthly allowance. His mother-in-law needed a by-pass operation for which Zamani contributed RM 4,600 and obtained a valid receipt in his name.

Details of his children for the year 2007 are as follows:

Zaiton	26	A student at Cardiff University for the sixth year. He repeated three years because he had to go for frequent dialysis treatment for which his father incurred the equivalent of RM 6,000 in 2007
Zaiman	25	Articled clerk with a legal firm in Kota Kinabalu earning RM 4,000 p.a.
Zaiful	23	Commenced a degree programme at Kansas University on 15.10.03. His father spent RM 950 on his fees in 2007 because he is a federal scholar
Zairul	22	He and his wife are 2nd year students at Massachusetts Institute of Technology.
Zaki	21	Studying at USM since July 2002. Though a polio victim registered with the Department of Social Welfare, he gives tuition on a part-time basis and made RM 4,500 in 2007.
Zaili	17	A brilliant student is pursuing a degree in Engineering at UKM due to double promotions that he has received.
Others	<18	All schooling

- Q2** Teo and his wife are both residents and citizens of Malaysia. They provided you with the following information for the year ended 31 December 2007:

	Mr Teo	Mrs Teo
	RM	RM
Business	10,000	(10,000)
Employment	10,000	3,000
Dividends (gross)	15,000	-
Rent	8,000	8,000
Life insurance premium	5,000	4,000
EPF	900	270

Assume that they have two children age 16 and 14 studying in Victoria Institution and Mrs Teo elects for combined assessment.

Required:

Compute the chargeable income for Y/A 2007.

- Q3** Tay and his wife, Josephine, have the following income for the year ended 31 December 2007.

Tay	RM
Business	79,500
Dividend (Net)	1,440
Approved Donation	(1,000)
Medical Expenses for parent	(5,500)
Josephine	RM
Employment	12,000
Dividend (Net)	720
EPF deducted	(1,200)
Approved Donation	(1,400)
Medical Expenses (self-not medical examination)	(800)

Compute the tax payable by Tay and Josephine for Year of Assessment 2007.

Suggested Answers

A1

Personal relief for Encik Zamani and Puan Zakiah for YA 2007 are as follows:

	En. Zamani		Puan Zakiah
	Personal allowances		Personal allowances
Self	8,000	Self	8,000
Disabled self	5,000	Disabled self	5,000
Study relief (350 X 12)	4,200		
Medical expenses for serious diseases (in respect of Zaiton – renal failure)	5,000	EPF	2,050
Spouse Relief			
Alimony payment (Since Zakiah has total income and has not elected to aggregate her income with that of Zamani)	2,500		
Child relief			
Zaiton (disabled and receiving College education)	9,000		
Zaiman (his Total Income being just RM 4,000 does not exceed the relief of RM 4,000)	4,000		
Zaiful	4,000		
Zairul (married)	NIL		
Zaki (disabled child, studying in a college and total income Does not EXCEED child relief)	9,000		
Zaili (although at university but still under 18)	1,000		
Others (4 X 1,000)	4,000		
EPF (RM 2,500 X 12 months X 11%)	3,300		

A2**TEO****Computation of Chargeable Income
Year of Assessment 2007**

	Self RM	Wife RM
Business	10,000	NIL
Employment	10,000	3,000
Dividend	15,000	-
Rent	8,000	8,000
Aggregate Income	43,000	11,000
44 (2) Loss-		<u>(10,000)</u>
Total Income	43,000	1,000
S.45 (2) elected		
Aggregate Total Income		44,000
Deductions		
Personal Relief	8,000	
Wife Relief	3,000	
Child Relief	2,000	
EPF/Life Insurance (Max RM 5,000)	5,000	18,000
Chargeable Income		<u>26,000</u>

A3**Tax Computation****Year of Assessment 2007****TAY**

	Tay RM	Josephine RM
BUSINESS	79,500	-
EMPLOYMENT	-	12,000
DIVIDEND Gross*	1,972	986
Aggregate Income	81,472	12,986
Less: DONATION	1,000	1,400
Total Income	80,472	11,586
Less: DEDUCTIONS		
Personal Relief	8,000	8,000
Medical Expenses	5,000	NIL
EPF	-	1,200
	<u>13,000</u>	<u>9,200</u>
Chargeable Income	<u>67,472</u>	<u>2,386</u>

Tax Payable

	Tay	Josephine
Income Tax on first RM 50,000 RM 2,500	3,475.00	Nil
Balance of RM 17,472 @ 19%	3,319.68	-
	<u>6,794.68</u>	<u>Nil</u>
Section 110 set-off 27% of Gross Dividend	532.44	266.22
Tax Payable/(Repayable)	<u>6,262.24</u>	<u>(266.22)</u>

Net tax payable (RM 6,262.24 – RM266.22) = RM 5,996.02

It is more beneficial to be assessed separately instead of combined assessment as the tax payable is lower than combined assessment, as computed below:-

Total income of Husband + Wife (RM 80,472 + RM 11,586)	92,058
Deductions	
Personal Relief	8,000
Wife Relief	3,000
Medical Expenses	5,000
EPF	1,200
	<u>17,200</u>
Chargeable Income	<u>74,858</u>
Tax Payable	
Income Tax on first RM 70,000	7,275.00
Balance of RM 4,458 @ 24%	1,165.92
	8,440.92
Rebates	NIL
	8,451.00
Section 110 set-off	798.66
Tax Payable	7,652.34

Chapter 11

Taxation of Partnerships

Chapter Outline:

- 11.1 Introduction
- 11.2 Existence of a Partnership
- 11.3 Tax treatment of a Partnership
- 11.4 Divisible Income and Adjusted Income
- 11.5 Illustration
- 11.6 Changes in Profit Sharing During the Year
- 11.7 Changes in Partnership
- 11.8 Conversion of Sole Proprietor Business to a Partnership
- 11.9 Partnership Losses
- 11.10 partnership Capital Allowance
- 11.11 Conclusion

Chapter Objectives

Students must be able to

- Define a partnership
- Understand that a partnership is not a person and therefore determine who is taxable
- Calculate the Provisional Adjusted Income
- Determine the Divisible Income of a partnership
- Explain what happens if there is a change in partnership
- Explain how capital allowances are computed and assigned to each partner
- Explain the difference in tax treatment between sole-proprietorship and partnership

11.1 Introduction

A partnership is defined by the Act as “an association of any kind (including joint ventures, syndicates and cases where a party to the association is itself a partnership) between parties who have agreed to combine any of their rights, powers, property, labour or skill for the purposes of carrying on a business and sharing the profits there from, but it excludes a Hindu joint family although such a family may be partner in a partnership.”

11.2 Existence of a Partnership

A partnership is usually formed by at least two persons but not exceeding twenty persons agreeing to carry on a business with a view to making profits.

From the definition above, there must be:

- a) an association of some kind between persons;
- b) an agreement between persons to combine their rights, powers, property, labour or skill in a partnership.

A partnership usually exists with the creation of a Deed of Partnership. However, in certain circumstances, a partnership exists even though there is no Deed of Partnership.

In determining whether a partnership exists without a Deed, the following guidelines may be used

- a) Profit/Loss sharing ratio (partner's entitled share of the profits or loss).
- b) Manner of operating the bank account and limitations to the signing of cheques.
- c) Name used in carrying on the business as shown in trade directories and business correspondence.
- d) Partners' remuneration, drawings, capital contributed, and interest allowed for capital.

ILLUSTRATION 1

A consortium is formed between a XYZ Pte Ltd and ABC Sdn Bhd to undertake a construction project in Malaysia for the State Government. Each party would be required to perform their functions as stipulated in the contract entered into with the State Government. All contract income and outgoings and expenses will be shown in the consortium's accounts. The net profit of the consortium (at the end of the contract) shall be allocated as follows:-

XYZ Pte Ltd	30%
ABC Sdn Bhd	70%

Based on the above, a partnership is deemed to exist between XYZ Pte Ltd and ABC Sdn Bhd even though there is no formal partnership agreement or deed:-

- a) Both parties have agreed on their share of net profit from the contract at a pre-determined ratio of 30% and 70%.
- b) All income and expenses from the project (contract) are reflected in the consortium accounts which are a normal form of accounting in a partnership.

11.3 Tax Treatment of a Partnership

A partnership is not a “person”, and therefore will not pay tax in its own name. No assessment will be raised on the partnership but each individual partner will be assessed on his share of the partnership income. Each individual partner is treated as having another source of business income.

The computation of partnership income is the same as that of computation for a business source except that no deductions are allowable for partners’ wages, interest payable on a partner’s capital and private expenses charged to the partnership accounts in arriving at the provisional adjusted income of the partnership. The gross business income is adjusted as though it is a sole proprietorship business. Sole proprietors are not entitled to deduct any payments to them. Similarly any payments or benefits to partners are added back in the adjustment.

11.4 Divisible Income and Adjusted Income

The divisible income of the partnership is the provisional adjusted income less:

- a) Partners’ wages or salaries;
- b) Interest payable to a partner; and
- c) Private expenses of the partners charged to the partnership account.

The adjusted income of an individual partner from the partnership for a basis period is the:

- a) Share of divisible income and
- b) Remuneration, interest, private expenses from the partnership.

11.5 ILLUSTRATION

The following information is available for Danny and Lynn, a partnership for the basis year 2007.

DANNY & LYNN

Profit and Loss Account Year ended 31 December 2007

	RM	RM
Sales		150,000
Less: Cost of Sales		40,000
Gross Profit		110,000
Less: General and Administrative Expenses		
Revenue expenses	50,000	
Partners’ salaries:		
Danny	20,000	
Lynn	12,000	
Partners’ interest:		
Danny	5,000	
Lynn	5,000	
Partners’ private expenses		
Danny	2,000	94,000
Net Profit		16,000

The provisional adjusted income for Danny and Lynn:

	RM	RM
Net profit as per Accounts		16,000
Add: Partners' salaries	32,000	
Partners' interest	10,000	
Partners' private expenses	2,000	44,000
Provisional adjusted income		<u>60,000</u>

The divisible income for the basis year 2003 shall be:

	RM	RM
Provisional adjusted income		60,000
Less: Partners' salaries	32,000	
Partners' interest	10,000	
Partners' private expenses	2,000	44,000
		<u>16,000</u>

Assuming that, Danny and Lynn agreed that the income be divided equally between them

	RM
Divisible Income	
Danny	8,000
Lynn	8,000
	<u>16,000</u>

The adjusted income for the basis year 2007 shall be:-

	Danny RM	Lynn RM
Partners' salaries	20,000	12,000
Partners' interest	5,000	5,000
Partners' private expenses	2,000	-
Share of divisible income	8,000	8,000
Adjusted income	<u>35,000</u>	<u>25,000</u>

11.6 Changes in Profit Sharing During the Year

Where there is a change in the profit sharing ratio during the year, the allocation of the divisible income will be apportioned on a time basis to the period before and after the change in the profit sharing ratio. The amounts allocated to the various periods are then aggregated for each partner to arrive at the adjusted income for the basis period.

ILLUSTRATION 2

A partnership firm has the following information for the year ended 31 December 2007.

- a) Each partner is entitled to a salary of RM 2,400 per annum.
- b) Profit sharing ratio.
- i) 1-1-07 to 30-6-07
- | | | |
|------|---|-----|
| Leo | : | 50% |
| Liza | : | 50% |
- ii) 1-7-07 to 31-12-07
- | | | |
|------|---|-----|
| L | : | 75% |
| Liza | : | 25% |
- c) Divisible income of the partnership for the year ended 31-12-07 was RM 24,000.
- Compute the Adjusted Income from the Partnership business for Leo and Liza.

L & L PARTNERSHIP
Income Tax Computation
(Year ended 31-12-2007)

	Allocation of Partners' Income			
	Leo		Liza	
	1-1-03 to 30-6-03	1-7-03 to 31-12-03	1-1-03 to 30-6-03	1-7-03 to 31-12-03
Partners' salaries	RM 1,200	RM1,200	RM1,200	RM1,200
Divisible income	6,000	9,000	6,000	3,000
	<hr/>	<hr/>	<hr/>	<hr/>
Partners' income	<u>RM 17,400</u>		<u>RM 11,400</u>	

The above adjusted income from partnership of Leo and Liza must be declared in each partners' Return Form for the Year of Assessment 2007. The statutory income from partnership follows the same type of computation as that of a business source i.e. after adjusted income you add any Balancing Charge and allow Capital Allowances.

11.7 Changes in Partnership

Where there is a change in the partnership either by a partner retiring or a new partner joining the partnership, the old partnership is deemed to cease and the new partnership is deemed to commence.

In the case where at least one partner from the old partnership is also a partner in the new partnership and the nature of trade of both the partnership is virtually the same, then the partner who is in the old and new partnership is deemed to have one continuing source of income in respect of the old and new partnership.

ILLUSTRATION 3

An old partnership of Leon and Lai, profit being divided equally, makes up its accounts annually to 31 December. Leon retired on 30 September 2007 and Lim joined the partnership on the same date sharing profits and losses equally.

The provisional adjusted income of both the partnerships are:

- a) Partnership of Leon and Lai.
 - i) Year ended 31-12-07 RM 24,000
- b) New partnership of Lai and Lim.
 - i) Year ended 31-12-08 RM 28,000

Determine the Adjusted Income of all the partners for the two Years of Assessment.

Allocation of Partners' Income

	Leon	Lai	Lim
	RM	RM	RM
Year ended 31-12-07	9,000	12,000	3,000
Year ended 31-12-08	-	14,000	14,000

ILLUSTRATION 4

The following information refers to the partnership of Loke and Lam.

	Loke	Lam
	RM	RM
a) Salaries per annum	10,000	8,000
b) Interest on capital	1,000	1,000

The accounts of the partnership are normally made up to 31 December with equal profit sharing.

Loke left the partnership on 30 June 06 and Long joined the partnership as a new partner.

The following particulars refer to the new partnership.

	Lam	Long
	RM	RM
Partners' salaries per annum	10,000	5,000
Interest on capital	1,000	-
Profit sharing	2/3	1/3

The provisional adjusted incomes of the partnership are:

	RM
Year ended 31-12-05	26,000
Year ended 31-12-06	27,000
Year ended 31-12-07	28,000

Compute the statutory adjusted incomes of the partners for the relevant Years of Assessment.

Allocation of Partners' Income
Year ended 31-12-05

	Loke RM	Lam RM
Salary	10,000	8,000
Interest on capital	1,000	1,000
Divisible income [26K – (18 + 2)]/2	3,000	3,000
Adjusted Income	14,000	12,000

The above income would be the adjusted income from partnership source of Loke and Lam for the Year of Assessment 2005.

Computation of Divisible Income
Year ended 31-12-06

	RM	RM
Provisional adjusted income		27,000
Less: Partners' salaries:		
Loke (1/2 x 10,000)	5,000	
Lam (1/2 x 8,000)	4,000	
Lam (1/2 x 10,000)	5,000	
Long (1/2 x 5,000)	2,500	
Partners' interest		
Loke	500	
Lam	1,000	18,000
Divisible Income		9,000

Allocation of Partners' Income

	Loke 1-01-06 to <u>30-06-06</u>	Lam 1-01-06 to <u>30-06-06</u>	Lam 1-7-6 to <u>31-12-06</u>	Long 1-7-06 to <u>31-12-06</u>
Salary	RM 5,000	RM 4,000	RM5,000	RM2,500
Interest	500	500	500	-
Divisible income	2,250	2,250	3,000	1,500
	7,750	6,750	8,500	4,000

The above are the adjusted incomes for the Year of Assessment 2006 i.e.:

Loke	:	RM 7,750
Lam	:	RM 15,250
Long	:	RM 4,000

**Allocation of Partners' Income
Year of Assessment 2007**

	Lam RM	Long RM
Salary	10,000	5,000
Interest	1,000	-
Divisible income	8,000	4,000
	19,000	9,000
Adjusted income	19,000	9,000

11.8 Conversion of Sole Proprietor Business to a Partnership

Where a sole proprietor of a business takes on a partner into the business, the sole proprietor business and the partnership business are treated as one continuing business.

ILLUSTRATION 5

Leong Lai, a sole proprietorship, makes up its accounts annually to 31 December, takes on Lau Wah into the business as a partner on 1 January 2007 and makes up its accounts to 31 December 2007. The profit is divided equally in the partnership.

The following information is available:

	RM
Adjusted income for the year ended 31-12-06	20,000
Adjusted income for year ended 31-12-07	10,000

Determine the Adjusted Income for Leong Lai and Lau Wah for the relevant years of assessment

For Lau Wah, the half share of the partnership adjusted income of RM 10,000 for the year ended 31-12-07 would be the adjusted income for the Year of Assessment 2007.

Leong Lai will have an adjusted income of RM 20,000 and RM 5,000 for the years of assessment 2006 and 2007 respectively.

11.9 Partnership Losses

The following information refers to the partnership of Lian Fatt & Tong Bee.

	Lian Fatt RM	Tong Bee RM
Salaries	10,000	8,000
Interest	1,000	1,000
Profit sharing	2/3	1/3

The provisional Adjusted Income of the partnership for the year ended 31 December 2007 was RM 14,000.

Computation of Divisible Income

	RM	RM
Provisional adjusted income		14,000
Less: Partners' salaries	18,000	
Interest	2,000	20,000
Divisible Loss		(6,000)

Year of Assessment 2007

	Lian Fatt	TongBee
	RM	RM
Salaries	10,000	8,000
Interest	1,000	1,000
Divisible loss	(4,000)	(2,000)
Adjusted income	7,000	7,000

ILLUSTRATION 6

Assume that the adjusted result for 2007 is a provisional adjusted loss of RM 1,000 instead of a provisional adjusted income of RM14,000.

	RM	RM
Provisional adjusted loss		(1,000)
Partners' Salaries	18,000	
Partners' Interest	2,000	(20,000)
Divisible Loss		(21,000)

**Allocation of Partners' Income
Year of Assessment 2007**

	Lian Fatt	Tong Bee
	RM	RM
Salaries	10,000	8,000
Interest	1,000	1,000
Divisible Loss	(14,000)	(7,000)
Adjusted Income/ (Loss)	(3,000)	2,000

The adjusted loss of RM 3,000 shall be claimed as an adjusted loss under Section 44(2) by Lian Fatt in his personal tax computation for Y/A 2007.

11.10 Partnership Capital Allowances

Capital Allowance is claimed on qualifying capital expenditure incurred on fixed assets used by the partnership for business purposes at the end of the basis period.

The Capital Allowance computed is allocated to the partners in the same proportion as their profit sharing ratio is at the end of the basis period for the year of assessment.

ILLUSTRATION 7

The following information refers to the partnership of Lai and Leong each sharing profit and losses equally for the year ended 31 December 2007.

	RM
Divisible income	12,000
Salary : Lai	4,000
Leong	2,000
Capital allowance computed	2,000

Compute the adjusted income from partnership source for Lai and Leong for the Year of Assessment 2007.

Income Tax Computation Year of Assessment 2004

	Lai RM	Leong RM
Statutory Income Partnership		
Divisible income	6,000	6,000
Salary	4,000	2,000
Adjusted income	10,000	8,000
Capital allowance	(1,000)	(1,000)
Statutory Income	9,000	7,000

ILLUSTRATION 8

Lam and Lee, a partnership, sharing profit and losses equally makes up its accounts to 31 December each year. Lam retired from the partnership on 31 July 2007 and Leong entered as a new partner on the same date. The profit sharing of the new partnership of Lee and Leong is two-thirds and one-third respectively.

Allocation of Capital Allowances

	Lam	Lee	Leong
Year of Assessment 2006 (Y/E 31 December 2006)	1/2	1/2	-
Year of Assessment 2007 (Y/E 31 December 2007)	-	2/3	1/3

Lam is not entitled to any relief of capital for YA 2007 as the amount of capital allowances is allocated amongst the existing partners at the end of the basis period based on their profit sharing ratio.

ILLUSTRATION 9

The partnership consisting of Ahmad and Bakri was formed on March 1, 2004 and the first accounts were made up to December 31, 2004 and subsequently to December 31 annually. The partners have agreed to the following:-

	Interest on Capital	Salary	Share of Profit/Loss
Ahmad	RM 1,800 p.a.	RM 1,000 p.m.	1/2
Bakri	RM 1,800 p.a.	RM 800 p.m.	1/2

Due to a misunderstanding, Bakri left the partnership on March 31, 2006 and withdrew all his accumulated profit and capital. Din then joined Ahmad as a partner on April 1, 2006. The accounts were still made up to December 31. The following new terms were agreed:-

	Interest on Capital	Salary	Share of Profit/Loss
Ahmad	RM 2,400 p.a.	RM 1,200 p.m.	2/3
Din	RM 1,800 p.a.	RM 800 p.m.	1/3

The provisional adjusted income of the partnership was as follows:-

Accounting Period	RM
01-03-2004 to 31-12-2004	27,000
01-01-2005 to 31-12-2005	22,800
01-01-2006 to 31-12-2006	44,250
01-01-2007 to 31-12-2007	29,400

The capital allowances in respect of partnership assets have been computed as follows:-

Year of Assessment	Amount
	RM
2004	3,400
2005	2,400
2006	3,000
2007	2,100

Required:

Allocate the partnership income for each accounting period from March 1, 2004 to December 31, 2007 and calculate the adjusted and statutory income of each partner for the basis periods for the years of assessment 2004 to 2007.

Suggested Solution

	01-03-04 to 31-12-04	Y/E 31-12-05	Y/E 31-12-06	Y/E 31-12-07
	RM	RM	RM	RM
Provisional Adjusted Income	27,000	22,800	44,250	29,400
Salaries				
Ahmad	10,000	12,000	13,800	14,400
Bakri	8,000	9,600	2,400	-
Din	-	-	7,200	9,600
Interest				
Ahmad	1,500	1,800	2,250	2,400
Bakri	1,500	1,800	450	-
Din	-	-	1,350	1,800
	21,000	25,200	27,450	28,200
Divisible Income/ (Loss)	6,000	(2,400)	16,800	1,200

Allocation of Partners' Income

	Ahmad RM	Bakri RM	Din RM
Y/E 31-12-2004			
Divisible Income	3,000	3,000	-
Salaries	10,000	8,000	-
Interest	1,500	1,500	-
Adjusted Income	14,500	12,500	-
Capital allowances	<u>1,700</u>	<u>1,700</u>	
Statutory income	<u>12,800</u>	10,800	
Y/E 31-12-2005			
Divisible Loss	(1,200)	(1,200)	-
Salaries	12,000	9,600	-
Interest	1,800	1,800	-
Adjusted Income	12,600	10,200	-
Capital allowances	<u>1,200</u>	<u>1,200</u>	
Statutory income	<u>11,400</u>	<u>9,000</u>	

Y/E 31-12-2006

Divisible Income	10,500	2,100	4,200
Salaries	13,800	2,400	7,200
Interest	2,250	450	1,350
Adjusted Income	26,550	4,950	12,750
Capital allowances	<u>2,000</u>	-	<u>1,000</u>
Statutory income	<u>24,550</u>	4,950	<u>11,750</u>

Y/E 31-12-2007

Divisible Income	800	-	400
Salaries	14,400	-	9,600
Interest	2,400	-	1,800
Adjusted Income	17,600	-	11,800
Capital allowances	<u>1,400</u>	-	<u>700</u>
Statutory income	<u>16,200</u>	-	<u>11,100</u>

11.11 Conclusion

The chapter has discussed different aspects of Taxation of Partnerships. Among the points discussed are: Existence of a Partnership, Tax treatment of a Partnership, Divisible Income and Adjusted Income, Illustration, Changes in Profit Sharing During the Year, Changes in Partnership, Conversion of Sole Proprietor Business to a Partnership, Partnership Losses and partnership Capital Allowance. The different aspects have been explained to provide a comprehensive knowledge on taxation of partnership.

Self Assessment

Q1 The following information refers to ABC partnership for the year ended 31-12-07.

		RM
Divisible Income		100,000
Partners' Salaries	A	12,000
	B	9,000
	C	3,000
Capital Allowance		28,000

B left the partnership on 30 September 2007 and C joined the partnership as a new partner. The profit sharing ratio remains the same, that is, 50: 50.

Determine the statutory partnership income of each partner.

Q2 Encik AB operated a barber shop. He recruited three individuals as barbers, paid each of them a small monthly allowance and provided board and lodging to them. At the end of the year after deducting operating expenses from the gross revenue ("the balance"), AB would draw 70% of the balance as salary and distribute the remaining 30% as "share of profits" to the three individuals. The above arrangement is verbally agreed between AB and the others.

Required:

Explain whether a partnership exist under the above arrangement.

Suggested Answers

A1

ABC
Tax Computation
Year of Assessment 2007

	RM
Divisible Income	100,000
Add: Partners' Salaries	24,000
	124,000
Provisional Adjusted Income	
	28,000

Allocation of Partners' Income

	A	B	C
Divisible Income			
1.1.07 - 30.9.07	37,500	37,500	-
1.10.07 - 31.12.07	12,500	-	12,500
Partners' Salaries	12,000	9,000	3,000
	62,000	46,500	15,500
Adjusted Income	62,000	46,500	15,500
Less: Capital Allowance	14,000	-	14,000
	48,000	46,500	1,500
Statutory Income	48,000	46,500	1,500

Notes:

- 1) Capital Allowance is only given to the partners at the end of the basis period i.e. A and C. B is not entitled to any Capital Allowance as he was not a partner at the end of the basis period.
- 2) The partnership is deemed to be a continuing partnership as Section 56 applies.

A2 The following points should be explained:

- a) There is a master-servant relationship between Encik AB and the three individuals.
- b) Encik AB is actually the sole-proprietor of the business employing the three individuals.
- c) Common arrangement for this kind of business where certain incentive such as "share of profit" is given in addition to the monthly remuneration.
- d) In a decided case law, K.AAbdul Gaffar v R.E. Mohd Kassim, this form of arrangement does not constitute a partnership.

Chapter 12

Taxation of Companies

Chapter Outline:

- 12.1 Introduction
- 12.2 Directors of Company
 - 12.2.1 Service Director
 - 12.2.2 Non-Service Directors of Controlled Company
- 12.3 Investment Holding and Investment Dealing Companies
 - 12.3.1 Investment Holding Companies – Section 60F of ITA 1967
 - 12.3.2 Corporate Tax (Other than Investment Holding Companies)
- 12.4 Self Assessment for Companies
- 12.5 Section 108 – Malaysian Imputation Tax System for companies
- 12.6 The situation prior to YA2008
- 12.7 Dividend
- 12.8 Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- Understand the tax structure of a company and explain how it is different from the other business entities
- Differentiate a „service „ director form an „ordinary“ director
- Differentiate an investment dealing company from an investment holding company
- Understand how tax is computed for an Investment Holding company
- Understand the process of computing the Chargeable Income of a company
- Explain the dividend tax imputation system used prior to YA2008
- Explain the consequences of the single tier corporate tax system on investors

12.1 Introduction

A company means a body corporate and includes any body of persons established with a separate legal identity by or under any laws of a territory outside Malaysia.

A controlled company means a company having not more than 50 and controlled in the manner described by Section 139, by not more than 5 persons.

12.2 Directors of Company

Directors of a company include any person occupying the position of Director (by whatever name called), any person in accordance with whose directions or instructions the directors are accustomed to act and any person who:

- a) is a manager of the company or otherwise concerned in the management of the company's business;
- b) is remunerated out of the funds of that business; and
- c) is either on his own or with one or more associates within the meaning of Section 139(7), the beneficial owner of (or able directly, through other companies or any other indirect means to control) 20% or more of the ordinary share capital of the company. Ordinary share capital means all the issued share capital of the company other than capital where the holders have a right to a dividend at a fixed rate but have no other right to share in the profits of the company.

12.1.1 Service Director

A service director is a director who together with his associates:

- a) would not receive more than 5% of any dividend distributed;
- b) is working in the company in a managerial or technical capacity;
- c) is not the beneficial owner of, and either directly or through associates is able to control more than 5% of the company's ordinary share capital.

12.1.2 Non-Service Directors of Controlled Company

Restrictions are imposed on directors of controlled companies regarding the amount of gross employment income assessed on him in respect of:

- a) Assessable amount of accommodations provided - Section 13(I) (c).
- b) Compensation for loss of employment - Section 13(I) (e) and Paragraph 15 of Schedule 6.

12.2 Investment Holding and Investment Dealing Companies

An investment holding company refers to a company whose activities consist mainly in the holding of investments and not less than eighty per cent of its gross income (whether exempt or not) is derived there from. (I.e. from dividends, interest and rent in the main)

The tax treatment pertaining to Investment Holding Companies is contained in section 60 F. The general tax treatment of investment holding companies will not apply to an investment holding company which is listed on Bursa Malaysia.

Where a company has been incorporated with the object of making profit from the buying and selling of investments, such company is termed as an investment dealing company.

The income derived by an investment holding company shall be assessable as an investment source, that is, assessable under Section 4(c), (d), (e) or even (f). Income derived by an investment dealing company shall be assessable as a normal trading or business concern, which is, assessed under Section 4(a) as business income.

Generally, the differences in tax treatment of, investment dealing and an investment holding company are as follows:-

	Investment Dealing Company	Investment Holding Company
a) Charging Section	Section 4(a) - Business	Section 4(c), (d), (e) source or (f) - non-business source
b) Deduction of Expenses	Normal rules as applied to a trading company	Section 60F's Deductions
c) Loss Relief (Expenses exceeded Gross Income)	Entitled	No relief to be given
d) Relief of Capital Expenditure [Schedule 3 Allowances]	Entitled to claim Capital Allowances and Industrial Building Allowances (IBA)	Not entitled to claim Capital Allowances Possibly IBA against rental income
e) Profit on sale of investments	Revenue Gains to be assessed under S4 (a)	Capital Gains outside the ambit of Income Tax Act

12.2.1 Investment Holding Companies –Section 60F of ITA 1967

The big issue with investment holding companies is the amount and kind of expenses that is allowable. It is generally regarded that administrative expenses are not wholly and exclusively incurred in the production of investment income. However, a portion of the permitted expenses is allowed under Section 60 F based on a formula. Direct expenses relating to investment income would of course be incurred in the production of income, and be allowed under Section 33(1), notably interest expense incurred in the acquisition of investment assets.

The portion of the administrative expenses incurred by investment holding company to be allowed to reduce Aggregate Income to arrive at the Total Income (before Approved Donations) shall be the lower of either (i) or (ii):-

$$i) \quad A \quad \times \quad \frac{B}{4C}$$

Where

A is the Total Permitted Expenses incurred which consist of:

- i) Directors' Fees
- ii) Wages, Salaries & Allowances
- iii) Management Fees
- iv) Secretarial, audit and accounting fees, telephone, printing & stationery and postage.
- v) Rent and other expenses incidental to the maintenance of an office.

B is the Gross Income consisting of Dividend, Interest and Rent Chargeable to tax, and

C is the aggregate of the Gross Income consisting of Dividend (whether exempt or not), interest, rent and gains derived from the realisation of investments.

OR

- ii) 5% of the Gross Income consisting of Dividend, Interest and Rent.

Any amount unabsorbed would not be allowed to be carried forward. The income from the holding of investments will not be regarded as a business source under any other provisions of the Act, and if there is any other income not classified as investment income it will be regarded as income under Section 4(f).

ILLUSTRATION 1

YMC Investment Holding Sdn Bhd

	Year ended 31 December	
	2006	2007
	RM	RM
INCOME		
Dividend - WA Bhd	10,000	6,000
Rental	60,000	30,000
Profit on realisation of Investment - YSB Sdn Bhd	4,000	-
	74,000	36,000
EXPENDITURE		
Audit Fees	2,000	2,000
Bank Charges	50	50

Bank Interest acquisition:		
Share in WA Bhd	5,000	5,000
Property	30,000	15,000
Depreciation	150	150
Directors' remuneration	4,000	4,000
EPF	600	600
Printing & Stationery	720	1,900
Telephone, telex and fax charges	1,200	2,400
Rental	6,000	6,000
	49,720	37,100
Net Profit/(loss)	24,280	(1,100)

Required:

Compute the chargeable Income of the Company for Years of Assessment 2006 and 2007.

YMC Investment Holding Sdn Bhd
Computation of Chargeable Income

Year of Assessment

	2006 RM	2007 RM
Statutory Income		
Dividend	5,000	1,000
Rental	30,000	15,000
Aggregate Income	<u>35,000</u>	<u>16,000</u>
Permitted Expenses		
Section 60F's Deduction	<u>3,446</u>	<u>1,800</u>
Chargeable Income	<u>31,554</u>	<u>14,200</u>

Note:

1.	<u>Dividend</u>		
	Gross Dividend	10,000	6,000
	Interest	5,000	5,000
	Statutory Income	<u>5,000</u>	<u>1,000</u>
2.	<u>Rental</u>		
	Gross Income	60,000	30,000
	Interest	30,000	15,000
	Statutory Income	<u>30,000</u>	<u>15,000</u>

3.	<u>Permitted Expenses</u>		
	Audit Fee	1,000	1,000
	Bank Charges	50	50
	Directors Remuneration	5,000	5,000
	EPF	600	600
	Printing & stationery	720	1,900
	Telephone, telex & fax	1,200	2,400
	Rental	6,000	6,000
		<u>14,570</u>	<u>16,950</u>
The lower of:			
a)	5% of Gross Income	3,500	1,800
or			
b)	$A \times \frac{B}{4C} = 14,570 \times \frac{70,000}{4(70,000 + 4,000)}$	$16,950 \times \frac{36,000}{4(36,000)}$	
	= 3,446	= 4,238	

12.2.2 Corporate Tax (Other than Investment Holding Companies)

A company is generally in business and all the provisions relating to the computation of business income applies to a company. Please revisit the chapters relating to business tax computation.

The chargeable income of a company shall be ascertained as follows:-

- 1) Start with net profit/ (loss) before taxation. DO NOT start with Gross Income unless it is an investment holding company or involved in a specialised industry. The company's net profit is its gross income. This gross income will have to be adjusted according to tax principles contained in the ITA, especially Sections 33 to 39.
- 2) Exclude the following receipt which has been included in (1) above:-
 - a) Non-business income, for example, rental, dividend, interest, etc.
 - b) Capital receipt or capital gains, for example, profit on sale of fixed assets.
 - c) Foreign income remitted to a resident company, other than the four types of business of banking, insurance, shipping and air transport companies.
- 3) Check items which appear after net profit before tax, for example, extraordinary item:-
 - a) To reduce the net profit before tax if the expenditure included in extraordinary item is revenue in nature. If it is capital in nature, DO NOT add this to net profit before tax as the expenditure has not been expensed off in arriving at net profit.
 - b) If the receipt or gains is revenue in nature, check whether it relates to the same business source of income. If not it is treated as a separate source of business income.

- 4) Consider the relevant tax adjustments required based on the notes to the accounts given.
- 5) Check any other expenditure in the Profit and Loss Account which need to be adjusted where no notes are given in the question, for example, depreciation and donation.

The suggested format to compute the chargeable income based on the above approach is shown below:

ABC SDN BHD COMPUTATION OF CHARGEABLE INCOME YEAR OF ASSESSMENT 2007			
	(-)		(+)
1) Net Profit/ (Loss) before Tax	NL	or	NP
2) Non-Business Income	NBI		-
Capital Gains/Receipt	CG		-
3) Extraordinary Item			
Revenue Expenditure	RE		-
Capital Expenditure	NIL		-
4) Notes to the Accounts			
Capital Expenditure	-		CE
Revenue Expenditure	-		NIL
Double Deductions	DD		-
5) Depreciation, Donation	-		DE
	(YY)		ZZ
			(YY)
<u>Adjusted Income</u>			AA
Balancing Charge			AB
Capital Allowances			(AC)
<u>Statutory Business Income</u>			AD
Section 43(2) Loss			(AE)
Net Statutory Business Income			AF
Non-Business Income			NB
(E.g. Dividend, Rental, Interest)			
<u>Aggregate Income</u>			AG
Section 44(2) Losses			(AH)
Section 44(6) Donation			(AI)
Total Income /			
<u>Chargeable Income</u>			AJ
TAX PAYABLE			
Corporate Tax of 27%* on AJ			AK
Less: Section 110 Set-Off, if any		AL	
(27% of Gross Dividend)			
Section 132/133, if any		NIL	
		(AL)	
<u>Tax Payable</u>			AM

Tax rates for Small & Medium companies:*(Paid up capital NOT > RM 2.5 million @ the beginning of the YA)****1st RM 500,000 20%****Balance @ 28%****ILLUSTRATION 2**

Sonic Sdn Bhd, a manufacturing company, prepares its accounts to 31 December annually. For the year ended 31 December 2007, the company's profit and loss account was as follows:-

	Note	RM'000	RM'000
Sales			16,000
Cost of Sales	1		(7,700)
			<hr/> 8,300
Salaries And Wages	2	3,320	
Directors' Remuneration	3	900	
Freight And Insurance	4	180	
Advertising		1,235	
Repairs	5	114	
Employee Benefits	6	290	
Professional Fees	7	410	
Overdraft Interest	8	100	
Provision for Bad Debts	9	54	
Leasing Charges	10	173	
Compensation	11	60	
Administrative Expenses	12	300	
Miscellaneous Expenses	13	45	
		<hr/>	7,181
			1,119
Other Income	14		420
			<hr/> 1,539
Profit before taxation			519
Provision for taxation			<hr/>
Profit after taxation			1,020
Extraordinary item	15		240
			<hr/> 780
Retained Profit			<hr/>

Notes:-1) Cost of Sales

Included in the cost of sales were the following:-

Depreciation of Fixed Assets

RM 422,000

Provision of Royalty

RM 510,000

In accordance with an agreement with an American company, a royalty of RM 510,000 was payable on 31 December 2007. The amount was paid to the American company on 17 January 2008 and the withholding tax was

paid to the Inland Revenue Department on 29 January 2008.

- 2) Included in Salaries and Wages was a monthly salary of RM 800 to a physically disabled person who was employed as a telephone operator for 10 months.

- 3) Directors' Remuneration was made up of the following:-

	RM
Directors' Salaries	640,000
Contributions to an Approved Provident Fund	126,400
Medical Insurance	100,000
Leave Passage	40,000

- 4) An amount of RM 12,000 was paid to an insurance company, incorporated in Germany as premiums for insuring goods imported by the company.

- 5) Repairs comprise the following: -

	RM'000
Construction of a power substation to provide an additional supply of electricity for the business	60
Replacement of broken glass windows and repainting of office	8
Replacement of a corrugated iron roof with a tiled roof	30
Rebuilding of a retaining wall which has collapsed	16

- 6) Employee Benefits were made up of the following:-

	RM'000
Entertainment allowances	100
Entrance fee to a club for the managing director	20
Club subscriptions	6
Subsidised meals for employees	19
Annual dinner for employees	17
Business entertainment expenses	128

- 7) Professional Fees are analysed as follows:

	RM'000
Special audit for listing purposes	10
Renewal of trademark	5
Accounting, tax and secretarial services	95
Appeal to Special Commissioners of Income Tax	120
Advice from local consultants on restructuring of the company's shareholding structure	90
Recruitment of staff	25
Technical fees paid to a Japanese company without deduction of withholding tax	65
	410

- 8) Overdraft interest payable per month has remained fairly constant over the last five years. The company has always had an overdraft of around RM 900,000.

- 9) The opening balance in the bad debt provision account was RM 520,000. During the year, the specific provision made amounted to RM 41,000 and was in respect of a debtor company which went into liquidation. It also recovered a debt of RM 20,000 for Atlantic Sdn Bhd which had been previously provided for. The closing balance in its bad debt provision account was RM 574,000. All the entries in this account were in respect of trade debts.
- 10) The company leased a motor car costing RM 200,000 for its managing director. The lease commenced in April 2006 at RM 4,000 per month and will expire on March 2009. Besides this, the company also leased plant and machinery.
- 11) The company paid compensation of RM 60,000 to a customer in Thailand for failing to deliver goods on time.
- 12) Administrative expenses include RM 60,000 being a cash contribution to an approved research institute for scientific research related to the company's business.
- 13) Miscellaneous expenses were made up of the following:-
- | | |
|--|---------------|
| | RM'000 |
| Donations to political parties | 8 |
| Donations to approved institutions | 18 |
| Donations to State Governments | 6 |
| Legal expenses to prevent the establishment of a new company to compete with Sonic Sdn Bhd | 13 |
- 14) Other Income was made up of the following:-
- | | |
|--|---------------|
| | RM'000 |
| Compensation from a supplier who supplied inferior materials to the company | 90 |
| Interest income (on fixed deposits placed in Hong Kong) remitted to Malaysia in 2007 | 260 |
| Out-of-Court settlement received from a newspaper that had printed a false report about the company's shareholding structure | 70 |
- 15) The company's only investment was in the shares of Betaco Sdn Bhd, which were acquired for RM 600,000 in 2005. The shares were disposed off on 1 September 2007 for RM 360,000. The investment never yielded any dividends.
- 16) Capital allowances for the Year of Assessment 2007 amount to RM 265,000.

Required:-

Compute the chargeable income of Sonic Sdn Bhd for the Year of Assessment 2007.

SUGGESTED SOLUTION
SONIC SDN BHD
Computation of Chargeable Income
Year of Assessment 2007

	(-) RM'000	RM'000	Remarks
Profit before taxation	-	1,539	Profit and Loss Account
Other Income Compensation	NIL	-	Taxable receipt in the course of business
Interest	260		Separate source of income
Out-of-Court Settlement	70	-	Non-business receipt
Extraordinary Item Disposal of Shares	NIL	-	Capital Loss
Cost of Sales Depreciation	-	422	Capital allowance given
Royalty	-	NIL	Expenditure incurred and withholding tax provision complied with
Salaries & Wages	8	-	Double deduction
Directors' Remuneration Contribution to EPF	-	4.8	S34(4) Restriction S39(1)(m)
Leave Passage	-	40	
Freight & Insurance	NIL	-	Risk must be insured with a local Co to qualify for double deduction

	(-) RM'000	RM'000	Remarks
Repairs			
Power Substation	-	60	Capital Expenditure
Replacement of Roof	-	30	Deemed Capital Expenditure
Rebuilding Retaining Wall	-	16	Capital Expenditure
Employees Benefit			
Entertainment Allowance	-	50	S 39(1)(l)
Entrance Fee	-	20	Capital Expenditure
Business Entertainment	-	64	S 39(1)(1)
Professional Fees			
Special audit for listing purposes	-	10	Capital Expenditure
Appeal to Special Commissioner	-	120	Capital Expenditure
Advice from Local Consultant	-	90	Capital Expenditure
Technical Fees	-	65	S 39(1)(j)
Overdraft Interest	-	44.4	W
Provision for Doubtful Debts	-	33	W2
Lease Rental	-	34	S 39(1)(k) - W3
Compensation	-	NIL	Revenue expenditure in the course of business
Contribution to Approved Research Institute	60	-	Double deduction
Miscellaneous Expenses			
Donation	-	32	Approved donation to be deducted after Aggregate Income
Legal Expenses	-	13	Capital Expenditure
	<u>398</u>	2,687.20 (398)	
Adjusted Income		2,289.20	
Capital Allowance		(265)	
Statutory Business Income		2,024.20	
Interest (remittance not taxable)		NIL	
Aggregate Income		2,024.20	
S44(6) Donation		24	
Chargeable Income		2,000.20	

Workings:

$$(W1) \quad \frac{600,000}{900,000} \times 100 \times \frac{8}{12} = 44.4(RM''000)$$

(W2)	P/L RM'000	Adjustment RM'000
Specific Provision	41	-
Recovery	(20)	-
General Provision	33	33
(Balancing Figure)	54	33

(W3) Lease Rental	RM'000
Payment for Year of Assessment 2007	48
Payment up to Year of Assessment 2006	36
Total Payments	84
Maximum Allowed	50
S39 (1) (k)	34

12.3 Self Assessment for Companies

Self-assessment is a system whereby taxpayers are required by law to determine their taxable income and compute their tax liability when submitting their tax returns based on existing tax laws, public rulings and regulations or guidelines issued by the IRB.

Although not legislated, the issue of return forms as per IRB practice is staggered on a quarterly basis as follows:

Companies year end	Issue of return forms in
31/Jan, 28/Feb, and 31/Mar	April
30/Apr, 31/May, and 30/Jun	July
31/Jul, 31/Aug, and 30/Sep	October
31/Oct, 30/Nov, and 31/Dec	January (next year)

In the case of companies, the return forms have to be filed in within 7 months from closing of their annual accounts. In the case of a change in accounting date, the company must file returns for that year and the following year within 7 months from the date the company closes its accounts.

The return should specify the chargeable income, the amount of tax payable (if any) and such particulars as required by Director-General.

For companies, the return is deemed to be a notice of assessment.

Companies are required to provide an estimate of tax payable for a relevant year of assessment 30 days before the commencement of the relevant basis period in Form CP 204. In the case of new companies, an estimate has to be provided 3 months from commencement of business. The estimate must **NOT** be less than eighty five percent of the revised estimated tax payable for the immediately preceding year of assessment. (Section 107C)

The Revenue will then issue a notice of instalment payment (CP 205) comprising of twelve instalments commencing from the second month in the relevant basis period and each instalment must be paid on or before the 10th of the month. For new companies, the instalment payments will commence from the 6th month of the first basis period. However, if they commence business in the second half of the year, there will be no instalment for that year of assessment. A revision of estimate (CP 206) can be made in the 6th or 9th month of the basis period.

Since companies are on a self-assessment system, the tax payable for the year of assessment should be settled on the required date of lodgement of returns i.e. 7 months from the end of basis period. Non-compliance will result in the imposition of a penalty of 10% of the tax payable and another penalty of 5% on both the tax payable and the 10% penalty, which remains unpaid, will be imposed after the expiration of a 60-day period. (Section 103)

12.4 Section 108 – Malaysian Imputation Tax System for companies

The Malaysian imputation tax system for companies has been abolished effective YA2008. Company profits will be taxed at their current tax level which for YA 2007 is 27% and for YA2008 is 26%. The dividends distributed will not be taxed on the shareholders. Company profits are therefore subject to a single tax at the corporate tax rate. With this the elaborate tax imputation system will come to an end with shareholders in the lower tax brackets losing some valuable revenue in the form of tax refunds under the tax imputation system. However, there is a grace period of six years for the tax already paid and to the credit of the company to be distributed to shareholders to claim the tax at source under Section 110. The good news for companies is that all distributions be it revenue or capital is not subject to tax. Previously capital gains cannot be distributed without being taxed as dividends. This new development has many consequences for both companies and shareholders. The single tier tax for companies, creating companies as the most prominent taxpayer to the government, has disadvantaged low tax bracket investors whose share investment has just got more expensive as they now suffer tax at the corporate tax rate instead of their lower tax bracket. It is therefore expedient on shareholders to include the tax impact on their investment in shares. The after tax yield on corporate dividends has become lower but where companies are busier making capital gains then the after-tax yield has improved as capital gains distribution suffers no more tax. Investors have to carefully study the companies they invest in.

12.5 The situation prior to YA2008

The imputation tax system

The objective of the imputation tax system was to mitigate or eliminate the double taxation of corporate profits i.e. they are taxed at company level and again as dividends on the shareholders. The mechanism for implementing the imputation system is found in Section 108 whereby the income tax paid by a company on its profits is fully passed on or imputed to the shareholders when a dividend is paid

For small & medium scale companies, one has to use the higher of the 2 rates applicable i.e. 28% prior to YA2007, 27% for YA2007, and 26% from YA2008.

Within 7 months after the end of its financial year, the company shall render to the DG a statement showing the total amount of tax the company is entitled to deduct or is deemed to deduct from the dividends paid, credited or distributed to its shareholders

Where at any time there is a shortfall in the Section 108 Account (i.e. a debit balance) a debt due to the Government will arise and the debt shall be due & payable within 7 months after the end of its financial year. Failure to pay will result in penalties of 10%

Where a company fails to render a statement and the DG is of the opinion that the company has paid credited or distributed dividends, the DG will serve a written requisition in respect of the excess of "compared total" over the "compared aggregate" and include a penalty not exceeding 10%, payable on the service of the requisition

Where a company is unable to pay, credit or distribute dividends due to insufficient Section 108 credit, but still paid credited or distributed dividends, and issued its shareholders a certificate which purports to show that tax had been deducted, the Director-General will serve a written requisition for that amount of tax purported to have been deducted with a penalty of not exceeding 10%

The Director-General may in his discretion for any good cause shown, remit or repay (if already paid) whole or part of the increase in tax due to penalties.

12.6 Dividend

The word dividend is not defined in the Act. Therefore, we have to rely on precedents established in tax cases to ascertain what constitutes a dividend.

In ***Hill v Permanent Trustee Company of New South Wales (1930) AC 720***, it was held that distribution of capital profits is still dividend. In addition, it was established that a limited company not in liquidation could make no payment by way of return of capital to its shareholders except as a step in an authorised reduction of capital. In Malaysia, a capital reduction scheme requires the sanction of the court.

In ***CIR v Trustees of Joseph Reid (Deceased) 30 TC 431*** the decision was that it is not competent for the court to look beyond the dividend in question to ascertain the whether the source of profits is "revenue" or "capital". The concept of dividends is distribution of accounting profits which includes capital gains such as gain on disposal of fixed assets. In the hands of the recipient, the source of income which gave rise to the dividends becomes irrelevant i.e. whether it is capital or revenue, the dividend will be subject to tax.

Rae v Lazard Investment Co. Ltd 41 TC, established that it makes no difference if part of the surplus assets of the company is distributed to shareholders in specie rather than cash. The payment of dividends can be in kind, i.e. investments, property etc. if the company has distributable profits but insufficient cash resources to pay dividends in cash.

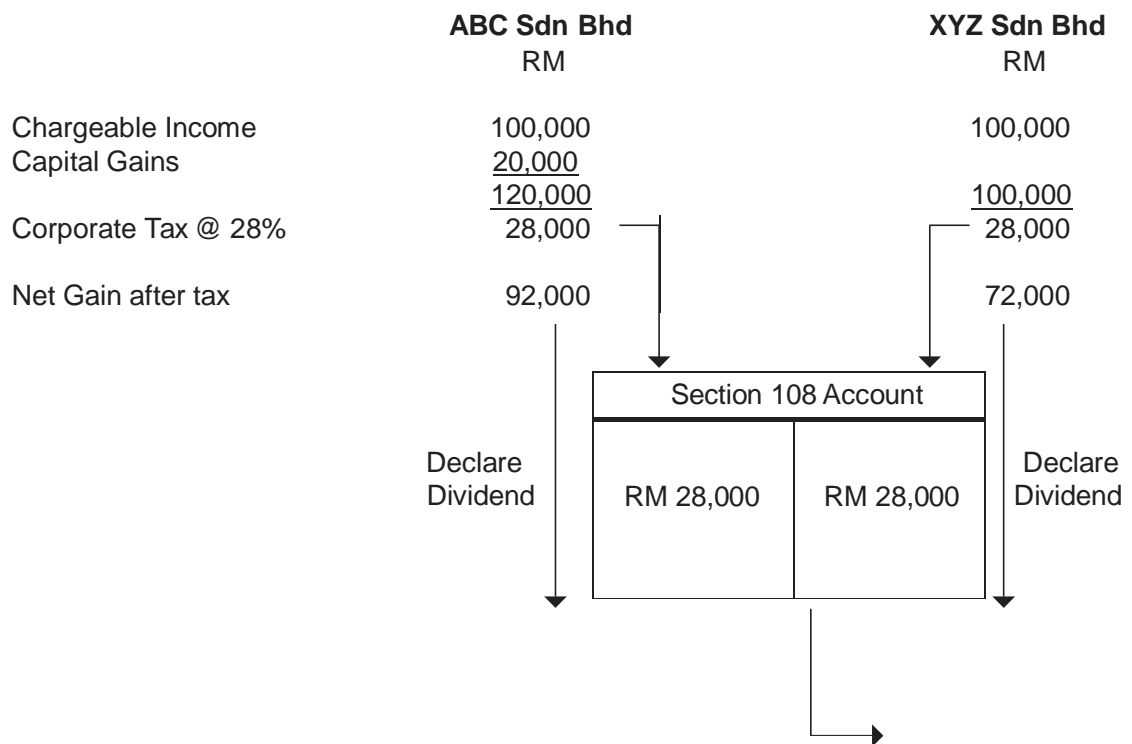
Bonus shares are not dividends because each shareholders percentage holding in the company remains unchanged as in ***CIR v Blott and CIR v Greenwood 8 TC 101***

A rights issue is also not a dividend because it is a capital transaction whereby the shareholders pay to acquire additional shares in the company.

The mere disguise of a dividend by calling it an advance or loan will not release it from the ambit of taxability. In ***TPT v DGIR (1988) 1 MSTC 2,058***, advances made to shareholders were held to be dividend because

- the payment to all shareholders were in proportion to their shares,
- the shareholders did not request for the advances, and
- there was no requirement to settle the advances prior to the disposal of the shares

ILLUSTRATION 3



Compared	RM 92,000 x 28 72		RM 72,000 x 28 72
Total:	= RM 35,777	←	= 28,000
	Shortfall of credit By RM 7,777		Sufficient to frank

ABC Sdn Bhd would therefore have to pay to the Inland Revenue Board the shortfall (Compared Total > Compared Aggregate) of RM 7,777.

12.7 Conclusion

The chapter has discussed different aspects of Taxation of Companies. Among the points discussed are: Directors of Company, Investment Holding and Investment Dealing Companies, Section 108 – Malaysian Imputation Tax System for companies and The situation prior to YA2008. The different aspects have been explained to provide a comprehensive knowledge on taxation companies.

Self Assessment

- Q1** The profit and loss account for the year ended December 31, 2007 of Investment Holdings Sdn Bhd, whose sole activity is the making of investments:-

	Note	RM
Gross Income		
Interest from Fixed Deposit		50,000
Rent (Shop house)		50,000
Dividend (net)		144,000
Dividend (tax exempt)		94,000
Rent (sublet of office)		20,000
Gain from Realisation of Investments	1	90,000
		448,000
Expenses		
Directors' Salaries		55,000
Employee' Salaries		25,000
Accounting and Secretarial Fees		12,000
Audit Fee		18,000
Interest	2	40,000
Printing & Stationery		2,000
Management Expenses		18,400
Rent (for office)		50,000
Quit Rent & Assessment		2,000
Entertainment		4,500
Depreciation		3,500
Employees Provident Fund		9,600
		240,000
Net Income		208,000
Notes:		
1)	Cost	Rental
	RM	RM
Investment Shop house	500,000	50,000
EW Bhd	2,000,000	-
YA Bhd	1,000,000	-
		144,000 (net)
		94,000 (tax exempt)

- 2)** Interest of RM 40,000 was incurred on loans for the above investments in Note (1).

Required:-

Calculate the chargeable income of Investment Holdings Sdn Bhd for the Year of Assessment 2007.

Suggested Answers

A1

Investment Holdings Sdn Bhd Tax Computation Year of Assessment 2007

	RM	Reference
Statutory Income		
Interest	50,000	
Dividend	174,403	W1
Rental	42,286	W2
Aggregate Income	269,429	
S 60F Deduction	14,863	W3
Total Income/Chargeable Income	254,429	

Workings:- (W1)

Dividend

		RM
Gross Income		
RM 144,000 x $\frac{100}{73}$		197,260
Interest Allowable		
$\frac{\text{RM 2 m}}{\text{RM 3.5 m}}$ x RM 40,000		22,857
		<u>174,403</u>

(W2)

Rental

		RM
Gross Income		50,000
Interest Allowable		
$\frac{\text{RM0.5 m}}{\text{RM3.5 m}}$ x RM 40,000		(5,714)
Quit Rent & Assessment		(2,000)
		<u>42,286</u>

(W3)**S 60F Deduction**

	RM
Directors' Salaries	55,000
Employees' Salaries	25,000
Accounting & Secretarial Fees	12,000
Audit Fee	18,000
Printing & Stationery	2,000
Management Fee	18,400
Rental (Net)	30,000
Employees Provident Fund	9,600
	<hr/>
	170,000
	(A)
	<hr/>
Interest	50,000
Rent	50,000
Dividend	197,260
	<hr/>
	297,260
	(B)
	<hr/>
Taxable Gross Income	297,260
Dividend (tax exempt)	94,000
Gains on Realisation of Investment	90,000
	<hr/>
	481,260
	(C)
	<hr/>

$$A \times \frac{B}{4C} = 26,251$$

OR

$$5\% \text{ of Gross Income (that is B) } = 14,863$$

Chapter 13

Trusts, Estates and Settlements

Chapter Outline:

- 13.1 Introduction
- 13.2 Estate under Administration
 - 13.2.1 Apportionment of Income
 - 13.2.2 Chargeable Income
 - 13.2.3 Assessments
 - 13.2.4 Tax Rate
 - 13.2.5 Estate and trust Created Under a Will
- 13.3 Trust
 - 13.3.1 Resident Status
 - 13.3.2 Non-Discretionary Trust
 - 13.3.3 Discretionary Trust
 - 13.3.4 Mixed Trusts
- 13.4 Settlement – Section 65 (A)
 - 13.4.1 General – Section 65 (1)
 - 13.4.2 Revocable Settlement – Section 65 (2)
 - 13.4.3 Income Deemed to Be That of the Settlor – Section 65 (3)
 - 13.4.4 Tax Recovered From Trustees – Section 65 (4)
 - 13.4.5 Settlement and Trust – Section 65 (5) & Section 65 (6)
 - 13.4.6 Two or More Settlor
- 13.5 Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- Differentiate Trusts, Estates and Settlements
 - Explain the tax treatment in the year the taxpayer is deceased
 - Explain the tax treatment of a Deceased Person's Estate
 - Explain the three main parties in a Trust
 - Explain the tax treatment in the case of distribution of income to beneficiaries in a resident Trust
- Explain the different approaches to taxing discretionary and non-discretionary and trusts for accumulation.
- Explain what is a Settlement and the rules regarding Settlements

13.1 Introduction

An increasingly important category of persons under the Income Tax Act are Trusts, Estates and Settlements. There are specific provisions in the ITA 1967 that elaborates the tax treatment of these bodies of persons or tax entities.

Trusts are covered in general under Section 61 of the ITA. Section 64 deals with Estates under administration and Settlements are covered under Section 65. In financial planning the three essential activities are wealth creation, wealth preservation and wealth distribution. Trusts, estates and settlements involve the third activity of wealth distribution or wealth management. However, an important investment activity is the use of trusts as investment vehicles. We have to study trusts as personal investment management vehicles and also look at trusts as an important investment vehicle. Trusts have two categories, one is the personal trust established to manage personal assets. The other is the investment vehicle which has its own tax treatment. We will examine personal estates first.

13.2 Estate under Administration

The income up to the date of death is assessable on the deceased person whilst income after that date is assessed on the estate.

13.2.1 Apportionment of Income

The income for a year of assessment between the deceased person and the estate shall be apportioned as follows:

Sources of Income	Apportionment
Business/Rent	Time basis
Interest/Dividend/Annuity	Receipt basis [<i>CIR V Oaking 9TC582</i>]

13.2.2 Chargeable Income

<u>Individual</u>	<u>Date of Deceased</u>	
	<u>Estate</u>	<u>Deceased</u>
Business	T.B.	T.B.
Rental	T.B.	T.B.
Foreign income received	Exempt	Exempt.
Other Malaysian income		
Interest	R.B./S.109C	R.B.
Dividend	R.B.	R.B.
Aggregate Income	A1	A2
44(2) loss	(T.B.	T.B.)
Annuity Payable	(-	xx)
44(6)	(xx	xx.)
Total Income	T1	T2
Deduction/Special Deduction	(S46 to 50)	(S64)
Chargeable Income	C1	C2

Notes:

1. T.B. - Time basis.
2. R.B. - Receipt basis.

The foreign income remitted shall be tax exempt.

Where an individual died domiciled in Malaysia, the special relief of RM 8,000 under Section 64(4) shall be given to the Executor of the Estate. The resident status of the executor is of no relevance.

The annuity received by an annuitant shall be taxed under Section 4(e) of the ITA 1967. Other than annuity, payments made to beneficiaries shall not be regarded as income as it is merely a distribution of the residue of the Estate.

ILLUSTRATION 1

Mr Axe died domiciled in Malaysia on 30-9-2007.

	RM	
Adjusted Income - Business I	200,000	
Adjusted Loss - Business II	100,000	
Adjusted Income - Foreign	30,000	remitted RM 4,000 On 01-11-2007
Dividend Income (Gross) received on 1-2-2007		8,000
Dividend Income (Gross) received on 1-11-2007		10,000
Rental	40,000	
Annuities payable (paid RM 4,000)	5,000	
Approved donation (paid on 30-04-2007)	4,000	

The Chargeable Income shall be:

	Deceased Individual		
	Axe RM	Estate RM	Remark
Business I	150,00	50,000	Time Basis
Remittance	0	Exempt	
Dividends	-	10,000	Receipt Basis
Rental	30,000	10,000	Time Basis
Aggregate Income	188,000	70,000	
Less: Current year loss	75,000	25,000	Time Basis
	113,000	45,000	
Less: Annuities payable	-	5,000	
	113,000	40,000	
Less: Donation	4,000	-	
TOTAL INCOME	109,000	40,000	
Less: Deduction	8,000	8,000	
CHARGEABLE INCOME	101,000	32,000	

Notes:

Special relief of RM 8,000 under Section 64(4) is claimed as the deceased died domiciled in Malaysia.

13.2.3 Assessments

Where an individual dies in the basis year for a year of assessment, the executor shall be assessable and chargeable to tax for:

- a) that year of assessment;
- b) the following year of assessment; and
- c) any previous years of assessment.

Any assessment or additional assessments shall be raised not later than the end of the third year of assessment following the year of assessment for the basis year in which the latest of the following events took place:

- a) the individual died;
- b) the estate duty affidavit * (if any) was filed in Malaysia with respect to any part of the estate of that individual; or
- c) where an estate duty affidavit * relating to that estate duty affidavit was filed.

*** Estate duty has been abolished effective from 1 November 1991 (1992 Budget).**

For example, if Mr. J died on 30-9-2006 the executor shall be assessed and charged to tax for:

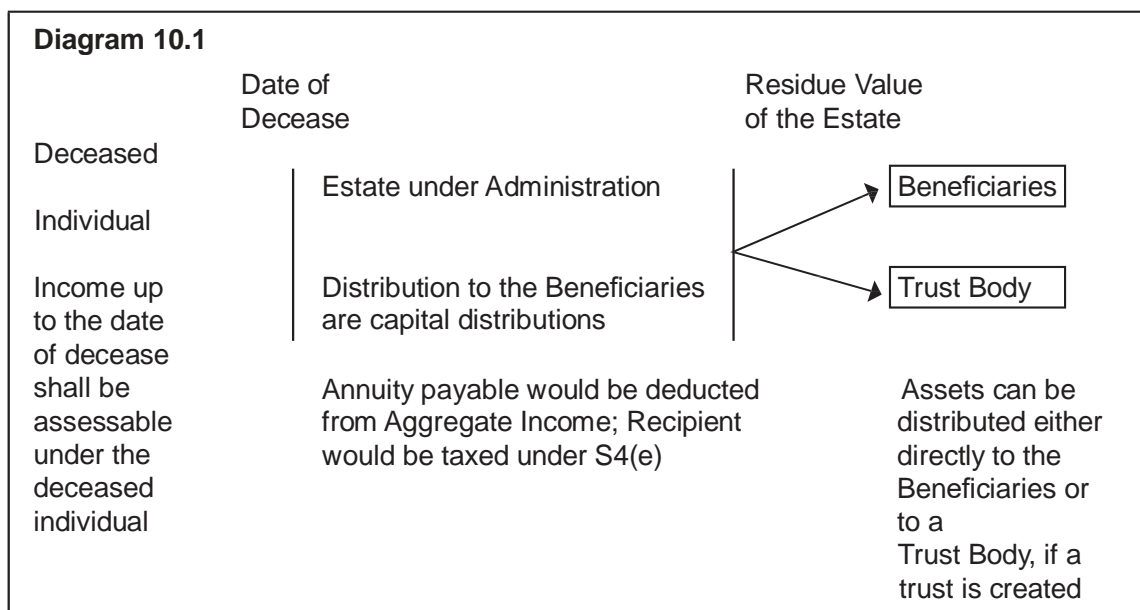
- a) Years of Assessment 2006 and 2007; and
- b) Assessments prior to Y/A 2006.

The above assessments shall be raised not later than 31 December 2009.

13.2.4 Tax Rate

- a) Where the Deceased died domiciled in Malaysia the estate shall be taxed at graduated or scale rates of tax on the chargeable income
- b) If the deceased died domiciled outside Malaysia at the time of death, the executor of the estate shall be taxed at the current corporate tax rate. For YA 2007 it is 27%.

13.2.5 Estate and Trust Created Under a Will



13.2 Trust

A trust is an equitable obligation, binding a trustee to deal with the trust property over which he has control for the benefit of the beneficiaries.

The following are the essential elements of a trust:

- a) Trustee;
- b) Trust Property; and
- c) Beneficiaries.

Where a trust subsists by virtue of Section 61(1), the trustees are considered to be a trust body, which is treated as a chargeable person for income tax purposes.

13.2.1 Resident Status

A trust is resident for a basis year if any one of the trustees is resident for that basis year.

However, a trust would be considered to be non-resident if:

- a) The trust is created outside Malaysia by a non-citizen;
- b) Income of the trust is derived outside Malaysia;
- c) The trust is administered outside Malaysia, and
- d) At least one-half of the trustees are non residents.

13.2.2 Non-Discretionary Trust

a) Ordinary Source of Income

Where a single beneficiary is entitled to the entire income of the trust for the whole basis year for a year of assessment, the total income of the trust shall be equal to the total income of the beneficiary from ordinary source.

ILLUSTRATION 2

	RM
Gross Business Income	110,000
Less: Expenses (including capital expenditure of RM 15,000)	25,000
	85,000
Distributable income	85,000
Add: Capital expenditure	15,000
	100,000
Total Income	100,000

The statutory income from ordinary source of the beneficiary from the trust shall be the total income of the trust of RM 100,000 as the beneficiary is entitled to the whole of the distributable income of the trust.

Distributable income is income available for distribution which is income for accounting purposes

Total income is the taxable income of the trust which is equal to:

	RM
Distributable income	A
Plus all non-deductible expenses	B
Minus non-taxable receipt/income	(C)
	<hr/>
Total Income	D
	<hr/>

Where there are several beneficiaries to a trust with their share of distributable income remaining unchanged throughout the basis year, the total income of each beneficiary shall be his share of the total income of the trust.

ILLUSTRATION 3

	RM
Total income of the trust for 31/12/07	80,000
Distributable income of the trust	60,000
Share of distributable income:	
A	15,000
B	45,000

The statutory income from ordinary source of:

A shall be	20,000 and
B shall be	60,000

b) Further Source of Income

The statutory income from further sources of a beneficiary of the trust is the sum received in Malaysia from the trust plus sum received from outside Malaysia and remitted to Malaysia minus the deemed statutory income from ordinary source. However, with effect from YA 2004, foreign income received by a trust would be exempt and therefore in consequence the further source of the beneficiaries would also be exempt

ILLUSTRATION 4

	RM
Statutory Business Income	60,000
Dividend (net)	7,200
Foreign Income	60,000*
	<hr/>
Distributable income	127,200
	<hr/>

*RM 20,000 remitted to the Trustee, balance remitted equally to the Beneficiary.

The total income for Y/A 2006 of the trust shall be:

	RM
Statutory Business Income	60,000
Dividend (Gross)	10,000
Foreign Income	Exempt
	<hr/>
	70,000
	<hr/>

Assume that the beneficiaries received the following:

	E (R) RM	F (NR) RM
In Malaysia	30,000	30,000
Outside Malaysia and Remitted back to Malaysia	20,000	20,000
	<u>50,000</u>	<u>50,000</u>

*R denotes tax resident
NR denotes non-resident.

The following income from ordinary source of E and F shall be RM 35,000 each as they share the distributable income of the trust equally.

The statutory income from further sources shall be:-

	E RM	F(NR) RM
Amount received from the Trust	30,000	30,000
Foreign Income of the Trust Received by the Beneficiaries	<u>20,000</u>	<u>20,000</u>
	50,000	50,000
Deemed ordinary source	<u>35,000</u>	<u>35,000</u>
Further source of income	<u>15,000*</u>	<u>15,000*</u>

* Exempted under Paragraph 28 of Schedule 6.

c) Trust Subject to Accumulation

Where part of the trust income is subject for accumulation, the total income of the trust body shall be adjusted as follows:

$$\text{Total income of Trust Body} = \frac{A \times B}{C}$$

Where A is the total income

B is the distributable income after accumulation

And C is the distributable income before accumulation

ILLUSTRATION 5

	RM
Gross business income	110,000
Rental income (net)	20,000
Business expenses (Capital expenditure of RM 20,000 included)	60,000
Accumulation for G	17,500

Balance of distributable income [after sum set aside for G] to be distributed equally to E & F.

The distributable income of the trust shall be:

	RM
Gross business income	110,000
Less: Expenses	60,000
	<hr/>
	50,000
Rental	20,000
	<hr/>
Before Accumulation	70,000
Accumulation for G	17,500
	<hr/>
After Accumulation	52,500
	<hr/>
The total income would be:	
Gross business income	110,000
Less: Tax deductible expenses	40,000
	<hr/>
Statutory Business Income	70,000
Rent	20,000
	<hr/>
Total Income	90,000
	<hr/>

The total income of the trust body would then be:

$$90,000 \times \frac{52,500}{70,000} = \text{RM } 67,500$$

The statutory income from ordinary source of E & F would be RM 33,750 (½ of RM67,500) each.

d) Deductions under Section 61(2)

Where the trust body is tax resident and the beneficiary is resident, the Director-General may deduct the share of the beneficiary income from the total income of the trust.

	RM
Total Income of the Trust (Resident)	80,000
Beneficiaries -X (50%)	40,000
-Y (50%)	40,000

Where both X and Y are resident, the chargeable income must be:

	Where S61 (2) Apply	Where S61 (2) does not apply
	RM	RM
Total Income	80,000	80,000
Less: Share of Beneficiary Income	80,000	N/A
Chargeable Income	NIL	80,000
Income Tax Payable @ 28%* (For YA 2006)	NIL	22,400
	<hr/>	<hr/>

Section 110 deduction against the tax charge of the beneficiary shall be:-

X	NIL	11,200
Y	NIL	11,200

Where one of the beneficiaries is resident, say X and Y is a non-resident, the Director-General may deduct the share of income of X from the trust.

	Where S61 (2) Apply RM	Where S61 (2) does not apply RM
Total Income	80,000	80,000
Less: Share of Income by A	40,000	N/A
Chargeable Income	40,000	80,000
Income Tax Payable @ 28 %(YA2006)	11,200	22,400

Section 110 set-off for
The beneficiaries

X	NIL	11,200
Y	11,200	11,200

It appears that S61 (2) shall not apply as it does not benefit beneficiary Y.

13.2.3 Discretionary Trust

Where there is only one beneficiary of the trust body, the share of the beneficiary from the trust body shall be the lower of:

- The total amount received by him in a basis year; or
- The total income of the trust body for that basis year;

Where there are several beneficiaries and if the aggregate of all sums received by the beneficiaries in Malaysia exceeds the total income of the trust body, the statutory income from ordinary source of the beneficiary shall be:

$$T \times \frac{R}{AR}$$

Where

T	is the total income of the trust body
R	is the total sums received by beneficiary
AR	is the aggregate sums received by all beneficiaries.

If the aggregate of all sums received by the beneficiaries in Malaysia is less than the total income of the trust body, the amount received by the beneficiary shall be the statutory income from the trust body.

ILLUSTRATION 6

	RM
Total income of the trust body (say)	40,000
Two beneficiaries - K received	20,000
L received	30,000

The amounts received by K and L in aggregate exceed the total income of the Trust. Their statutory income from ordinary source shall be computed as follows:

$$\begin{aligned}
 K &= \text{RM } 40,000 \times \frac{\text{RM } 20,000}{\text{RM } 50,000} && \text{RM } 16,000 \\
 L &= \text{RM } 40,000 \times \frac{\text{RM } 30,000}{\text{RM } 50,000} && \text{RM } 24,000
 \end{aligned}$$

If the amounts received by K is RM 12,000 and L is RM 18,000, then their statutory income shall be the amounts received by them.

The statutory income from ordinary source shall be:

	RM
K	12,000 (amount received)
L	18,000 (amount received)

13.2.4 Mixed Trusts

In the case of mixed trusts, the total income of the trust body is segregated into Discretionary and Non-Discretionary portions.

ILLUSTRATION 7

	RM
Distributable Income	60,000
Total Income (derived from Malaysia)	75,000

3/4 of the trust income shall be distributed to:

K	1/4
L	3/4

And the balance of 1/4 of the trust income shall be distributed to M at the discretion of the trustee

The Total Income shall be apportioned as follows:

$$\begin{aligned}
 &\text{Discretionary portion} \\
 &\text{RM } 75,000 \times \frac{1}{4} = \text{RM } 18,750 \\
 &\text{Non-Discretionary portion} \\
 &\text{RM } 75,000 \times \frac{3}{4} = \text{RM } 56,250
 \end{aligned}$$

The principles of determining the statutory income from ordinary source and further source shall also apply to mixed trusts.

Beneficiaries	Received from trust	Received from outside Malaysia and remitted
K	4,000	16,000
L	10,000	40,000
M	2,000	1,000

The Statutory Income of K shall be:

- a) Ordinary source
 $\frac{1}{4} \times \text{RM } 56,250 = \text{RM } 14,062$
- b) Further source
 $(\text{RM } 4,000 + \text{RM } 16,000) - \text{RM } 14,062 = \text{RM } 5,938$
 [However, the further source will be exempt]

The Statutory Income of L:

- a) Ordinary source
 $\frac{3}{4} \times \text{RM } 56,250 = \text{RM } 42,188$
- b) Further source
 $(\text{RM } 10,000 + \text{RM } 40,000) - \text{RM } 42,188 = \text{RM } 7,812$
 [However, the further source will be exempt]

The Statutory Income of M (Discretionary):

- a) Ordinary source
 RM 2,000 (amount received as it is < Total Income)
- b) Further source
 $(\text{RM } 2,000 + \text{RM } 1,000) - \text{RM } 2,000 = \text{RM } 1,000$
 [However, the further source will be exempt]

13.3 Settlement - Section 65(a)

13.3.1 General - Section 65(1)

Section 65 of the ITA 1967 provides that any:

- Settlement made during the life of the Settlor or a relative;
- Any income which will or may become payable or application in the basis period for a year of assessment to or for the benefit of a relative of the Settlor; and
- At the beginning of a year of assessment where the relative is unmarried and has not attained the age of 21;

the income shall be deemed to be income of the Settlor and not income of any other person.

A settlement includes any disposition, trust, covenant, arrangement or agreement and any transfer of assets or income, but excludes:

- a) A settlement which in the opinion of the Director-General is made for valuable and adequate consideration;
- b) A settlement resulting from an order of a court; or
- c) Any agreement made by an employer to pay to an employee or to the widow or any relative or dependant of an employee after his death such remuneration, pension or lump sum as in the opinion of the Director-General is fair and reasonable.

A Settlor includes any person by whom the settlement was made or entered into directly or indirectly and any person who was provided or undertaken to provide funds or credit directly or indirectly for the purposes of the settlement or has made with any other person a reciprocal arrangement for that other person to make or enter into the settlement

Relative means a child of the Settlor and includes a stepchild or a child of whom the relative has custody or who he maintains wholly or partly at his own expense, a child adopted by the Settlor or the husband or wife of the Settlor in accordance with any law, and any person who is a wife, grandchild, brother, sister, uncle, aunt, nephew, niece or cousin of the Settlor.

13.3.2 Revocable Settlement - Section 65(2)

Where a settlement is revocable by any person, whether immediately or in the future, with the consequence of which the Settlor or a wife or husband of the Settlor will or may become beneficially entitled to the whole or any part of the property comprised in the settlement or of the income arising from the whole or any part of the property so comprised, all income arising under the settlement from the property comprised in the settlement shall be deemed to be income of the Settlor.

It is provided that Section 65(2) shall not apply if the only reason the property reverted back to the Settlor is in the event that the beneficiary predeceased (died before) the Settlor).

ILLUSTRATION 8



13.3.3 Income Deemed to Be That of the Settlor - Section 65(3)

- a) Where the Settlor in relation to a settlement or any relative of the Settlor or any company with respect to which the Settlor or any of his relatives has control makes use for his or its own purposes whether by borrowing or otherwise any income or any accumulated income of the settlement, the income or accumulated income shall be deemed to be the income of the Settlor and not of any other person;
- b) Where any other person other than the Settlor is or was beneficially entitled to that income there shall be a tax refund to him on the taxes that he has paid in respect of the income.

13.3.4 Tax Recovered From Trustees - Section 65(4)

Where any tax is charged on or paid by the Settlor in respect of income of a settlement, he shall be entitled to recover from any trustee of the settlement. The Director-General shall furnish a certificate specifying the amount of tax so paid, and any certificate so furnished shall be conclusive evidence of the facts appearing therein.

13.3.5 Settlement and Trust - Section 65(5) & Section 65(6)

Where the income or assets representing income are deemed to be the income of the Settlor, then

- 13.3.5.1 In a case where the terms of the settlement are such that there is a trust created and the person has a beneficial interest in that trust, the income of the Settlor shall be taken to be the statutory income of the beneficiary from the settlement treating all beneficiaries as resident. The Director-General would direct the amount deemed to be Settlor's income if S 65(3) applies.

ILLUSTRATION 9

Mr Axe transfers his property to a trust body tax resident in Malaysia for his son B and daughter C in 2007. B & C are aged 10 and 15 as at 1-1-2007. The total income for Y/A 2007 is RM 100,000. The distributable income for the year ended 31-12-2007 is RM 90,000 of which B and C are entitled equally.

Assume that B (resident) and C (non-resident) each received RM 45,000 for Y/A 2007. In addition, C received RM 20,000 income from abroad.

B and C would be deemed to have no statutory income. The statutory income of A is deemed to be

	RM	RM
B's income ($1/2 \times \text{RM } 100,000$)		50,000
C's income ($1/2 \times \text{RM } 100,000$)		50,000
Further source ($\text{RM } 45,000 + 20,000 - 50,000$)	15,000*	Exempt
		<u>100,000</u>

* C shall be treated as resident for purposes of Section 65(5).

13.3.5.2 If no trust is created in settlement, the deemed income of the Settlor shall be taken to be statutory income of that other person and if that other person is not resident, he is deemed to be resident. The Director-General may direct the deemed income of the Settlor where Section 65(2) applies.

13.3.6 Two or More Settlers

Where there are two or more settlers, Section 65 shall apply in respect of each settlement as if he was the only settlor and in such case:

- a) Reference to property comprised in the settlement includes in relation to any settlor, only property originating from that settlor;
- b) Reference to income relates to only income originating from the property of that settlor

ILLUSTRATION 10

Bee and Zee contributed the following to a trust body resident in Malaysia for the benefit of X and Y, children of Bee. X and Y are aged 15 as at 1-1-2007.

- 1) 2 properties by Zee - Income RM 20,000
- 2) RM 100,000 worth of shares in XYZ Bhd, jointly owned by Bee and Zee - Dividend RM 15,000

Assume that it is irrevocable trust.

Section 65(1) applies in respect of the 2 properties, and 1/2 the shares of XYZ Bhd are to be the income of Zee. Bee would be considered to be a settlor for the RM 50,000 worth of shares in XYZ Bhd.

The income of RM 35,000 shall be deemed to be the income of the settlor.

	RM
Bee's deemed portion would be:	
1/2 share of the dividend income	7,500
	<hr/>
Zee's deemed portion would be:	
Rental income	20,000
1/2 share of the dividend income	7,500
	<hr/>
	27,500
	<hr/>

13.4 Conclusion

The chapter has discussed different aspects of Trusts, Estates and Settlements. Among the points discussed are: Estate under Administration, Trust, and Settlement – Section 65 (A). The different aspects have been explained to provide a comprehensive knowledge on trust, estates and settlements.

Self Assessment

- Q1** Mr A owns several properties from which he received rentals. He decided to settle his properties and the income there from among his children in the following manner:

*1st Son - Mr
B*

Mr B is married and is 42 years old. Under the terms of the settlement, Mr B is to receive the income from the properties so long as he lives. On his death, the properties and the right to the income would revert to Mr A.

*2nd Son- Mr
C*

Mr C is 22 years old and is married. Under the terms of the settlement, Mr A can revoke the settlement at anytime.

Required
:

Explain who would be assessable on the income in respect of the above settlements.

- Q2** Why is the concept of 'died domicile' important for purposes of computing the tax payable by the Executor for the Estate?

Suggested Answers

A1

- a) Mr B shall be assessed and chargeable on the income as he is married and has attained the age of 21 years.

Proviso of Section 65(2) shall apply as Mr A would or may become beneficially entitled to the income or property settled in the event that Mr B predeceased Mr A.

- b) Mr A shall be assessable and chargeable on the income of the properties settled on Mr C as Mr A has the right to revoke the settlement anytime.

A2

Where an individual died domicile:-

- (a) In Malaysia
- (i) Special Relief of RM 8,000 shall be given to the executor to reduce the Total Income in arriving at the Chargeable Income.
 - (ii) Chargeable Income shall be taxed at the graduated scale rates.
- (b) Outside Malaysia
- (i) No deduction of the special relief.
 - (ii) Total Income shall be taxed at the corporate tax rate (YA2006 was 28 %.)

Chapter 14

***Zakat* for Individuals in Malaysia**

Chapter Outline

- 14.1. Introduction
- 14.2. The Meaning of *Zakat*
- 14.3. The Importance of *Zakat*
- 14.4. The Conditions for Paying *Zakat*
- 14.5. The Beneficiaries of *Zakat*
- 14.6. The *Zakat* System in Malaysia
- 14.7. Types of *Zakat*
 - 14.7.1. *Zakat Fitrah*
 - 14.7.2. *Zakat* on Wealth
- 14.8. *Zakat* on Agricultural Product
 - 14.8.1. The rate of *Zakat* on agricultural product
 - 14.8.2. The time to pay *Zakat* on agricultural produce
 - 14.8.3. Implementation in Malaysia
 - 14.8.4. Calculation of *Zakat* on Paddy
- 14.9. *Zakat* on Livestock
- 14.10. *Zakat* on Gold and Silver
- 14.11. *Zakat* on Mineral (*Ma'adin*) and Buried Treasure (*Rikaz*)
- 14.12. *Zakat* On Business
- 14.13. *Zakat* on Money
- 14.14. *Zakat* on EPF withdrawal
- 14.15. *Zakat* on Shares
- 14.16. *Zakat* on Earned Income
- 14.17. Relationship between *Zakat* and Tax for Individuals in Malaysia
- 14.18. Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- Understand the position and significance of *Zakat* in Islam.
- Understand the basic concepts of *Zakat* as practiced in Malaysia
- Apply the concept of *Zakat* for individuals in Malaysia
- Plan their financial resources more wisely whilst attaining the blessings of Allah SWT

14.1 Introduction

The search for wealth is one of the religious obligations that need to be fulfilled which could lead Muslims to taqwa. While Islam clearly urges Muslims to accumulate wealth, it also tells Muslims that certain part of their wealth is a payable due to other Muslims in the society. Therefore, *Zakat* being paid is not as a gift of *Zakat* payer, but simply an act of returning the right of other in one's wealth.

As a way of life, Islam provides guidelines for the whole spectrum of wealth, from the accumulation, the preservation, how it is being spent, its circulation among people and distribution to heirs upon one's death.

This chapter will provide an insight into the practices of *Zakat* for Muslim individuals in Malaysia. The chapter will briefly explain on the importance of paying *Zakat*, the *Zakat* system, types of *Zakat* and the relationship between *Zakat* and tax for individuals in Malaysia. The scope of this module does not cover *Zakat* calculation for business entity and its tax treatment in this country.

14.2 The Meaning of *Zakat*

The meaning of *Zakat* could be derived from three aspects as follows:

- a. Literally, *Zakat* means cleansing or purifying of something from dirt or filth. It also means praise, growth and increase.
- b. Legally it is a transfer of ownership of specific wealth to specific recipients under specific conditions.

A quick look at the differences between *Zakat* and charity

	ZAKAT	CHARITY
Status	Obligatory (<i>Fardhu</i>)	Recommended / Optional
Rate	Specific (fixed & non fixed)	N/A
Recipient	Specific	N/A (even to animals)
Terms	Defined	General
Types of wealth	Defined	Not defined
Management System	Quran & Sunnah	Depend on giver
Payment Sequence	After obligatory giving (<i>nafaqah wajibah</i>)	Close relatives first
Frequency	Annually	N/A
Claimable from the deceased	Yes (becoming a debt)	No
Minor & insane	Not excepted	N/A

14.3 The Importance of *Zakat*

Zakat is the third pillar of Islam. Immediately After *Kalimah Shahadah* (pronunciation of embracing Islamic faith), prayer and *Zakat* are two succeeding obligations that take precedence over all other obligations in Islam. In fact, prayer and *Zakat* complement each other and cannot be separated. The ignorance of one will make the performance of the other one in vain. But uniquely, out of the five pillars of Islam, *Zakat* is the socio-financial worship. The other four pillars of Islam are pure worship, without the socioeconomic effect.

Zakat are so important that it stand as a core worship and is included in the first introduction and calling to Islam toward Non-Muslims. This is recorded in the authentic *hadith*:-

Narrated By Ibn Abbas : When Rasulullah (Pbuh) sent Muadh to Yemen, he said (to him), “O Muadh! You are going to a community who are of the People of the Book (Jews and the Christians). So, first invite them to bear witness that there is none worthy of worship except Allah and that Muhammad is the Messenger of Allah. If they accept this, then inform them that Allah makes five prayers in a day and night obligatory for them. If they accept this, then inform them that Allah makes charity (i.e., *Zakat*) obligatory for them. (It is) to be taken from their rich and given to their poor.” Sahih Bukhari

The word “al zakah” occurs in the Qur’an thirty times. From these thirty places in the Qur’an, eight of them were revealed at Makkah and the others at Madinah. In twenty-seven of them it is associated with prayers in the same verse. Abundant number of *hadith* of Prophet (Pbuh) also emphasized on the importance of *Zakat* in Muslim societies.

Basic act of worship in Islam such as Solat, *Zakat* & Fasting were not only revealed to Prophet Muhammad (Pbuh). Indeed these basic worships were also obligated upon the ummah of previous Prophets (peace be upon them).

“And We made them (descendants of Abraham) leaders, guiding by our Command, and We send them inspiration to do good deed, to establish regular Prayers, and to practise *Zakat*, and they constantly served Us” Al-Anbiya” (21:73)

Verses like this, confirming that prayer and *Zakat* are the obligation of previous ummah are many, such as in Maryam (19:30-31 and 54-55), Al-Baqarah (2:83) and others. This injunction is also to verify that Muhammad (Pbuh) was the Last Prophet, that role is to succeed and to finalised the religions conveyed by many Prophets that came before him.

It is extremely important for Muslims to fulfill their *Zakat* obligation because:

- a. As a reminder to Muslims that ultimate owner of all things is Allah as stated in Ta Ha (20:6) “To Him belongs all that is in the heaven and all that is on the earth, and all that is between them and all that is under the soil”
- b. It is always perceived as an act of worship to Allah SWT for all His bounties to mankind as stated in Al-Baqarah (2:267) “O you who believe! Spend of the good things which you have (legally) earned, and of that which We have produced from the earth for you...”

- c. Since *Zakat* is an annual obligation, the poverty among the Muslims could be minimized because through *Zakat* we could continuously assist the poor and the needy as stated in Adh-Dhariyat (51:19) “and their wealth and possessions (was remembered) the right of the (needy)..”
- d. By paying *Zakat* it will purify the wealth and soul of the *Zakat* payer as stipulated in at-Taubah (9:103) “Take charity from their wealth in order to to purify and sanctify them..”

14.4 The Conditions for Paying *Zakat*

There are conditions that need to be fulfilled by a Muslim before it is compulsory for that individual to pay *Zakat*. The conditions as stipulated by the *shariah* are:

- a. The payer is a Muslim (individual or group of Muslims or entity)
- b. The person has full ownership of the wealth (absolute right of ownership)
- c. A free person. He is not a slave.
- d. The wealth meets the full *Hawl* (the wealth is kept for a full year)
Hawl is defined as the completion period for a *Zakatable* wealth. Possession of the wealth for one Hijrah Year that is 354 days
- e. The wealth achieves the *Nisab*. *Nisab* is the threshold of wealth in order for the Muslim to be obliged to give *Zakat*. The amount depends on the type of *Zakatable* wealth. The example of *Nisab* are 20 dinars (equivalent to 85 gm) for gold, 200 dirhams (equivalent to 595 gm) for silver, 30 for cows and buffaloes, 40 for goats and sheep and 5 for camel. For currencies and liquid investments, *Nisab* is the current value of *Nisab* for gold (the value of 85 gm of gold may change every year. Muslims should check nisab with the zakat authority).

It should be noted that unlike the obligation of prayer and fasting, *Zakat* does not need the condition of reaching puberty (becoming adult) and being sane. This is the ruling of majority school of *fiqh* (except *Hanafiyyah*). Therefore insane person and underage children who own *Zakatable* wealth is obliged to pay *Zakat* and this responsibility must be performed by their guardian.

14.5 The Beneficiaries of *Zakat*

The Holy Quran in at-Taubah (9: 60) states the eight beneficiaries of *Zakat* namely:

- a. *Fuqara'* (The hardcore poor)
- b. *Masakin* (The needy)
- c. *Amil* (those include zakat institution who are appointed by the Muslims ruler to collect and distribute *Zakat*)
- d. *Muallaf* (Non Muslims who embraced Islam or have the potential to embrace Islam)
- e. *Ar-riqab* (to free someone from bondage or the shackles of slavery)
- f. *Gharimin* (those people in debt), debt is for survival but not for luxurious
- g. *Ibnu sabil* (the wayfarer)
- h. *Fisabilillah*. In the Way of Allah or “ any effort to uphold Islam” (Zakat, Al Qaradawi)

14.6 The *Zakat* System in Malaysia

In Malaysia, all religious matters are under the governance of each state in this country. According to the Federal Constitution, List II (State List) of Schedule 9, it is clearly stated that *Zakat*, *fitrah* or any other *Baitulmal*'s Islamic religious revenue are under the purview of state government and not federal government. (Federal Constitution, Part 1, Clause 3(2))

Therefore, the administration of *Zakat* in Malaysia is under the respective Islamic Council of each state. The federal territories also have their own councils. Due to that, the operation and services provided by the states in administering *Zakat* is different from one state to the other.

In 1991, Federal Territory Islamic Council has privatised Pusat Pungutan *Zakat* (PPZ). Before that *Zakat* collection is managed by state government agency (*Baitulmal*) which involved in all types of Islamic religious revenue with no function specialisation. PPZ acts as an *amil* which entitles to receive management fees and since then has changed the system of *Zakat* administration among states in Malaysia. Later other states followed by establishing new *Zakat* entity like Lembaga *Zakat* Selangor, Pusat Kutipan *Zakat* Pahang, Pusat Urus *Zakat* Pulau Pinang and Pusat *Zakat* Melaka.

Before 1990s *Zakat* collection in Malaysia, the emphasis was only on *Zakat Fitrah* and less on *Zakat* on wealth. However, after 1990s the management of the Islamic Councils has become more proactive and innovative in increasing the types of *Zakat* being collected and also the number of *Zakat* payer. Some *Zakat* authorities have introduced various payment channels such as auto teller machine kiosk, internet transfer, implemented the monthly salary deductions and collaborated with banks to provide similar services offered by the Inland Revenue Board (IRB).

The results of these innovative efforts perhaps could be seen from the significant amount of *Zakat* being collected by the authorities. For instance, Lembaga *Zakat* Selangor managed to collect RM393.4 millions in 2011. In general, the sources of *Zakat* collection in Malaysia are mainly from *Zakat* on employment income and business income.

The disbursements of *Zakat* collected are under the responsibility of the Islamic Religious Council. Besides giving aid through cash money to the recipients of *Zakat*, assistance is also provided through acquiring machine such as sewing machines for single mothers, fund to start small businesses and financial assistance for those who pursue their studies in higher learning institutions.

Since in Malaysia *Zakat* matters are under the purview of each Islamic State Council, there is no standardized practice. Thus Malaysian government had set up new department in 2004 Jabatan Waqaf, *Zakat* dan Haji in order to establish a standard approach among states and to ensure good governance is practiced for all Islamic Religious Councils.

14.7 Types of *Zakat*

There are two main types of *Zakat* which are:

14.6.1 *Zakat Fitrah*

The word *Fitrah* is from the arabic word *al-Fitr* means the same as *Iftar*, breaking a fast and it comes from the same root word as *Futoor* which means breakfast. *Zakat Fitrah* is also known as *Zakat* of body (*badaniah*) and *Zakat* of Ramadhan.

Zakat Fitrah is compulsory of every muslim whereby the Prophet (Pbuh), made *Zakat Fitrah* compulsory on every slave, freeman, male, female, young and old among the Muslims; one Saa` of dried dates or one Saa` of barley due from the starting of *Ramadhan* and ends before the *eid' fitr* (Hari Raya Aidil Fitri) prayer. The head of the household may pay the required amount for the other members.

i. Conditions

Conditions of *Zakat Fitrah* are:-

- a. Muslim
- b. Owns food, assets or money that is more than enough for his basic needs and the basic needs of his dependants for one full day (the day and night of first *Syawal*)
- c. Able to live between 2 periods – end of Ramadhan and beginning of *Syawal*. A person who has passed away before the sun sets or a child born after the sun sets on the night of first *Syawal* is not obliged to pay.

ii. Period of performing

Period of performing *Zakat Fitrah* are:-

Zakat fitrah can be performed at the beginning of Ramadhan but it is obligatory on the night of Hari Raya Aidil Fitri and it is divided into five timings:-

- a. Obligatory time : Between sunset on the last day of Ramadhan and the sunrise the next day
- b. *Afdhal* (More Preferred) time : After the sunset on the last day of Ramadhan until before Hari Raya Aidil Fitri prayer
- c. Permissible time: Throughout the month of Ramadhan.
- d. *Makruh* (Not preferred) Time: After Hari Raya prayer but before sunset on the first of *Syawal*
- e. *Haram* time: After sunset on the first of *Syawal*

iii. Main Purpose

The main purpose of *Zakat Fitrah* is to provide the poor with a means with which they can celebrate the festival of breaking the fast (Hari Raya Aidil Fitri) along with the rest of the Muslims. It is as a levy on the fasting person. This is based on the *hadith*: The Prophet of Allah, upon whom be God's peace and blessings, said, "The fasting of the month of fasting will be hanging between earth and heavens and it will not be raised up to the Divine Presence without paying the *Zakat Fitrah*." Besides, it can purify those who fast from any indecent act or speech and to help the poor and needy. If one misses the time period without a good reason, he has sinned and he still required to pay but it will be considered as *sadaqah*.

iv. *Zakat Fitrah* In Malaysia

In Malaysia, the ruling of paying the value of the *Zakat Fitrah* in money instead of food. Paying in the form of money can benefit the recipient since their needs are not just food and from the view of administrator, it is more economic, more efficient and more effective in helping the needy. The food or grain used to pay as a basis for *Zakat Fitrah* is rice and the amount of one sa` is equivalent to about 2.60 kg that is RM7.00 for the year 2013. State religious authorities review the amount from time to time based on the market value of rice. Therefore the rate of *Zakat Fitrah* are sometimes varies from one state to another and will change year by year.

14.6.2 *Zakat* on Wealth

The Holy Quran mentions a few kinds of *Zakatable* assets, such as

- (1) Gold and Silver (at-Tawbah (9:34))
- (2) Crops and fruits (al-An a`m (6:141))
- (3) Earnings of trade and other business enterprises (al-Baqarah (2:267))
- (4) What is drawn from beneath the earth (al-Baqarah (2: 267))

Besides clear-cut Quranic verses as above, *Zakat* on livestock also being imposed based on the authentic sayings of Muhammad (Pbuh). Thus there are five types of *Zakatable* wealth that are *Zakated* with absolute law (*qat'i*). But one thing for sure, *Zakatable* wealth are not only limited to specific wealth that were mentioned in the Quran or authentic *hadith*.

General principles of *Zakat* in the Quran were explained by Muhammad (Pbuh). He was assigned this responsibility and he is the one who knows most about what Allah legislates in the Quran :

“And We have also sent down unto you (Muhammad (Pbuh) the reminder and the advice (Quran), that you may explain clearly to to men what is sent down to them” an-Nahl (16:44).

Thus, from the explicit verses in the Quran and the authentic traditions of Muhammad (Pbuh), Islamic jurist across centuries have developed general categories of *Zakatable* assets from the original types of *Zakat* mentioned in the Quran and authentic tradition of Muhammad (Pbuh).

Zakat on Wealth or *Zakat Al-Mal* could be classified into:

- i. Agricultural product
- ii. Livestock
- iii. Gold and silver (that is the origin of ruling for all derivation of money or currency, whether intrinsic or fiat money)
- iv. Mineral (*Ma'adin*) and Buried Treasure (*Rikaz*)
- v. Business / Trade
- vi. Money (and all of it derivations like saving and statutory saving e.g EPF)
- vii. Shares and investment in capital market
- viii. Employment income

A summary of rules for Zakatable wealth

1. Financial Assets	Zakatable Base	Zakatable Value	Hawl & Nisab	Rates
General Rulings - Unrestricted use of assets - Double <i>Zakat</i> adjustment	Principal + Return	Market Value or Year End Value	A year & 20 dinar (85gm gold)	2.5%
<i>Shariah</i> Compliant	Principal + Return	Market Value or Year End Value		
Non <i>Shariah</i> Compliant	Principal only + Immediate divestment	Cost Value		
2. Non Financial Assets	Principal Profit	Zakatable Value	Hawl & Nisab	Rates
Livestock	Principal + Return	Total No (excl working)	A year & 5/30/40 cattle	As per Schedule
Agriculture	Return only	Total	No & 5 wasaq	5% / 10%
<i>Ma'adin & Rikaz</i> (Minerals and buried treasure)	N/A	Total	N/A	20%

14.7 Zakat on Agricultural Product

Zakat on agricultural product is imposed on Muslims whether they are in the forms of cereals or fruits. As for agricultural product other non basic food, *Zakat* on business will be imposed on them instead of *Zakat* on agricultural product if they are traded.

14.7.1 The rate of Zakat on agricultural product

The rate for *Zakat* on agricultural products depends on the methods of watering the plants as follows:

- Sources which are taken from well, pond or treated water is 5%
- Natural Resources e.g. rain is 10%

Since most of agricultural produce today are not watered naturally and also need some extra works (fertilizing, insect & disease controlling etc), *Zakat* on crops (paddy in Malaysia) is levied at the rate of 5%. *Zakat* on crops at the rate of 10% is a mere academic today.

14.7.2 The time to pay Zakat on agricultural product

In general, *Zakat* on agricultural products are paid out after the agricultural produces ripe and cleansed.

“...Eat of their fruit when they ripen, but the dues thereof on the day of its harvest, and waste not by extravagance, Verily He likes not those who waste by extravagance...”

al-An a"m (6) : 141

14.7.3 Implementation in Malaysia

Many states such as Kedah, Selangor and Terengganu have determined that *Zakat* on agricultural product only imposed on paddy. It must be paid after harvested at the rate of 5% from the total crops excluding subsidy given by government. The *Nisab* is 5 *wasaq* (360 gantang) equivalent to 1,306kg or 1.306 tones. The subsidy is treated as *mal mustafad* (earned income) which has to be added up with other income.

14.7.4 Calculation of *Zakat* on Paddy

Total weight of paddy : For e.g.	=	2,000 kg
Value of paddy per kg : For e.g.	=	RM1.60
Value of paddy :	=	RM3,200.00
Value of <i>Zakat</i> : Value of paddy X 5%	=	RM151.00

14.8 *Zakat* on Livestock

Zakat on livestock is compulsory to the owner of the livestock when it fulfils the condition to pay *Zakat*. It is based on the *hadith* as narrated by *Ibnu Majah* "...from forty sheep it is imposed (*Zakat*) of one sheep".

The types of animals which are subject to *Zakat* on livestock are:

- Cows
- Sheep
- Buffaloes
- Camel

The *Nisab* for cows and buffaloes is 30, goats and sheep are 40 and camel is 5. The *hawl* of the livestock is one year of *hijra* or 354 days. Other than the livestock must be fully owned by a Muslim and a freedom person, there are also conditions that need to be fulfilled which are:

- Animals must be pastured naturally.
- The animals should not be working animals (e.g: plough the field, lift goods)
- Nisab* must be maintained during the *hawl*
- The *Nisab* for cattle is 30, sheep is 40 and camel is 5.

Due to the structural changes in economic activities, Zakatable animal rearing is has become obsolete in Malaysian economies, so these modules will skip *Zakat* rate table for camels and cows. However for the sake of illustration, we will take a look at the table of *Zakat* for goats, as below:

Number of sheep		Amount of zakah (in sheep)
From	To	
1	39	nothing
40	120	one
121	200	two
201	300	three
301	400	four
401	500	five

14.9 Zakat on Gold and Silver

The obligation of *zakah* on money is confirmed by the Qur'an, Sunnah, and ijma'. The the Holy Quran indicates that it is compulsory to pay *Zakat* on gold and silver “...*And there are those who bury gold and silver and spend it not in the way of Allah: announce unto them a most grievous penalty*” at-Taubah (9: 34).

Muslims jurist have unanimously agree throughout all generations that zakah is obligatory on these two currencies of gold and silver. Thus these two metals are uniquely *Zakatable* in whatever forms, be it in the form of currency, solid bar, or unrefined as long as the weight is above the *Nisab*.

Types of *Zakatable* gold and silver are as follows:-

a. Gold and Silver jewelry that is not worn

There are various kind of using conditions as follows:

- i. Jewelry made of gold and silver that is kept as a treasure and an accumulation of wealth such as bullions and coins.
- ii. The jewelry used unlawfully such as men are forbidden to wear jewelry made of gold, silver or any other substance. *Zakat* is obliged on men jewelry if exceed *Nisab*.
- iii. Gold or silver utensils, decorations, equipments. Islam forbids the use of gold and silver as kitchen and dining utensils because that is a feature of a lavish way of living. All items is *Zakatable*.

It is not disputed among Muslim scholars that whenever gold and silver are used in a forbidden manner they are also subject to *Zakat*. It is compulsory to pay *Zakat* if gold and silver meet the *Nisab* of 85 grams for gold and 595 grams for silver and it must also meet the *hawl*. Jewelry made of combination gold and silver with pearls, diamonds and other precious stones and metals, estimation is needed to determine the weight only for gold or silver.

The rate is 2.5% from the total amount of gold and silver that is exceed *Nisab* after a period of one year.

Example 1 :

Hasnah has 100 gm broken gold and old fashioned jewelry that she has not worn even once during the year. The current value of gold is RM100.00 and the total value of her gold is RM10,000

Answer : The amount of *Zakat* that she has to pay is calculated as $RM10,000 \times 2.5\% = RM250$

Example 2 :

Malek is a business man. He has been keeping some gold bullion and coin in his safe box in the bank since last year. The total weight of his gold is 1,000 gram for bullion and 51 gram for coins. Is Malek has to pay *Zakat* and how much should he pay? The current value of gold is RM100 per gram.

Answer: Malek has to pay *Zakat* since his total gold is more than *Nisab* (85gm of gold).

The total value of his gold is RM105,100. Therefore, the amount of *Zakat* that he has to pay is calculated as follows:

$$RM105,100 \times 2.5\% = RM2,627.50$$

b. Gold and Silver jewellery that is worn by women

Jewelry that is obtained for personal use as ornament and used lawfully by women is not *Zakatable*. However if the amount or quantity of jewelry exceeds the customary amount, *Zakat* will be imposed. The terminology used in Malaysia for customary amount is called „*Uruf*“. „*Uruf*“ is an Arabic word with the meaning customary. Only jewelry that reaches *Uruf* (customary amount for extravagance) is *Zakatable*. The customary amount for Selangor state is 800 gm for gold. Since the usage of silver ornament among women in Malaysia is not popular, there is no customary amount collected from any states.

Zakat is calculated based on 2.5% on the total current value of gold or silver less any gems (diamonds, jade, sapphire, pearls, rubies etc.) attached to the jewelries.

Example 1:

Pn. Azizah has 900 gm gold jewelry and she worn at least once for the whole year. The current value of gold is RM90.00 per gram. The total value of gold that Pn. Azizah is wearing is RM 81,000.

Answer : Therefore Pn. Azizah has to pay: $RM 81,000 \times 2.5\% = RM 2,025$.

Example 2:

Pn. Aminah has 300 gm gold jewelry and she wore at least once for the whole year.

Answer: Her jewelry is not subject to *Zakat* because the *uruf* in Selangor is 800 gm.

14.10 Zakat on Mineral (*Ma'adin*) and Buried Treasure (*Rikaz*)

Minerals (*ma'adin*) are the jewels extracted from the earth like fuel and gas, gold, copper, silver, iron, diamond, sulphur and others. The rates are basically 20% but many recent jurist agreed that it is reasonable to impose a rate of 10% or 5% or 2.5% according to the value of extracted mineral and the production cost.

Buried treasure (*Rikaz*) including all things of value left in or on the earth by people in the past such as gold, silver, used metals). Many scholars agreed that *Zakat* is imposed without any *Nisab* and without imposing *hawl*. However finding treasure is always rare and more important is *Zakat* on mineral which represent a substantial sector of the economy. The rate is 20% or 1/5 because it does not involve great expenditure which needs to be deducted to reduce the burden of the payer. In today's context, *Zakat* on crude oil and natural gas extracted from the deep sea by large companies which involved a very big exploration cost maybe calculated using *Zakat* on business method, instead of *Zakat* on *Rikaz*.

Neither *Zakat* on minerals nor *Zakat* on buried treasure ever collected by religious authority in Malaysia. *Zakat* on mineral has a great potential and a lot more to be explored hence Malaysia is gifted with many valuable mineral especially like petroleum and gas.

14.11 Zakat On Business

A business whether it is in the form of sole proprietor, partnership or company is subject to *Zakat* if it fulfills the conditions. It is based on a *hadith*:

Samura Ibn Jundub said that "...Indeed, the Prophet (Pbuh) asked us to pay *Zakat* from the property that we prepare to sell"

Sunan Abu Daud

Basic equation or basic steps to assess *Zakat* on business is:- Cash + Stocks for sale + Debtors – Creditors. This simple equation is applied whether to assess *Zakat* on sole proprietor or on large multinational corporation.

The conditions that must be fulfilled to be subject to *Zakat* are:-

- a. Muslim (individual or entity)
- b. A free person
- c. The wealth must be from *halal* sources which means those activities prohibited against Islam cannot be included in the *Zakat* calculation
- d. Meet the *Nisab* at the end of *hawl* which is 2.5% or equivalent to 85 grams of gold
- e. Meet the *hawl*
- f. It must be from productive property e.g cash, Shariah compliant shares, Islamic bond, ending inventory etc.
- g. The business must be fully owned at the date of *hawl*

In contrary to popular misconception, *Zakat* on business is computed based on assets at *Hawl* completion, and not based on profit gains during the year.

This module does not cover *Zakat* calculation for large companies with formal financial report (Audited Financial Statement)

Zakat Calculation Guide For Small Businesses
(Businesses with no Audited Financial Reports)

At the end of *Hawl* completion, dated ____/____/____ complete the followings:

Zakatable Assets	Accounting Terminology	RM
1. Cash	Cash in hands	
	Cash in banks / deposits in Financial Institution	
2. Stock of Trade	Inventories	
3. Trade Debtor	Trade debtors / Trade Receivables	
A. Sum of Liquid Assets (No 1 to No 3)		
4. Trade Creditor	Trade payables / Trade creditors	
5. Operational Debt	Accruals (Financing debt not deductible)	
6. Current Unpaid Tax	Tax Payable (current portion)	
B. Sum of Current Payables (No 4 to No 6)		
Zakatable Business Wealth = Sum of Liquid Assets – Sum of Current Payables (equal or exceeding <i>Nisab</i>) <i>Nisab</i> of 2012 is RM13,000 C. Zakatable Business Wealth = Value of “A” – “B”		
Value of “C” Multiply with 2.5%		
Zakat Payable		
Note : The concept of this simple table will be used in the calculation of <i>Zakat</i> for large multinational or listed companies.		

14.12 Zakat on Money

Money is used as a measurement of value, a medium of exchange and storage of value. Both, intrinsic and fiat money have the purchasing power like gold. So *Zakat* rules regarding money will be based on *Zakat* rules for gold (non jewelery). Money means “money which is deposited or kept in saving accounts, fixed deposit, current accounts, and any other kinds of savings”. The *Nisab* for *Zakat* is the current value of 20 *mithqal* of gold which is 85 grams. The rate of *Zakat* is 2.5%. According to Malaysian practice, *Zakatable* value of money is the lowest amount during the completion of *Hawl*.

Example 1: Conventional accounts

Date	In (RM)	Out (RM)	Balance (RM)
02/01/12	22,000		22,000
25/04/12		2,000	20,000
31/05/12	200 (interest)		20,200

15/07/12		1,500	18,700
15/08/12	3,100		21,800
18/09/12		3,200	18,600*
12/12/12	1,000		19,600

Additional note: The *Nisab* for the *hawl* is RM13,000.

Therefore, the calculation is based on RM18,600 since it is the lowest balance of the year (> *Nisab* of RM13,000.). The interest portion also forms the amount of the lowest balance and thus, the interest must be deducted from the lowest balance in order to calculate the *Zakat* on money.

The calculation of *Zakat* is as follows:

Period of *hawl* : 1 *Muharram* – 30 *Zulhijjah*

Nisab : RM13,000.

lowest balance: RM18,600 – RM200 (interest)
= RM18,400

Rate of *Zakat* : 2.5%

Thus, *Zakat* on money/savings is = RM18,400 x 2.5% = RM 460.00

Example 2: Al Wadiah account

Date	In (RM)	Out (RM)	Balance (RM)
02/01/12	22,000		22,000
25/04/12		2,000	20,000
31/05/12	200 (<i>Hibah</i>)		10,200
15/07/12		1,500	18,700
15/08/12	3,100		21,800
18/09/12		3,200	18,600 *
12/12/12	1,000		19,600

Included in the lowest balance is RM200 which is *hibah* (gift by the banks to the depositor after performing business for a year). Thus the calculation of *Zakat* is as follows:

Period of *hawl* : 1 *Muharram* – 30 *Zulhijjah*

Nisab : RM13,000

Lowest balance: RM18,600

Rate of *Zakat* : 2.5%

Thus, *Zakat* on money/savings is = RM18,600 x 2.5% = RM465

Based on the *shariah*, the *hibah* is permitted and hence, it is not deducted from the ending balance amount

Example 3: Multiple savings

If a person has multiple savings accounts, thus a standard *hawl* for all accounts has to be determined. The lowest balance from each account will be added up. If the total amount is more than the *Nisab*, *Zakat* on money will be imposed.

For instance:

Hawl : 1 *Muharram* – 30 *Zulhijjah*

Lowest balances: Accounts No. 1: RM4,000

Accounts No. 2: RM1,000

Accounts No. 3: RM10,000

Total amount: RM15,000

Zakat = RM15,000 x 2.5% = RM375

14.13 *Zakat* on EPF withdrawal

Zakat on savings in Employees Provident Fund (EPF) or any funds similar to it, is imposed if it completes the *hawl* and meets the minimum *Nisab* and within the full control of the owner.

Zakat is imposed on the retirement day when all the funds are withdrawn from the EPF. Before retirement when part of the money is withdrawn from the EPF accounts for instance withdrawal made to buy a house, *Zakat* is imposed on the whole amount of withdrawn amount and the rate on *Zakat* is 2.5%.

Example: The EPF withdrawal is RM100,000, thus the *Zakat* is RM100,000 x 2.5% = RM2,500

14.14 *Zakat* on Shares

According to Dr Yusoff al-Qardawi, in *Fiqh-Zakat*, shares refer to “valuable papers which are traded specifically in trade transactions in the shares market”. As a secondary types of wealth, shares and bond (at capital market) will use *Zakat* ruling for trade goods (absolute rule) The *Zakat* on shares will not be imposed on the investor if the company has already paid *Zakat* on its business. However, if the company does not pay *Zakat* on its business, the holder of the shares has to pay *Zakat* on shares.

How do we calculate *Zakat* from Employee Share Option Scheme?

The calculation depends on two conditions:

- Shares bought in cash. The calculation will be similar to the calculation on *Zakat* on shares.
- Shares bought through loan. The loan installment will be deducted from the worth of the shares (market value) at the end of *Hawl*.

For illustration and examples on *Zakat* calculation, please refer to **Appendix 1**.

14.15 Zakat on Earned Income

Income for *Zakat* means “gains” inclusive of employment income, income from professional services, income from seasonal job or effort and rental income. Islamic scholars such as Prof. Dr. Yusof Qaradhwai, Prof. Dr. Shawqi Ismail Shahata, suggest that employment income and income from rendering professional services are among the wealth from *mustafad* sources. There is no specific *verses* or *hadith* pronouncing that *Zakat* on *mustafad* sources are compulsory. However, Islamic scholars agreed that *Zakat* on *mustafad* sources are compulsory based general meanings of the following: “O ye who believe! Give of the good things which ye have (honourably) earned” (al-Baqarah 2: 267)

Most of the Islamic Council in Malaysia decided that it is compulsory to pay *Zakat* on income from employment and professional services and the Muslim in that state who receive income from the said sources are compulsory to abide the decision.

Types of income subject to *Zakat*

- a. Employment income which subjects to *Zakat* refers to:-
 - ☐ Annual salary
 - ☐ Deferred salary
 - ☐ Various allowances (related to employment)
 - ☐ Others (e.g. bonus or any other income which could be considered as income related to employment)
- b. Income from professional services
 - ☐ Income from undertaking tasks or rendering professional services (e.g consultants)
- c. Income derive from *Mustaghallat* for e.g rental (take net rental)

Methods of calculating employment *Zakat*

There are two approaches in determining the amount of *Zakat* payable:

a. Approach 1

Multiply the rate of 2.5% on gross income for that respective year (without any deduction whatsoever).

b. Approach 2

Multiply the rate with the income chargeable to *Zakat* after deducting allowable expenses. The allowable expenses are defined according to the decision made by the respective Islamic State Council. In the latest fatwa of Selangor in early 2010, deduction for *Zakat* calculation will be using Level of Sufficiency (*Had al Kifayah*) as being used in the determination of poor and hardcore poor.

Deductible expenses

(Allowable annual expenditure for basic needs (Six items of “Limit of Sufficiency” (*Had al Kifayah*) are home, food, clothing, education, medical expenses and transportation)

- ☐ Self RM 8,200
- ☐ Spouse RM 5,000
- ☐ Children still in schools RM 2,200 per person
- ☐ Children under school age, 6 years and below RM 1,500 per person.
- ☐ Adult dependants, e.g parents (RM 2,900 for a year)

- ❑ Net annual contribution / deposit made to institutions that pay *Zakat* (e.g. Tabung Haji)
- ❑ Payment made to Employees Provident Fund (EPF). It is because the money contributed to EPF could not be considered as a “fully owned” since the employee will only receive the money after retirement.

In addition to the above, some Islamic scholars also suggest the inclusion of *mustaghallat* sources in *Zakat*.

Mustaghallat is defined as sources are fixed properties such as land for agricultural purpose and house or buildings which are not meant for trade. Originally, these properties are not subject to *Zakat*. However, if there are benefits arising from the renting or leasing the properties, then they are subject to *Zakat*. The argument is based on *al-Baqarah* (2:267) which Allah SWT states: “O ye who believe! Give of the good things which ye have (honourably) earned.”

Method to calculate the *Zakat* on *Mustaghallat* sources is:

The wealth is deemed as assets which are not subject to *Zakat* and thus only the revenue is subject to *Zakat* once it is gained and meet the *Nisab*. There is no *hawl* condition to be met and the rate of *Zakat* is 2.5%.

There is also an opinion suggesting the actual cost of maintaining the *Mustaghallat* sources such as quit rent and assessment, maintenance of the property to be deducted against the revenue before calculating the *Zakat*.

14.16 Relationship between *Zakat* and Tax for Individuals in Malaysia

The first incentive is on the Scheduler Tax Deduction (STD) payment which is imposed on those salaried individuals who meet the minimum criteria stipulated by the Income Tax Act 1967. Effective from January 2000 an employed individual who deducts *Zakat* from his employment income on monthly basis and at the same time is also subjected to STD payment by the IRB could request from the employer to deduct the amount of monthly *Zakat* from the STD. Therefore, the amount of STD remitted to the IRB is the net amount after deducting the *Zakat* paid. If the amount of *Zakat* deducted on monthly basis is more than or equal to the amount of STD, thus there is no STD remitted to the IRB.

The amount of *Zakat* paid is entitled to be claimed as rebates pursuant to Section 6A (3) of the Income Tax Act 1967. In addition to that, any payment which is related to Islamic religious due such as *Zakat Fitrah* is also entitled for rebates under the same section. However, if the amount of *Zakat* paid is more than the final tax due, no refund will be granted by the IRB

The 2005 Budget for instance provides a new incentive for those corporate taxpayers who pay *Zakat* on business income.

14.16 Conclusion

The chapter has discussed different aspects of *Zakat* for Individuals in Malaysia. Among the points discussed are: The Meaning of *Zakat*, The Importance of *Zakat*, The Conditions for Paying *Zakat*, The Beneficiaries of *Zakat*, The *Zakat* System in Malaysia, Types of *Zakat*, *Zakat* on Agricultural Product, *Zakat* on Livestock, *Zakat* on Gold and Silver, *Zakat* on Mineral (*Ma'adin*) and Buried Treasure (*Rikaz*), *Zakat* On Business, *Zakat* on Money, *Zakat* on EPF withdrawal, *Zakat* on Shares, *Zakat* on Earned Income, and Relationship between *Zakat* and Tax for Individuals in Malaysia. The different aspects have been explained to provide a comprehensive knowledge on zakat for individual.

Self Assessment

1. These are the general conditions for paying *Zakat* **except**:

- A. Muslim
- B. The wealth is fully and partially own
- C. The wealth meets the *Nisab*
- D. The wealth meets the hawl

2. These are the beneficiaries of *Zakat*, **except**

- A. *Fakir* and *miskin*
- B. *Muallaf*
- C. Orphan and single mother
- D. Wayfarer

3. How many approaches are there to calculate *Zakat* on earned income?

- A. One
- B. Two
- C. Three
- D. Four

4. On 5 January 2011, Ina bought 30 lots of shares in Ekano Power Berhad. The acquisition cost per unit of shares was RM1.00. On 31 December 2011, Ina still held the same number of shares and the value of shares per unit was RM0.95. How much *Zakat* on shares did Ina had to pay for year 2011?

- A. RM 750
- B. RM 712.50
- C. RM 650
- D. Nil

5. Encik Shahrul has multiple savings accounts and the lowest balances of the accounts for the year 2011 are as follows:-

	RM
Conventional saving accounts in Public Bank Berhad	3,400.00
<i>Al-Wadiah</i> accounts in Maybank Berhad	7,500.00
<i>Al-Wadiah</i> accounts in Bank Muamalat Berhad	3,900.00

Included in the above balances were interests from the conventional bank of RM100.00, *hibah* from Maybank Berhad and Bank Muamalat Berhad of RM200.00 and RM40.00 respectively. How much *Zakat* on savings that Encik Manan had to pay for year 2011?

- A. RM295.00
- B. RM367.50
- C. RM370.00
- D. RM266.25

6. The wealth below are subject to *Zakat* **except**:

- A. Agricultural product (e.g.rice)
- B. Land and building
- C. Gold and silver
- D. Saving and shares

7. Amira has 5 sets of gold rings, necklaces and bracelets that she wears whenever she attends functions like weddings or dinner. At the end of year 2012, the weight of the gold from her 5 sets of rings, necklaces and bracelets was 220 grams. The current price of 1 gram gold was RM132.50. The *uruf* for owing jewellery is 800 grams. How much *Zakat* on gold that Amira has to pay for year 2012?

- A. RM728.75
- B. RM1,475.50
- C. RM3,543.75
- D. Nil

8. Calculate *Zakat* on paddy below and choose the right answer for each boxes.

Total weight of paddy	:	2,000 kg
Value of paddy per kg	:	RM1.60
Value of paddy	:	<input type="text"/>
Rate <i>Zakat</i> on agriculture	:	5 %
Value of <i>Zakat</i>	:	<input type="text"/>

- A. RM3,200.00; RM320.00
- B. RM3,200.00; RM80.00
- C. RM3,200.00; RM0.00
- D. RM3,200.00; RM160.00

9. Which one of the following statements is true in respect of *Zakat* on business?

- A. Basic equation or basic steps to assess *Zakat* on business is:- Cash + Stocks for sale + Debtors – Creditors
- B. Trade receivable and cash in hand is not *Zakatable*.
- C. *Zakat* on business is calculated based on profit earned during the year.
- D. Trade creditor is *Zakatable*

10. Encik Ramli rears 40 goats in his village. At the end of year 2011, he has 47 goats. What is number of his *Zakatable* goats?

- A. 1 goat
- B. 47 goats
- C. 40 goats
- D. 7 goats

Answer: 1-B, 2-C, 3-B, 4-B, 5-B, 6-B, 7-D, 8-D, 9-A, 10-A

APPENDIX 1

Example of *Zakat* on Shares Calculation based on Fatwa *Zakat* Pelaburan Saham 2009.

GUIDELINES FOR CASE SAMPLES:

1. All share prices and name of companies are for the purpose of illustration only.
2. Assumption of *Nisab* is RM 5,000.00.
3. This sample uses *hawl* Masihi

SCENARIO 1 : SHARES KEPT IDLE FOR ONE YEAR

PORTFOLIO

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Tenaga Nasional	2,000.00				1,800.00			2,300.00				2,200.00
Media Prima	5,000.00		4,700.00							5,700.00		5,500.00
Puncak Niaga	3,000.00					3,500.00			2,800.00			2,700.00
Sime Darby	4,500.00			5,000.00			4,700.00					4,800.00
Telekom	6,000.00		6,400.00			6,200.00				5,800.00		6,100.00
TOTAL	20,500.00											21,300.00

$$\text{Zakat} = \text{RM } 21,300 \times 2.5\% = \text{RM } 532.5$$

SCENARIO 2 : NEW SHARES + SHARES KEPT IDLE FOR ONE YEAR

PORTFOLIO

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Tenaga Nasional	2,000.00				1,800.00			2,300.00				2,200.00
Media Prima	5,000.00		4,700.00							5,700.00		5,500.00
Puncak Niaga	3,000.00					3,500.00			2,800.00			2,700.00
Sime Darby	4,500.00			5,000.00			4,700.00					4,800.00
Telekom	-	-	6,400.00			6,200.00				5,800.00		6,100.00
TOTAL	14,500.00											21,300.00

1. Telekom shares was purchased in March at RM 6,400 with 100% borrowed money.
2. Loan installment payment in current year is RM 5,000. Balance of RM 1,400 will be paid in next year.

$$\text{Zakat} = (\text{RM } 21,300 - 5,000) \times 2.5\% = \text{RM } 407.50 \text{ [(market value at } \textit{Hawl} \text{ completion - purchase cost incurred in current year) } \times 2.5\%]$$

SCENARIO 3 : SHARES ACTIVELY TRADED DURING THE YEAR

PORTFOLIO

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Tenaga Nasional	2,000.00				1,800.00			2,300.00	-	-	-	-
Media Prima	5,000.00		4,700.00							5,700.00		5,500.00
Puncak Niaga	-	-	-	-	-	-	-	3,500.00	2,800.00			2,700.00
Sime Darby	4,500.00			5,000.00			4,700.00					4,800.00
Telekom	6,000.00		6,400.00			6,200.00				5,800.00		6,100.00
TOTAL	17,500.00											19,100.00

1. TNB shares bought at January with cost of RM2,000. Then sold at August at RM 2,300. Cash profit realised RM 290 net of brokerage fees.
2. Puncak Niaga bought at August at RM 3,500 but at the end of *Hawl* worth reduced to RM 2,700

$Zakat = (RM\ 19,100 + RM\ 290) \times 2.5\% = RM\ 484.75$ [(market value at *Hawl* completion + net profit realised during current *Hawl*) \times 2.5%]

SCENARIO 4 : SHARES ACTIVELY TRADED DURING THE YEAR

PORTFOLIO

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Media Prima	5,000.00	5,100.00	5,200.00	-	-	-	-	-	-	-	-	-
Puncak Niaga	-	-	-	-	2,800.00	3,100.00	-	-	-	-	-	-
Sime Darby	-	-	-	-	-	-	4,700.00	4,500.00	5,000.00	-	-	-
Telekom	-	-	-	-	-	-	-	-	-	-	5,800.00	6,100.00
TOTAL	5,000.00											6,100.00

1. Media Prima shares bought in January at RM 5,000 and sold in March at RM 5,200 (cash profit RM 195 after brokerage fees)
2. Puncak Niaga shares bought in May at RM 2,800 and sold in June at RM 3,100 (cash profit RM 290)
3. Sime Darby shares bought in July and later sold in September at RM 5,000 (Cash profit RM 290)
4. Telekom shares bought in November at RM 5,800 and at end of December worth RM 6,100. This shares remain unsold at the end of December
5. In April and October, there is no share hold by this investor.

$Zakat = (RM\ 6,100 + RM\ 775) \times 2.5\% = RM\ 171.88$ [(market value at *Hawl* completion + net profit realised during current *Hawl*) \times 2.5%]

EXPLANATIONS

1. Current year installment of loan taken to buy shares (whether has been paid or in arrears) will be deducted from the worth of portfolio at the end of *Hawl*.
2. Investment in shares (or other instruments at capital market) will be deemed as trade goods, so *Hawl* used is the *Hawl* of the portfolio (investor has been investing for a complete year) We are not tracking the *Hawl* of each share or counter.

This guideline was prepared for all kind of investment in this country under the supervision of Securities Commission (SC). It is not limited to normal shares, can be used for other instrument traded at the capital market. Samples of investment at the Bursa Malaysia / KLSE are as follow:

1. Bonus Issue
2. Right Issue
3. Unit Trust (state or private)
4. Preference Shares
5. Exchange Traded Fund / ETF
6. Warrant / Transferable Subscription Rights / TSR
7. Structured Warrant
8. Loan Stock

All kind of investment in local or foreign capital market are deemed as '*urud tijarah*' and *Zakat* will be imposed on market value at the end of *Hawl*.

For ownership in investment with terms attached as:

1. Restriction of transaction for shares bought through loans (ASB purchased with Maybank loan) or
2. Transaction suspended (under PN4 or PN 19) or
3. Any other reason that makes the owner incapable to spend/sell/give-out the assets owned.

Investment portfolio is deemed as Incomplete Ownership. Will be *Zakat* exempted until all the restriction are removed.

For Investment In Non Shariah Compliant Shares

Only initial capital is *Zakatable*. Capital gain and dividend received after the conversion to Non Compliant status is not permissible and not *Zakatable*. If value drop from original investment value, investor can wait till he recover initial cost. For more details please refer to SC Islamic Capital Market Guideline on the matter.

APPENDIX 2

SUMMARY OF ZAKAT COMPUTATION

A. Standard table of computation					
TYPE	HAWL	NISAB	RATE	ZAKATABLE VALUE	ZAKAT DUE
Agriculture	No	5 awsuq	5% / 10%	Harvest amount	Harvest time
Livestock	Yes	Sheep & goats 40 Cow 30 Camel 5	Non fixed rate, refer classical reference	Amount at year end	Annually
<i>Maadin</i> (extracted underground content)	No	No	20%	„Harvest amount“	„Harvest time“
<i>Rikaz</i> (buried ancient treasure)	No	No	20%	„Harvest amount“	„Harvest time“
Gold & Silver (any form) For women's ornaments, must exceed „ <i>uruf</i> “	Yes	20 dinar/ 85 g gold/ „ <i>uruf</i> “	1/40 / 2.5%	Market Price	Annually
Monetary assets (treated similar with gold & silver), such as <ul style="list-style-type: none"> Shares (private / public) Cash / Cash Equivalent Statutory Savings Unit Trust / Mutual Fund / REITs Cash Value in Life / Education Insurance / Takaful Policies Investment Linked Policies 	Yes	85 g gold	2.5%	Market Price (for non- shariah compliant, only initial capital) *	Annually (except EPF, on balance available after one year of withdrawal OR immediately)
Business	Yes	85 g gold	2.5%	Working Capital (<i>Zakat</i> adjusted)	Annually
Earned Income (Employment Income & Non Employment / Passive Income)	Yes	85 g gold	2.5%	Surplus over basic needs	Annually (Msian view) or immediately
<p>Notes :</p> <ol style="list-style-type: none"> All monetary assets must be free for use (without being pledged or terms of usage attached), if any of assets above is being held as pledge, then its stop being <i>Zakatable</i>. If only part of the assets was pledge, then only that particular portion is waived from <i>Zakat</i>, the portion being free for use will be <i>Zakatable</i>. <p>All annual type of <i>Zakat</i> amwal can be paid in advance / installment</p>					

Chapter 15

Tax Administration

Chapter Outline:

- 15.1 Introduction
- 15.2 Returns, Assessments and Appeals
- 15.3 Returns
 - 15.3.1 Failure to Submit Returns
 - 15.3.2 Returns by Employer
- 15.4 Assessments (Section 90)
 - 15.4.1 Additional Assessment [Section 91]
 - 15.4.2 Advance Assessment [Section 92]
 - 15.4.3 Reduced Assessment
 - 15.4.4 Notice of Increased Assessment [Section 101(8)]
 - 15.4.5 Finality of Assessment [Section 97]
- 15.5 Appeals
 - 15.5.1 Review of Appeal by Director – General
 - 15.5.2 Special Commissioners
- 15.4 Summary of Return, Assessment and Appeal
- 15.6 Relief in Respect of Error or Mistake
- 15.7 Responsibility of a Taxpayer & Employer (other than a company)
- 15.8 Offences and Penalties
- 15.9 Tax collection
 - 15.9.1 Where A Notice of Assessment Is Not Issued (Deemed Assessment)
 - 15.9.2 Where A Notice of Assessment Is Issued
 - 15.9.3 Penalty Where A Notice of Assessment Is Deemed Issued

15.9.4 Penalty on Late Payments When Notice Issued

15.9.5 Penalty For Late Payment Of Instalments

15.9.10 Scheduler Tax Deduction (STD)

15.9.11 Section 107B Tax

15.9.12 Penalties

15.9.13 Remittance Slip

15.9.14 Notification to Collection Branch

15.9.15 Companies

15.9.16 Recovery of Tax [Section 104]

15.9.17 Legal Proceeding [Section 106]

15.10 Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- Appreciate the importance of tax administration
 - Explain the rules regarding Returns, Assessments and Appeals
 - Appreciate the consequences of not complying with the rules regarding submission of tax returns
 - Understand the responsibilities of an Employer as regards forms and submissions
 - Understand the various types of assessments like advance assessments, additional assessments, increased assessments, and reduced assessments
 - Understand the appeals procedure under Schedule 5, ITA 1967
 - Understand the penalties imposed for the various offences under the ITA 1967
 - Appreciate the importance of timely payment of taxes and the penalty for late payment.
 - Appreciate the tax collection procedure and recognize that collection is different from assessment
 - Explain the Scheduler Tax Deduction scheme for employees
 - Explain the provisions for errors and omissions by taxpayers
- Explain the whole procedure for payments on estimated income and the timing of revisions
- Understand fully when tax returns become final and conclusive
 - Appreciate the new approach of tax audits versus tax investigations and the role of self assessment

15.1 Introduction

Under the self-assessment system knowing the IRB tax administration is going to be vitally important. Tax compliance is important for the smooth functioning of your tax operation. Penalties are often accrued at this vital stage. Tax compliance must be taken seriously.

15.2 Returns, Assessments and Appeals

Section 77 (1) states that, — Every person, other than a company, trust body or co-operative society to which Section 77A applies, shall for each year of assessment furnish to the Director General a return in the prescribed form

- (a) in the case of that person who is carrying on a business, not later than 30 June in the year following that year of assessment or
- (b) in any other case than Para (a) not later than 30 April in the year following that year of assessment

In a combined assessment situation under Section 45(2), any reference to a person carrying on a business also includes the wife or husband who elects and therefore follows the 30 June filing date.

Provided that that person has —

- (a) Chargeable income for that year of assessment; or
- (b) No chargeable income for that year of assessment, but has chargeable income or has furnished a return or has been required under this Act to furnish a return, for the year of assessment immediately preceding that year of assessment.

Where a person is required to furnish a return, Director General may by way of notification waive that requirement for any year of assessment.

An individual who arrives in Malaysia during a particular year of assessment and

- (a) is chargeable to tax for that particular year; or
- (b) is not chargeable to tax for that particular year but is chargeable to tax for the year of assessment following that particular year, shall, within two months of his arrival give notice to the Director General that he will be so chargeable.

Under Section 77A, — every company, trust body or co-operative society shall for each year of assessment furnish to the Director General a return in the prescribed form within seven months from the date following the close of the accounting period which constitutes the basis period for the year of assessment.

15.3 Returns

The general issue of tax return forms are normally in February or March [except for Form E] following the relevant year of assessment. The different categories of return forms are as follows:

- a) Form B : is for Individuals. Form BE is for employment cases and Form B is for individuals with other types of income, for example business or rental.

- b) Form C : is for Companies
- c) Form P : is issued to Partnerships to report their income, but will not be taxed in their name. Each partner is taxed as an individual having a business source.
- d) Form T : is for Trusts, Associations, Clubs, Societies, Deceased person's estate, and Hindu Joint families.
- e) Form M : for Non-Resident Individuals receiving income derived from Malaysia
- f) Form E : for Employers ☐ showing the remuneration paid to the employees

A person chargeable to tax who changes his address in Malaysia to another address in Malaysia shall within 3 months notify the Director-General in writing regarding the change of address.

15.2.1 Failure to Submit Returns

Under Section 112 (1), —a person who without reasonable excuse fails to submit his returns within the prescribed time or fails to give notice of his chargeability to tax, is guilty of an offence and on conviction by court is liable to a fine from RM 200 to RM 2,000 or to imprisonment for a term not exceeding 6 months or to both.

In any prosecution against him, the taxpayer has the burden to prove that a return has been made.

However, if the Director-General decides not to prosecute the accused taxpayer who has failed to submit the return form or to give notice of his chargeability for a year of assessment, a penalty of up to 300% the amount of tax payable for that year of assessment may be imposed. (Section 112[3][a]).

If a person pays the above penalty ([or a penalty that is abated or remitted), he shall not be liable to be charged on the same facts with an offence under Section 112(1). [Section 112(3) (b) applies].

The penalty imposed under Section 112(3) of the Act is included in the notice of assessment and recoverable as tax. The said penalty should in no case exceed 3 times the total tax charged for the year of assessment.

15.2.2 Returns by Employer

The employer has various duties under the ITA. His compliance includes the following:

a) Form E and EA/EC

Under Section 83 (1) -every employer is required to prepare and submit a return (Form E and EA/EC) to the Director-General within a time so specified (normally within 30 days) with the return containing:-

- i) Names, places of residence of employees and personal details of each employee; and
- ii) Amount of remuneration (cash and benefit-in-kind) paid payable or provided by the employer to each employee.

b) Notice Required for New Employee (Form CP 22)

Where an employer commences to employ an individual who is or is likely chargeable to tax in respect of his employment income, the employer is required to notify the Director-General within one month from the date of commencement of employment (in the prescribed form CP 22).[Section 83(2)]

c) Notice to be given for Termination (Form CP 22A/21)

Where an employer is about to cease to employ an employee, the written notice (Form CP 22A) must be submitted to the Director-General stating the full name and address of the employee and the expected date of cessation of employment not later than one month before the cessation.[Section 83(3)]

It is provided that where the Director-General is satisfied with the reasons given, he may accept a notice (Form CP 22A) given less than one month before cessation or a notice given on or after the cessation.

Where an employee chargeable to tax (in respect of his employment income) is about to leave or intends to leave Malaysia for a period exceeding 3 months, the employer shall not later than one month before the expected date of departure give written notice (Form CP 21) of the employee's departure to the Director-General. [Section 83(4)]

Employers are not required to submit Form CP22A to the DGIR, with effect from 1 January 1997,

- i) where the income of the employees had been subject to monthly tax deduction under the STD scheme; or
- ii) where the employee's income is below the minimum amount of income that is subject to monthly tax deduction under the STD scheme.

The dispensation from filing Form CP22A only applies if the employee is not retiring from employment permanently: - Proposed in the 1997 Budget.

d) Money Payable to Employee (Section 83(5))

Where an employer has in his possession any money which is or may be payable to the employee who has ceased or about to cease to be employed or about to leave Malaysia for a period of more than 3 months with no intention of returning, the employer shall not pay the money in his possession to the employee, without the permission of the Director-General.

However, the employer may pay the money in his possession after 90 days from the date the notice of termination is received by the Director-General. The employer shall pay the money in his possession either to the employee or to the Collector of the Inland Revenue Department within the 90 days period, as directed by the Director-General.

EXAMPLE

Eddie commenced employment with Express Sdn Bhd in Johor Bahru with effect from 1 March 2004 at a monthly remuneration of RM 5,000. On 1 June 2005, he was transferred to the Company's branch in Kuala Lumpur. Eddie took up residence in Cheras, Kuala Lumpur. On 1 March 2007, he was posted to the parent company of Express Sdn Bhd in Singapore for a period of 6 months and would return to Malaysia on 1 September 2007.

What are the responsibilities and duties to be carried out when giving notice to the Inland Revenue Department?

Notification required by Eddie

- a) To submit a return of his income by the 30th of April 2005 in respect of YA 2004. [Section 77(1)]
- b) To notify the Director-General of his change of address from Johor Bahru to Kuala Lumpur, within 3 months of the change of address. [Section 89]

Notification required by Express Sdn Bhd [Employer]

- a) Notify the Director-General of commencement of employment in respect of Eddie within one month of his employment. [Section 83(2)].
- b) Notify the Director-General of Eddie leaving Malaysia for more than 3 months. The notification is to be given not less than one month before the expected date of departure. [Section 83(4)]

15.3 Assessments (Section 90)

With self assessment in place a notice of assessment (Form J) will not be issued anymore as in the past. Section 90 of the ITA 1967 states that the return furnished by the taxpayer is deemed to be a notice of assessment and the deemed notice of assessment shall be deemed to have been served on the day the return is furnished to the IRB. An assessment is deemed to be made by the IRB on the day on which the tax return is furnished.

An assessment will be made and notice will be issued only in the following cases:

- When an additional or reduced assessment is made
- When an estimated assessment is made following failure to furnish returns within the stipulated period
- Where the taxpayer has not been taxable and subsequently further income was reported for an earlier year and now falls in the taxable range or becomes taxable after adjustments were made by the taxpayer or the IRB.

15.3.1 Additional Assessment [Section 91]

Under the provisions of Section 91(1), an assessment or additional assessment may be raised if:

- a) the original assessment was inadequate and there is additional income subject to income tax;
- b) there has been an over-repayment of tax; and
- c) there has been excessive set-off in the earlier assessment.

Additional assessments may be raised within 6 years after the end of the year of assessment i.e. additional assessment for Y/A 2001 may be raised at any time before 31 December 2007. This section implies a time bar of 6 years. However, under Section 91(3) the D-G has the power to raise an assessment at any time where it appears to him that fraud or wilful default has been committed or there has been negligence.

Note: One has to rely on case laws to get a better idea as to what is fraud, wilful default or negligence. The burden of proof to impose tax beyond six years will now be with the D-G.

Section 74(3) states that -if the person chargeable to tax is a deceased person, assessments or additional assessment must be raised within 3 years after the end of the year of assessment in the basis year in which:

- a) the individual died;
- b) the Estate Duty Affidavit* was filed in Malaysia, if any;
- c) where there is an Estate Duty Affidavit*, the last of any corrective affidavits relating to the Estate Duty Affidavit was filed being the latest basis year of any of the above events taking place.

*Note: Estate Duty has been abolished effective from 1 November 1991.

15.3.2 Advance Assessment [Section 92]

Advance assessment may be raised by the Director-General in the following circumstances where

- a) A person ceases to possess a source consisting of a business in a year of assessment;
- b) A person is about to leave Malaysia and his sources of income are likely to cease on his leaving Malaysia.
- c) where a person commences to receive income from an employment in respect of pension, annuity or other periodical payments

The advance assessment is raised in the year in which the business source ceased or in the year in which the person departs Malaysia.

EXAMPLE

An individual received employment income until 30 September 2007 and was about to leave Malaysia on 15 October 2007. The assessment for 2007 can be raised as an advance assessment in 2007 (although normally you would submit the return form only in 2008.)

15.3.3 Reduced Assessment

The Director-General may make a reduced assessment where:

- a) The taxpayer's chargeable income is less than what has been assessed;
- b) Certain relief to which the taxpayer is entitled have not been deducted in his earlier assessment

The amount of tax reduced or discharged can either be refunded to the taxpayer or carried forward to set off against the taxpayer's future tax payable.

15.3.4 Notice of Increased Assessment [Section 101(8)]

Where a taxpayer appeals against the Assessments issued and the case in dispute is referred to the Special Commissioner for hearing. When the dispute is resolved and the taxpayer's agreed final liability is more than the previous assessment, the Director-General will issue a Notice of Increased Assessment to the taxpayer.

Since the above assessment is issued as agreed with the appellant, the taxpayer (appellant) cannot appeal against the Notice of Increased Assessment as the assessment becomes final and conclusive.

15.3.5 Finality of Assessment [Section 97]

An assessment made shall be final and conclusive where:

- a) No valid notice of appeal against the assessment has been given.
- b) An agreement has been arrived at with respect to an assessment being appealed between the taxpayer and the Director-General.
- c) An assessment has been determined on appeal and there is no right of further appeal or
- d) A valid notice of appeal against an assessment has been given, but the appellant dies before the hearing of the appeal by the Special Commissioner has commenced or completed and no personal representative of the estate of the deceased appellant applies to the Special Commissioner within 2 years after his death to proceed with completing the hearing.

15.4 Appeals

Section 99 (1) provides that, — a person aggrieved by an assessment made in respect of him may appeal to the Special Commissioners against the assessment by writing to the Director-General within the time specified in the notice, stating his grounds of appeal and such other particulars as may be required by the form CP 14.

The time specified in the notice for appeal is normally within 30 days after the service of the notice of assessment but in the case of an advance assessment under section 92, the time limit for a valid appeal is within the first 3 months of the year of assessment for which the assessment was made.

15.4.1 Review of Appeal by Director-General

On receipt of a notice of appeal, the assessment must be reviewed and if necessary, the Director-General may:

- a) Request the appellant to furnish such particulars with respect to the income to which the assessment relates;
- b) Require the appellant to produce all books, or other documents relating to the source the assessment relates;
- c) Summon any person who in his opinion is able to give evidence relating to the assessment to come before him;
- d) Examine any person so attending on oath.

Where as a result of a review, the Director-General and the appellant come to an agreement in writing as to the amount of the chargeable income and the tax chargeable thereon, the assessment against which the appeal is made shall be treated as having been confirmed, reduced or discharged in accordance with the agreement.

Where as a result of the review, the Director-General and the appellant come to an oral agreement regarding the amount of chargeable income and tax chargeable thereon, the Director-General will serve a written confirmation of the agreement on the appellant. The appellant can repudiate the agreement within 21 days from the date of service of the notice in writing. Otherwise, the oral agreement shall be deemed to be an agreement in writing after the expiration period.

If on reviewing the appeal, the Director-General may make a proposal in writing to the appellant regarding amendments to the assessment, the appellant may, within 30 days give notice in writing rejecting the proposal. Otherwise, the proposal shall be deemed to have been accepted.

15.4.2 Special Commissioners

An appeal must be forwarded to Special Commissioners within 12 months of its receipt by the Director-General. However, if the review cannot be completed within that period, the DG may apply to the Minister of Finance for extension of the period **NOT LATER THAN 30 DAYS** before the expiry of the 12 months, and the maximum extension is for **6 months**

The taxpayer will be notified in writing when the Form Q is forwarded to the Special Commissioners. The place and date of hearing will be fixed and the appellant will be notified 28 days in advance of the hearing.

However, if anytime before hearing, the Director-General and the appellant can come to an agreement; the appellant can withdraw the appeal.

15.5 SUMMARY OF RETURN, ASSESSMENT AND APPEAL

Taxpayer

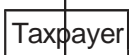
Submits tax return and settles his tax



The Director-General (DG) may:

- 1) Accept the return.
- 2) Refuse to accept the return and raise an assessment according to his best judgement.

If no return is submitted by Mr A, the DG may raise an assessment (including the penalty) under Section 90(2).



Or

- 1) Taxpayer is satisfied with the returns submitted by him. Assessment becomes final and conclusive; or.
- 2) Taxpayer may appeal against the Assessment & submit his appeal together with the returns. For advance assessment, the appeal must be lodged by 31 March in the year of assessment following the year of assessment for which the assessment was raised.

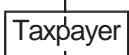


The DG may review the assessment under Section 101 and for that purpose may

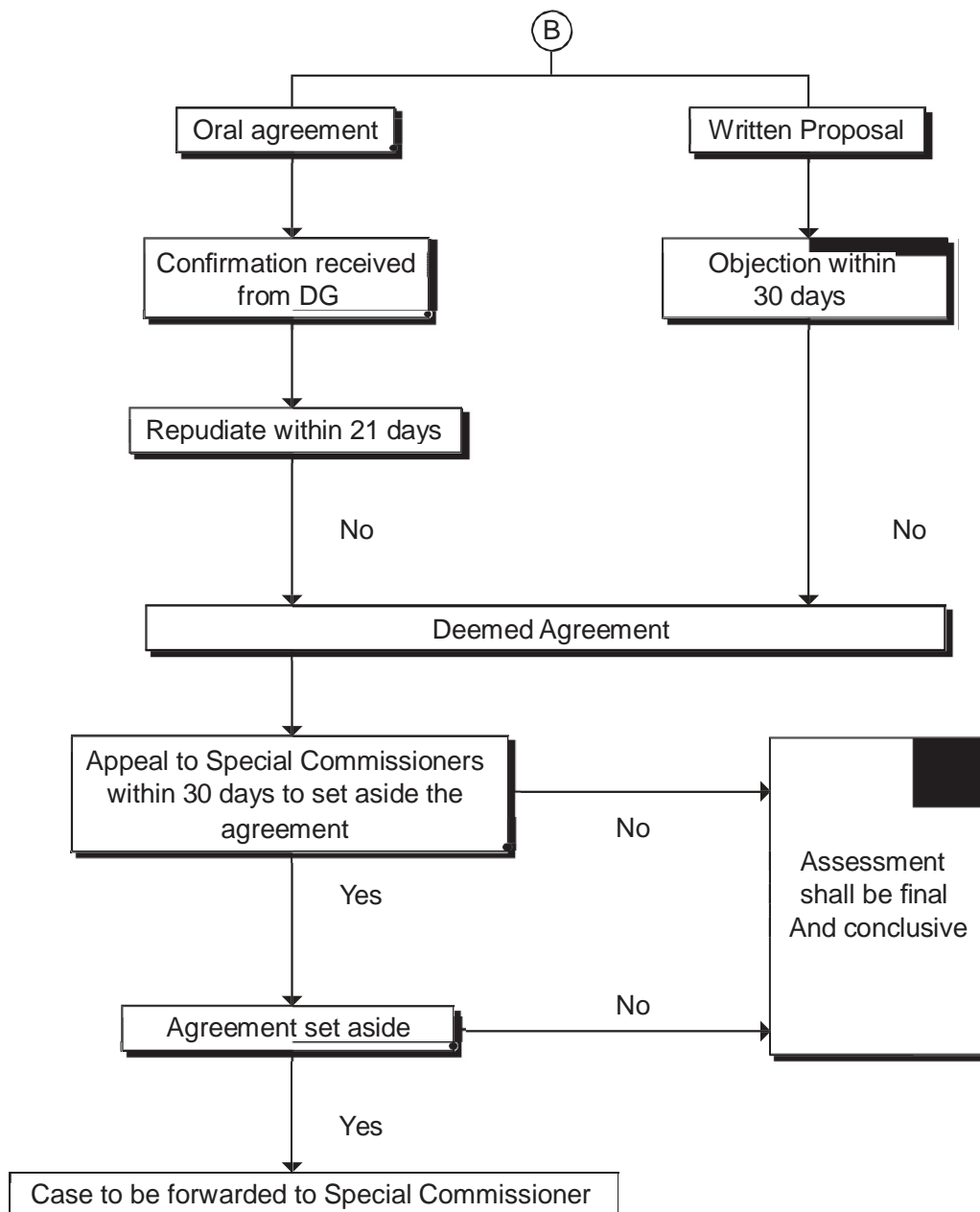
- 1) require further particulars;
- 2) require the production of books etc.;
- 3) summon persons to give evidence;
- 4) examine persons so attending on oath.

The DG may:

- 1) come to an agreement in writing with Taxpayer Assessment becomes final and conclusive
- 2) Decide that no agreement can be reached with Taxpayer. Taxpayer may appeal to Special Commissioner
- Section 102(1) or
- 3) review the taxpayer's appeal if taxpayer is not satisfied; or
- 4) come to an oral agreement with Taxpayer
- 5) make a written proposal to Taxpayer



(B)



Taxpayer or the Director-General may appeal to the High Court or the Court of Appeal if either party is not satisfied with the decision of the Special Commissioner.

15.6 Relief in Respect of Error or Mistake

Where a person who has paid his tax for any year of assessment alleges that the assessment for that year is excessive by reason of some error or mistake made in the tax return form, furnished to the Director-General prior to the assessment becoming final and conclusive, he may within 6 years after the end of the year of assessment within which the assessment was made, make an application in writing to the Director-General for relief under Section 131(1).

A claim for error or mistake shall be made in the same manner as a notice of appeal against an assessment. If the taxpayer is not satisfied with the rejection for claim under Section 131(1), he may appeal to the Special Commissioner and pursue his rights of appeal.

EXAMPLE

Assume that the taxpayer submitted his return of income for Y/A 2001 and the Inland Revenue Department has issued a Notice of Assessment for Y/A 2001 on 31 July 2002.

The taxpayer may claim for relief under Section 131(1) at any time up to 31 December 2007 for -error or mistakell made in the return submitted, for example, claiming an admissible deduction (omitted) which he is entitled.

If the Inland Revenue Department issued a notice of assessment (original) for Y/A 1997 in 2000, the taxpayer has the right to claim under Section 131(1) for -error or mistakell made in the return for Y/A 1997 by 31 December 2006.

EXAMPLE

The notice of assessment (original) for Y/A 2000 was issued in 2002. The Inland Revenue Department raised an additional assessment for Y/A 2000 in 2004. The taxpayer has the right to claim for -error and mistakell made in the return by 31 December 2008.

The expression -within 6 years after the end of the year of assessment within which the assessment was madell refers to the year the original assessment was raised.

15.7 Responsibility of a Taxpayer & Employer (other than a company)

- | | | |
|--------------------------------------|---|---|
| a) Tax Instalments | Taxpayers must remit to the Collector of the IRB, monthly /bimonthly tax instalments as per instalment scheme. | Within 30 days from due date. |
| b) Filing of Tax Returns | Every person who receives a tax return is required to complete and submit the return to the DGIR or the extended date granted. (whether liable or not). | By 30 th April of the next year of assessment |
| c) Notice of Objection/Appeal | Notice of objection/appeal against an assessment must be lodged with the DGIR
Advance assessment under Section 92. | Together with the return form
Within 3 months from the beginning of the year of assessment |
| e) Withholding Taxes | Income Tax must be withheld from - <ul style="list-style-type: none"> • Contract payments - 10% + 3% • Interest - 15% • Royalties - 10% • Special classes of income - 10% • Remuneration of public entertainers - 15% made to non-resident persons and remit the tax deducted to the Collector of IRD. | Within 1 month from the date of payment or credited |

- | | | |
|----|--|--|
| f) | Notice of Chargeability
An individual who arrives in Malaysia is required to give his notice of chargeability. | Within 2 months from the date of arrival. |
| g) | Change of Address
Every chargeable person who changes his address in Malaysia to another address in Malaysia must inform the DGIR in writing. | Within 3 months of the change of address |
| h) | Commencement of Employment
An employer who commences to employ an individual likely to be chargeable to tax is required to notify the DGIR. | Within 1 month from date of commencement of employment |
| i) | Cessation of Employment
An employer is required to notify the DGIR of the cessation before the termination of employment of an employee. | Not less than 1 month (from date of cessation). |
| j) | Moneys to be withheld on Cessation of Employment
Employers are required to withhold payment of any monies payable to the employee | To withhold for 90 days until tax clearance is given whichever is earlier |
| k) | Form E and EA/EC
Submission of the above to the DGIR. | Together with the return form
- 30 th April or the approved extended time granted. |
| l) | Deductions from Salaries
Employers must remit to the Collector of IRD the tax deducted from employee's salaries as directed or under the Scheduler Tax Deduction scheme. | To complete the prescribed form together with remittance |

DGIR - Director-General of Inland Revenue (Assessment Unit)
 Collector of the IRB - Collection Branch of the Inland Revenue Board

15.8 Offences and Penalties

Some of the common offences and penalties under the Income Tax Act are:-

OFFENCE		PENALTY
<ul style="list-style-type: none"> Failure to furnish a return or give notice of chargeability 	Prosecution: No prosecution:	Fine RM 200 -RM 2,000 or Jail 6 months or BOTH Penalty 3 X the amount of tax
<ul style="list-style-type: none"> Incorrect returns / information 	Prosecution: No prosecution:	Fine RM 1,000 - RM10,000 & Penalty 2 X the amount of tax undercharged Penalty equals the amount of tax undercharged
<ul style="list-style-type: none"> Wilful evasion of tax 	Prosecution:	Fine RM 1,000 - RM20,000 or jail 3 years or BOTH & Penalty 3 X the amt. of tax undercharged.
<ul style="list-style-type: none"> Leaving Malaysia without paying tax 	Prosecution:	Fine RM 200 - RM 2,000 or Jail 6 months or BOTH
<ul style="list-style-type: none"> Obstruction of officers in the course 	Prosecution:	Fine RM 1,000 to max. RM 10,000 or jail term of one year of their duties or BOTH
<ul style="list-style-type: none"> Breach of confidence by a classified person 	Prosecution:	Fine not > RM 4,000 Jail 1 year or BOTH
<ul style="list-style-type: none"> Offences by officials 	Prosecution:	Fine not > RM20,000 Jail 3 years or BOTH
<ul style="list-style-type: none"> Unauthorised collection of tax or penalties 	Prosecution:	Fine not > RM 20,000 Jail 3 years or BOTH
<ul style="list-style-type: none"> Failure to comply with a notice: <ul style="list-style-type: none"> calling for specific returns & production of books requiring books, accounts, etc. to be translated into national language calling for information & particular to be given in writing requiring records to be kept in a certain way & receipts issued requiring audited accounts to be produced 		Prosecution Fine RM 200 - RM 2,000 or Jail 6 months or BOTH

<ul style="list-style-type: none"> • requiring returns to be submitted by agents • requiring returns by occupiers of premises • calling for further returns 		<p>Prosecution Fine RM 200 - RM 2,000 or Jail 6 months or BOTH</p>
<ul style="list-style-type: none"> ▪ Failure to comply with an order <ul style="list-style-type: none"> • requiring records to be kept in a certain way and receipts issued • requiring employer to submit a return of his employees 		<p>Prosecution: Fine RM 200 - RM 2,000 or Jail 6 months or BOTH</p>
<ul style="list-style-type: none"> ▪ Failure to give notice by an employer of an employee <ul style="list-style-type: none"> • who has commenced work • who is ceasing work • who is about to leave Malaysia 		<p>Prosecution Fine RM 200 - RM 2,000 or Jail 6 months or BOTH</p>
<ul style="list-style-type: none"> ▪ Contravention of the duty imposed under the Act <ul style="list-style-type: none"> • by a person who fails to keep business records and issue receipts • by a person who fails to make appropriate entries in his records • by an agent acting for a non-resident who fails to submit quarterly returns • by precedent partner who fails to submit partnership returns • by a chargeable person who fails to inform of change of address • by a person who holds himself out as a tax agent and does not satisfy the provisions of the Act 		<p>Prosecution Fine RM 200 - RM 2,000 or Jail 6 months or BOTH</p>
<ul style="list-style-type: none"> ▪ Failure to comply with a direction to deduct tax 		<p>Prosecution Fine RM 200 - RM 2,000 or Jail 6 months or BOTH</p>
<ul style="list-style-type: none"> ▪ Failure to furnish an estimate of tax payable under Section 107C 		<p>Prosecution Fine RM 200 - RM 2,000 or Jail 6 months or BOTH</p>
<ul style="list-style-type: none"> ▪ Failure to render a statement or provide information –Section108(5) 		<p>Prosecution Fine RM 200 - RM 2,000 or Jail 6 months or BOTH</p>

15.9 Tax Collection

The Assessment Branch of the Inland Revenue Board which issues return form to a person will send a copy of the tax computation to the Collection Branch which will then proceed with the tax collection. Section 103 is the general section that covers collection and recovery of tax

15.9.1 Where A Notice of Assessment Is Not Issued (Deemed Assessment)

When a notice of assessment is not issued, tax assessed must be paid by 30 April the following year, at the latest for individuals who have non-business income. For individuals with business income the date is 30 June the following year.

15.9.2 Where A Notice of Assessment Is Issued

Where an assessment is raised, the payment must be made within 30 days from the notice of assessment.

15.9.3 Penalty Where A Notice of Assessment Is Deemed Issued

For an individual with non-business income, a penalty of 10% will be imposed on any amount outstanding after 30 April in the following year. If the tax and penalty is still outstanding within 60 days from the due date (30 April), a further penalty of 5% will be imposed on the tax and penalty that is outstanding. For individuals with a business source the due date is 30 June and the penalty provisions are as above.

15.9.4. Penalty on Late Payments When Notice Issued

If tax is not paid within 30 days from the date of the notice of assessment, a 10% penalty on the amount outstanding will be imposed. If the tax and penalty is not paid at the end of 60 days, from the date of such increase, a further 5% will be imposed on the tax and penalty that is outstanding.

15.9.5. Penalty For Late Payment Of Instalments

Where an installment is not paid within 30 days from the due date, a 10% penalty will be imposed on the amount outstanding.

EXAMPLE

Frank submitted his return form for Y/A 2006 on 30 April 2007. The tax payable for that year amounted to RM500. However, he did not pay the tax liability on 30/04/2007. The penalties and tax outstanding for Y/A 2006 shall be:-

	RM
Tax payable per notice of assessment	500.00
Payment received by 30 April 2007	<u>nil</u>
	500.00
Section 103(3) penalty of 10%	<u>50.00</u>
	550.00
Section 103(4) penalty of 5%	<u>27.50</u>
Tax and Penalty outstanding	<u>577.50</u>

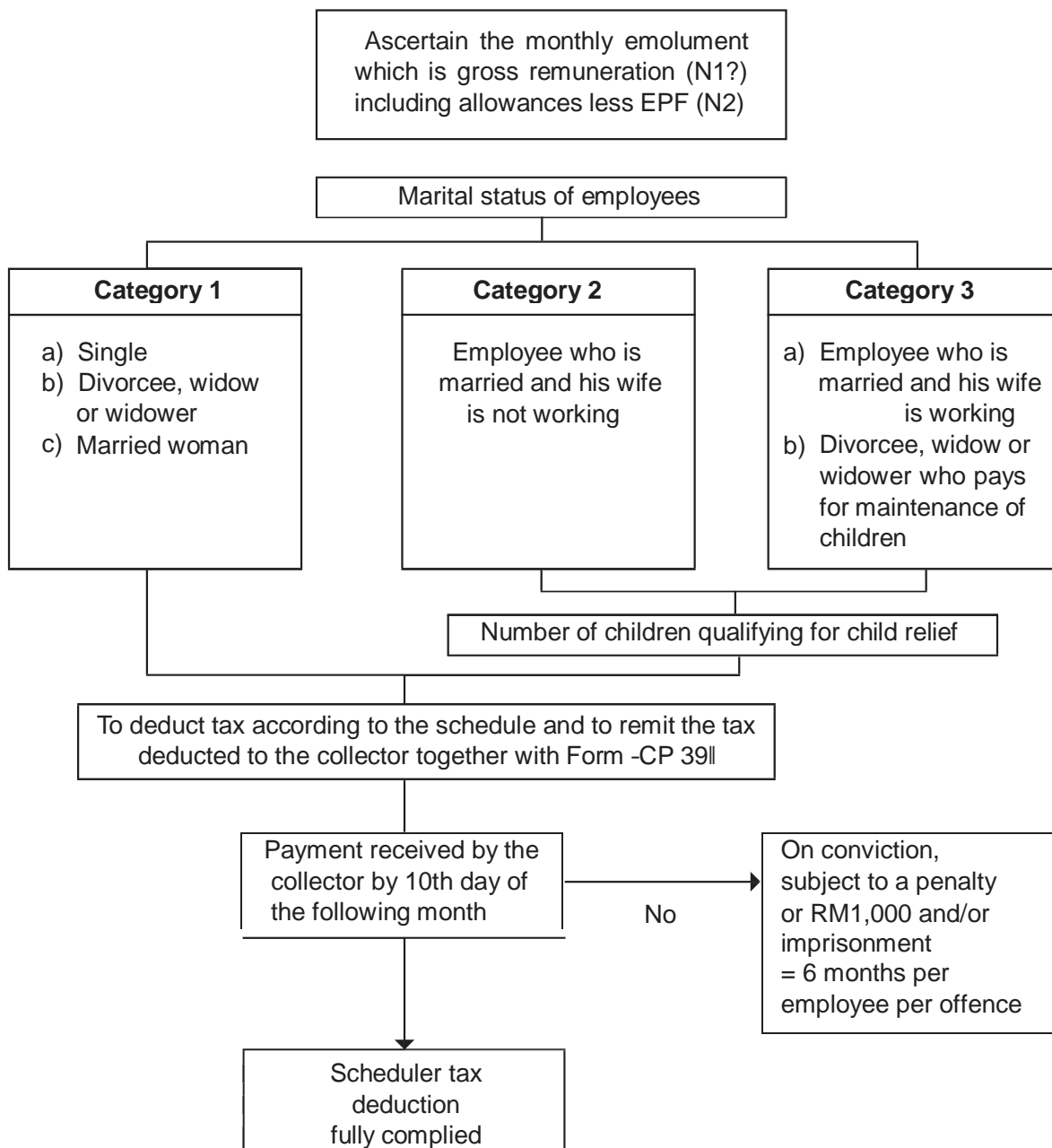
15.9.10 Scheduler Tax Deduction (STD)

Effective from 1 January 1995, the Inland Revenue Department have introduced the Scheduler Tax Deduction scheme to put in place 'Pay as You Go' tax collection system. Under this system, monthly deductions are made from the employee's salary based on tables issued by the IRB. Section 107 provides for this deduction from employment income.

The system applies to all employment income taxable under Section 13 of the Income Tax Act 1967 (as amended). The sums deducted together with the Form CP 39 (Statement of Tax Deductions) must be submitted to the IRB by the 10th day of the subsequent month. Failure to remit the tax deductions will result in a fine of RM 1,000 imprisonment of six months or both.

Once the assessment is finalised, any excess payment is refunded. However, if the tax payable is higher, then the employee must settle the difference within 30 days of the notice of assessment or the month after the last installment, whichever comes later.

SCHEDULER TAX DEDUCTION PROCEDURE (Effective from 1 January 1995)



Notes:-

1. Total monthly remuneration (other than benefit in kind under Section 13(1)(b) and Section 13(1)(c) of the Act) in respect of which monthly deductions are to be made under this Schedule are remuneration of every description paid during the month to the employee, including director's fee less any money paid to the employee by the way of refund for bona fide out-of-pocket expenses incurred in respect of travelling or subsistence in the performance of the duties of the employment and less the employee's compulsory contributions to Employees Provident Fund or to any approved pension fund, subject to a maximum of RM416 per month or RM5,000 per year.
2. Where a bonus, gratuity, commission or other similar payment is made to an employee, additional to normal monthly remuneration, the amount of additional tax to be deducted in the month in which that bonus, gratuity, commissions or other similar payment (the -additional payment) is made shall be calculated as follows:

$$\begin{array}{r} 12 \times \text{deduction on notional monthly remuneration} \\ \text{less} \\ 12 \times \text{deduction on normal monthly remuneration} \end{array}$$

The notional monthly remuneration shall be calculated as the normal monthly remuneration plus one-twelfth of the additional payment.

3. -Child, in relation to an employee, means an unmarried dependent legitimate child or stepchild or adopted child of his, under the age 18 years. If above 18 years old, the child must be
 - a) receiving full-time instruction at any university, college, school or other similar educational establishment; or
 - b) serving under articles or indentures with a view to qualify in a trade or profession.
4. Where an employee is a divorcee, a widow, or a widower, and pays for the maintenance of the children, Category 3 of the SCHEDULER monthly tax deduction applies. Where that employee has no children, Category 1 applies.
5. Effective from 1-1-1996,
 - a) Claim For Child Relief

The Scheduler Tax Deduction (STD) tables are calculated on child relief under normal circumstances. There may be instances where employees could be entitled to additional child relief. Under these circumstances, employers may make deductions in accordance with the following guidelines:

<u>Relief to be given as if the</u> <u>In circumstances where</u>	<u>employee has this number</u> <u>of children :</u>
--	---

- | | |
|---|---|
| i) Child over the age of 18 years and receiving full-time education in a college or university outside Malaysia | 2 |
|---|---|

- | | |
|--|---|
| ii) Child over the age of 18 year and receiving full-time education in a college or university in Malaysia | 4 |
| iii) Child certified by the Department of Social Welfare to be disabled | 6 |
- b) Effective from Y/A 1996

The wife may elect to wholly claim relief. Where she elects, her STD deduction shall be determined in accordance with Category 3 and the STD deduction for the husband shall be determined in accordance with Category 1.

EXAMPLE

An employee who is married has two qualifying children and is earning a monthly remuneration (after deduction of EPF) of RM 2,700 in 2004. His wife is working.

The amount of deduction to be made shall be:-

- a) Category 3 shall be relevant
- b) Monthly deduction of say RM 114

Where bonus payment of RM 3,600 is paid in 2004, the relevant deduction of tax to be deducted in the month that bonus is paid shall be:-

- a) Monthly deduction of say RM114
- b) Monthly remuneration including averaged bonus
 $(1/12 \times \text{RM } 3,600) + \text{RM } 2,700 = \text{RM } 3,000$
- c) Tax deduction in category 3 based on emoluments of RM 3,000 of say RM144
- d) Tax deduction relevant for bonus payment of RM 3,600 shall be:-
 $(\text{RM } 144 - \text{RM } 114) \times 12 = \text{RM } 360$
- e) Amount of tax to be deducted in the month that bonus is paid shall be:-
 $\text{RM } 114 + \text{RM } 360 = \text{RM } 474$, that is (a) + (d)

15.9.11 Section 107B Tax

This applies to taxpayers other than companies and salaried staff (generally individuals with business income). The notice of installment payment comprises of six bi-monthly payments commencing from the month of March of the relevant year of assessment and ending on the month of January in the next year. However, if the taxpayer is of the opinion that the estimate is excessive, he can request for a Variation Notice of Installment Payment by June 30 of that year of assessment.

Each installment is due on the first of the month and must be paid within 30 days from that date, failing which a late penalty of 10% of the installment payment will be imposed.

The return form has to be submitted by 30th June and where the final tax is in excess of the total installments paid or payable, the excess is payable on that date.

EXAMPLE

- i) Estimated tax payable of RM 2,400/- for YA2006
Payment by installments @ RM400/- per month for March, May, July, September, November and January
- ii) Tax payable for the year of assessment 2006 is RM 3,000/-.
- iii) The excess of RM600/- has to be paid by the due date i.e. by 30th June 2007

15.9.12 Penalties

Non-settlement of the any excess tax payable on the due date will result in the imposition of a penalty of 10% of the tax payable. An additional penalty of 5% on both the tax payable and the 10% penalty will be imposed after the expiration of a further 60-day period.

However, if the taxpayer had requested for a variation of instalment scheme, and the actual tax payable exceeds the total varied installments, the variance between this difference and 30% of the actual tax is subject to a penalty of 10%.

EXAMPLE

Tax payable for the year of assessment	RM 10,000
Total installment payments as requested	RM 6,000
	<hr/>
Difference	RM 4,000
	<hr/>

The estimate varies by more than 30%, a RM 1,000 difference. A 10% penalty of RM 100 will be added to the tax due. When 30% of tax payable under an assessment is revised, the penalty will also be revised automatically.

15.9.13 Remittance Slip

All installment payments must be accompanied by remittance slips which will be issued together with the Notice of Installment Payment. It is important that the remittance slip be used when making a payment as this will ensure payment is credited to the correct account. Payments made under this scheme and those made for any other outstanding liabilities should be in separate cheques.

15.9.14 Notification to Collection Branch

As this scheme has been designed to ease the burden of paying tax in one lump sum, any taxpayer who has not received the Notice of Installment Payment by 31st January is advised to notify the Collection Branch immediately.

EXAMPLE

The Collector of the Inland Revenue Department (IRD) issued a Notice of Installment Payment of RM 600,000 under Section 107B to Mr. Kalaivanan in January 2004.

However, according to his estimate, the estimated tax liability for the year of assessment 2004 is only RM 200,000.

He requested for a variation of the installment scheme. The IRB agreed and issued an amended Notice of Installment Payment to Kalaivanan. The due dates for installment payments and the dates the payments were made are as follows:-

Due Date	Amount RM	Date Payment Made
01-03-2004	40,000	06-04-2004
01-05-2004	40,000	30-05-2004
01-07-2004	40,000	08-08-2004
01-09-2004	40,000	24-09-2004
01-01-2005	40,000	18-01-2005
	<u>200,000</u>	

When he submitted his returns for the year of assessment 2004, the actual tax liability amounted to RM 360,000.

Required:

- State the date by which any request for variation of installments must be made by the company. Is it possible to request for changes in due dates?
- Determine the penalties that will be imposed based on the actual dates of payment.
- Compute the penalty for the excessive difference in tax payable arising from the variation in installment payments.
- State when the balance of the tax amounting to RM 160,000 is to be paid.
- Would the above installment scheme apply to employees?

Solution

- A request for variation of installments must be made before 30 June, 2004. It is not possible to request for changes in due dates.
- The IRB will issue a notice of late payment penalties and the penalties would be as follows:-

	RM
For March 2004 RM 40,000 @ 10%	4,000
For July 2004 RM 40,000 @ 10%	4,000
	<u>8,000</u>
iii) Actual tax payable for Year of Assessment 2004	360,000
Total installment payments requested	200,000
	<u>160,000</u>
Difference	
30% of actual tax payable (30% x RM 360,000)	108,000
Excess subject to a penalty of 10%	<u>52,000</u>
Penalty payable	<u>5,200</u>

- v) The excess tax of RM 160,000 has to be paid by 30th June 2005, the due date for individuals with business income.

15.9.15 Companies

Companies are required to provide an estimate of tax payable for a relevant year of assessment 30 days before the commencement of the relevant basis period in Form CP 204. In the case of new companies, an estimate has to be provided 3 months from commencement of business. The estimate must **NOT** be less than 85% of the revised tax payable for the immediately preceding year of assessment.

The Revenue will then issue a notice of installment payment (CP 205) comprising of twelve installments commencing from the second month in the relevant basis period and each installment must be paid on or before the 10th of the month. For new companies, the installment payments will commence from the 6th month of the first basis period. However, if they commence business in the second half of the year, there will be no installment for that year of assessment. A revision of estimate (CP 206) can be made in the 6th month or the 9th month of the basis period.

Since companies are on a self-assessment system, the tax payable for the year of assessment should be settled on the required date of lodgement of returns i.e. within 7 months from the end of basis period. Non-compliance will result in the imposition of a penalty of 10% of the tax payable and another penalty of 5% on both the tax payable and the 10% penalty will be imposed after the expiration of a 60-day period. [Section 103]

Late payment of installments and difference of more than 30% in the estimate will also suffer penalty as in Section 107B case for individuals.

15.9.16 Recovery of Tax [Section 104]

Where the Director-General is of the opinion that any person is about or likely to leave Malaysia without paying his tax liabilities, he may issue a certificate to the Commissioner of Police or Director of Immigration containing the amount of tax payable and requesting that the person be prevented from leaving Malaysia unless he has paid all his tax liability or furnishes security to the satisfaction of the Director-General.

Subject to any order issued or any written law relating to banishment or immigration, the Commissioner of Police or Director of Immigration who receives such a request or a certificate must take steps to prevent that person from leaving Malaysia by seizing that person's passport or other travel documents.

Where a person in respect of whom a certificate has been issued:

- a) produces a written statement signed on or after the date of the certificate by the Director-General or an authorised officer stating that security has been furnished for their payment; or

- b) pays all the tax outstanding specified in the certificate to the officer in charge of the Police Station or to an immigration officer,

he shall be allowed to leave Malaysia.

No legal proceedings shall be constituted or maintained against the Government, a State Government, police or public officer in respect of anything lawfully done.

15.9.17 Legal Proceedings [Section 106]

Tax due and payable may be recovered by the Government by civil proceedings as a debt due to the Government. The legal proceedings are undertaken under Section 106 of the Act when a taxpayer has failed to pay his tax after a Notification of Increase of Income Tax is issued to him.

In any proceedings under Section 106, the court shall not entertain any plea that the amount of tax sought to be recovered is excessive, incorrectly assessed, under appeal or incorrectly increased.

Section 142(1) provides that in a suit under Section 106 the production of a certificate signed by the Director-General giving the name and address of the defendant and the amount of tax due from him shall be sufficient evidence of the amount so due and sufficient authority for the court to give judgement for that amount.

15.10 Conclusion

The chapter has discussed different aspects of Tax Administration. Among the points discussed are: Returns, Assessments and Appeals, Returns, Assessments (Section 90), Appeals, Relief in Respect of Error or Mistake, and Responsibility of a Taxpayer & Employer (other than a company). The different aspects have been explained to provide a comprehensive knowledge on tax administration.

Self Assessment

Q1 Mr. Yap received a directive for instalment payment for 6 bi-monthly payments of RM 250,000 each commencing from March 2004. Basing on the draft management accounts, the accountant computed the estimated tax liability for Y/A 2004 to be about RM 500,000.

You are required to advise the accountant on the following questions raised by him:

- a) How may the instalment payments for 2004 be reduced to RM 500,000?
- b) Would there be any penalty imposed if the variation in (a) is approved by the In and Revenue Board?
- c) When should the difference be paid in the event that the 2004 agreed tax liability is higher than RM 500,000.

Q2 Under what circumstances can the following be made to a person:

- (i) An additional assessment;
- (ii) A tax repayment/refund.

Anselm Sdn Bhd has a 3rd May year-end

Suggested Answers

A1 a) Mr. Yap may vary the instalment payment by writing to the collector of the Inland Revenue Department before 30th June 2004. Request for changes will only be granted by the collector in respect of the amount of each instalment. Changes in due dates (6 bi-monthly) would not be granted.

b) Where approval is given to change the amount of the instalment and should the tax payable for Y/A 2004 exceed the total of the instalments payable (varied by the company), then the difference which exceeds 30% of the tax payable shall be liable to a penalty of 10%.

	RM
Tax payable for Y/A 2004	J
Instalment varied by the company	500,000
	<hr/>
Difference	y
30% of J (z)	<hr/>
	<hr/>
10% penalty shall be imposed on	P
	<hr/> <hr/>

c) Where the agreed tax payable for Y/A 2004 exceeds the tax payable under the instalment scheme, the difference must be settled by the due date.

A2 (i) An additional assessment may be made in the following circumstances:

- 1) Where there is additional income chargeable to tax and the original assessment has not taken account of this income
- 2) Where there is an error in the tax charged in the original assessment for e.g. due to an excessive set-off
- 3) Where there is an over-repayment of tax

(ii) A tax repayment/refund may be made:-

- 1) Where tax has been wrongly paid on income which is tax exempt
- 2) Where tax has been paid by deduction from the income of a person who is not liable to tax

Chapter 16

Tax Planning

Chapter Outline:

16.1. Introduction

16.2. Tax Avoidance is legal Tax Planning

16.2.2. Doctrines of Substance Over Form

16.2.3. Substance over Form-Ramsay Doctrine

16.2.4. Section 140 of the Income Tax Act

16.3. Tax Planning for Individuals

16.2.1. Employee Salary Package

16.2.2. Policyholders

16.2.3. Joint and Separate Assessment

16.4. Dividends

16.3.1. Relief of Capital Expenditure

16.3.2. Tax Losses

16.3.3. Investment Incentives

16.3.4. Bad Debts

16.3.5. Hire Purchase versus Leasing

16.3.6. Case Studies

16.5. Conclusion

Chapter Objectives

Upon completion of this chapter, you should have knowledge of:

- Differentiate tax avoidance with tax evasion
- Understand the concept of substance over form
- Understand the provision of Section 140 ITA 1967
- Appreciate basic tax planning ideas for individuals
- Articulate important tax benefit features in any employment remuneration package
- Explain the role of benefits-in-kind in an employment package and IRB valuations of benefits in kind as per IRB Public Rulings
- Explain the utilization of EPF as a tax efficient savings instrument
- Explain the tax advantage of income shifting and the advantage of scale rates of tax
- Understand all the relief and incentives available to individuals and businesses
- Appreciate the advantage of a corporate structure to run a business operation notwithstanding the single tier tax system for corporate directors
- Appreciate the different tax treatment for controlled companies and ordinary companies.

16.1 Introduction

Tax planning is often misunderstood and misrepresented in many literatures and by many financial planners. Tax planning in a simplistic sense is, knowing the tax laws for tax compliance purposes. With self assessment one has to know how to compute tax and all the compliance procedures along with the penalties for a variety of offences. Financial planners want to master tax planning so that they can save some financial resources in a legal and appropriate sense for the client. The appreciation is very high for good tax planning ideas.

Tax planning can only be undertaken when you understand the tax laws. Therefore, knowing the tax laws and the tax system is vital to undertake tax planning.

16.2 Tax Avoidance is legal Tax Planning

Tax avoidance is the deliberate attempt to plan a person's financial affairs so that the scheme or transaction would not fall within the ambit of taxation or reduces the impact of taxation or defers taxes to take advantage of timing.

In *IRC v Duke of Westminster, Lord Tomlin* said:-

“Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be”.

In a local case, *DGIR v Rakyat Berjaya Sdn Bhd, Lee Hun Hoe CJ (Borneo)* held the view that

“There is nothing wrong at all for a company to organise the affairs in such a way so as to minimise tax”.

16.2.1 Doctrines of Substance Over Form

Form over Substance-Duke of West Minister Doctrine

In *IRC v Duke Westminster* the facts were whether salaries paid to servants and household staff were deductible from the income of the payer as expenses. Under the law prevailing in United Kingdom then, amounts paid under deed of covenants were transferable to the recipients, in this case the household staff, for income tax purposes. The Duke, therefore, covenanted with his household staff to pay them regularly sums of money in lieu of salary under a deed of covenant. The result was that the Duke had a deduction and the employees were taxable but, being mostly under the threshold for taxation, no tax liability in fact arose. The covenant clearly stipulated that payments were not in lieu of salary. The Duke by way of a letter with the employees agreed with the employees that as long as the deed was in force they were not to be paid wages.

It was held that the Court was not entitled to go beyond the documents. The Court should rely on the legal rights and liabilities of the parties created by the deed. The above was known as the Duke of Westminster doctrine or form (documentation) over substance (intent or undertaking motive) doctrine.

16.2.2 Substance over Form-Ramsay Doctrine

The court may reject form for substance if the former is a mere sham. Recent decisions by the UK courts appear to have placed substance over form (the Ramsay doctrine) as decided in *Ramsay Ltd v CIR, CIR v Burma Oil Co. Ltd and Furniss v Dawson*

In the Ramsay case, a company made a capital gain on a sale of farm land. To avoid capital gains tax on the profit, the company bought a ready made tax avoidance scheme. In essence, to offset the gains, the company sought to create an equivalent loss in law, which was in fact economically non-existent. The Inland Revenue Department advanced their argument that a distinction must be made between transactions which have value and substance and those which have none. Lord Wilberforce, while pointing out that the Court cannot go behind a document or transaction, did say "that such a principle must not be overstated or overextended". His Lordship then explained what the transaction had involved;

"It began by making two loans to a subsidiary investment company formed for the purpose of the tax avoidance scheme. One loan was repayable after 30 years and the second after 31 years. Interest charged by the taxpayer on the loans was about the current market rate for such obligations. Each of the loan agreements contained two peculiar provisions. At any time the taxpayer owned both debt instruments, it had the option of altering the interest rates on the loans by raising the interest on one and decreasing or lowering on the other, as long as the total interest payable remained the same."

This case established or clarified that there must be economic substance or economic reality to a transaction or a series of closed integrated transaction.

The above principle was reaffirmed by *IRC v Burmah Oil Co. Ltd* where a taxpayer created a tax loss on certain shares transaction. In Burmah case, Lord Fraser said, "If the agreement for Burmah is right, this would be one more case in which the taxpayer had achieved the magic result of creating a tax loss that is not a real loss..."

16.2.3 Section 140 of the Income Tax Act

Section 140 provides:

- 1) The Director-General, where he has reason to believe that any transaction has the direct or indirect effect of:
 - a) Altering the incidence of tax which is payable or suffered by or which would otherwise have been payable or suffered by any person;
 - b) Relieving any person from any liability which has arisen or which would otherwise have arisen to pay tax or to make a return;
 - c) Evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by this Act: or
 - d) Hindering or preventing the operation of this Act in any respect,

may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustment as he thinks fit with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction.

It is important to note:

- a) A transaction means any trust, grant, covenant, agreement, arrangement or other disposition or transaction made or entered into orally or in writing and includes a transaction entered into by two or more persons with another person or persons, which makes Section 140 provision very wide.
- b) A transaction to be caught under this section need only to be in the opinion of the Director-General (the DG) to be one that affects the incidence of tax, that is, the DG need not necessarily have evidence in the initial stage.

In an Australian case, *Newton v Federal Commission of Taxation*, it was held that if the transaction is capable of explanation by reference to ordinary business or family dealing, without being labelled as a means to avoid tax, then the arrangement does not come within the anti-avoidance section, which is Section 260 of the Australian Income Tax Assessment Act. [Similar to Section 140 of our ITA 1967]

The above test was applied in a local case, *Lahad Datu Timber Sdn Bhd v DGIR* where the learned judge rejected the tax authorities for invoking Section 140.

In the Lahad Datu case, the company signed two agreements; one for extraction of timber and the other for the sale of timber on the same date. The intention was to separate the income derived from the extraction of timber and the income from the sale of timber in order to escape timber profit tax liability on the sales of timber but not the income from timber extraction fees.

The court applied the test in the Newton case that the arrangement is not caught by Section 140.

In *Sungai Batu Perlombongan Sdn Bhd v DGIR*, the Inland Revenue Department invoked Section 140, where the taxpayer, acquired a tax loss company which has ceased its mining activity and injected into the tax loss company, which was merely an empty shell, a profitable mining operation.

In the SBP case, the transaction carried out was not for bona fide commercial reason nor was it in the ordinary course of a business as the company was virtually an empty shell having sold even its mining asset and the only asset (tax avoidance asset) was the unabsorbed losses.

The Special Commissioner held that such a scheme would fall foul under Section 140. Besides Section 140, the following are some of the other tax avoidance provisions under the Income Tax Act:-

- | | | | |
|----|----------------|---|--|
| 1) | Schedule 3 | - | Market value of certain plant and machinery |
| | | - | Sale between associated persons |
| 2) | Section 35 (5) | - | Transfer or sale of stocks on discontinuance of business |
| 3) | Section 65 | - | Settlements |
| 4) | Section 141(1) | - | Assessment of profit of non-residents |
| 5) | Section 139 | - | Controlled companies |

16.3 Tax Planning for Individuals

Individuals feel that they have very little leeway in terms of tax planning. The biggest hurdle is that any tax planning that they wish to attempt must get the co-operation of the employer. The employer's concern is that they must get a full and proper deduction for these expenses. They also do not wish too much administrative inconvenience. Only if the employee can prove the value of tax planning at the least cost to the employer can tax planning be employed with employees. However, there are basic approaches that all employees can try to save a few ringgits here and there. There cannot be massive cash flow advantage in employee tax planning. Much of the tax advantage is from restructuring the remuneration package to take advantage of IRB's public rulings on employment income taxation.

16.3.1 Employee Salary Package

Employment income is divided into five sections. The two basic sections are those pertaining to cash income or cash benefits and the other is benefits-in-kind. The valuation of benefits in kind allows for some advantage to the employee. IRB has accepted some values as acceptable which can be quite advantageous to the employee. Please refer to the IRB Public Rulings on Perquisites in employment and Benefits in kind. Any tax savings is good for the employee as it increases the employee's after-tax cashflow.

ILLUSTRATION

Mr Brown, a bachelor, is posted to Malaysia as a technical director of Consultants Sdn Bhd. His total remuneration, in other words his economic package for 2007 is RM 180,000 in cash with no other benefit.

Mr Brown is advised by his consultants to restructure his remuneration package with the following elements which are agreeable by his employer:

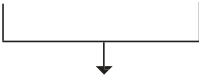
	RM
Salary	100,000
EPF @19%	19,000
Accommodation	
Unfurnished portion	36,000
Furnishings	18,000
Car provided (cost RM 80,000)	*
	<hr/>
	173,000
	<hr/>

* Estimated economic cost of RM 7,000 to the employer.

Compute the amount of tax savings on the restructured remuneration package.

MR BROWN

	Without Tax Planning RM	Restructured Remuneration Package RM
Salary	180,000	100,000
Furnishings	nil	3,360
Car provided [RM 3,600 + RM 1,200]	nil	4,800
Accommodation (30% of RM 100,000 or RM 36,000)	nil	30,000
	<hr/>	<hr/>
Total Income	180,000	138,160

Personal Relief	8,000	8,000
EPF	nil	5,000
	<hr/>	
Chargeable Income	172,000	125,160
	<hr/>	
	<div style="text-align: center;">  </div>	
Tax Savings based on Y/A 2007 tax rates:	RM	
Reduction of Chargeable Income	<u>46,840</u>	
Tax savings at the marginal tax rate of 27%	<u>12,646.80</u>	

In planning for a remuneration package, one should structure the package with a lower cash remuneration and a higher benefit-in-kind, to suit the employee (net home pay would be the criterion) so that the tax payable by employees would be much lower.

Benefits-in-kind that can be used in tax planning schemes for employees include:-

- 1) Accommodation
Rentals paid by employer are tax deductible whereas the employees' income would be assessed on the lower of:
 - a) Defined value (unfurnished portion) which is the annual value or economic rent; or
 - b) 30% employees Section 13(1) (a) gross income.
- 2) Leave Passage
Non-taxable benefit to employee whereas specifically prohibited as tax deduction under Section 39 to the employer.
- 3) Car benefit
Expenses for maintenance of motor vehicle would be tax deductible and capital allowances on qualifying expenditure of up to RM 50,000 or RM 100,000 would be given as a relief to reduce adjusted income of the business of the employer

An employee enjoying such a benefit would be assessed a nominal value based on the IRB's Public Rulings.
- 4) Reimbursement of expenses
Employees are often required to travel or entertain on behalf of the company. There are basically two ways of providing for this. One is to give the employee a travelling or entertainment allowance and the other would be to reimburse the employee expenses. Allowances are first taxed on the gross amount as Section 13(1) (a) income and then the employee can claim expenses incurred on behalf of the company at the Adjusted Income stage. With reimbursements they do not enter as employee remuneration at all. The employee saves the headache of proving to IRB that all the expenses were incurred duly and properly on behalf of the employer.

Entertainment expenses incurred in the production of income are only allowed a 50% deduction. Therefore, reimbursement of entertainment expenses will only be allowed 50%, whereas business travelling is wholly tax deductible, unless it is private like from home to office or office to home.

5) Provision of Household items

An employee would be assessed on the value for the use of the above based on the IRB's guidelines. Rentals incurred by employer for such items would be tax deductible or capital allowances will be given on the above assets incurred by the employers.

6) Increased employers contribution to approved scheme.

An employer can increase the above to say, 19% instead of the mandatory rate of 12%. An employee would not be assessed on the additional contribution if it is a contractual obligation as between the employer and the employee. Withdrawal of EPF at age 55 shall be tax free as EPF is an approved scheme.

7) Share options

Share options are beginning to be an important tax benefit to employees. The rules regarding share options are covered in the public ruling related to perquisites in employment. An employee is taxed on the price gain between the exercise price or option price and the lower of the market value at the date of option or date of exercise. Shares usually appreciate in value over time but the gain is locked, at least at the value on the date of the option is granted. This is clearly a perquisite worth considering.

8) Insurance Premiums on Keyman Policies

There is a Public Ruling on key man policies. The company is allowed to deduct premium expenses incurred in insuring key employees. The reason it is an allowable expense is that it protects the company from loss of income or increase in expenses when a key man dies or is permanently disabled. Both are revenue items related to income or expenses.

However, the public ruling has declined all policies with an investment element. They are not agreeable to policies that accumulate cash value as then the policies could be surrendered and the cash value utilised for the benefit of the key employee. Therefore, acceptable key man insurance policies can be only term policies or accident policies which do not have a cash value. It is expressly stated that no part of any sums recovered should go to the employee's benefit or to the family members. Further, controlled company directors are not entitled to this deduction, as it is claimed that controlled company directors derive some benefit from these policies as they own closely these companies.

16.3.2 Policyholders

Where an individual is married and his wife is a full time housewife, the income (if any) of his wife shall be aggregated together based on combined assessment (where an election is required).

EXAMPLE

	<u>Husband</u>	<u>Wife</u>
Total Income (say)	60,000	Nil
EPF	4,500	Nil
Life Insurance paid by	2,000	5,000

Based on combined assessment (RM 60,000 + NIL), the relief to be given to the husband in respect of EPF + Life Insurance shall be:-

		<u>Relief</u>
EPF & Life Insurance	6,500	restricted 6,000
Life Insurance - Wife	5,000	Nil*
		<u>6,000</u>

If some units of shares (which generate gross dividend of say RM 26,000) are transferred to his wife, then the position would be different.

	<u>Husband</u>	<u>Wife</u>
Total Income	34,000	26,000 (Dividend)

Separate assessment

EPF + Life Insurance (as a family) shall be (12,000) instead of RM 6,000.

The above applies to the additional relief for insurance premium of up to RM 3,000 for educational policies or Medical benefits policy. In a separate assessment the family will utilize relief of RM 6,000.

	<u>Husband</u>	<u>Wife</u>
Total Income	60,000	Nil
EPF & Life Insurance	6,500	3,000
Educational Policy or Medical Benefit	3,500	2,000

The relief to be given shall be:-

		<u>Relief</u>
EPF + Life Insurance		
Husband	6,500	6,000
Wife	3,000	-
Educational Policy or Medical Benefit		
Husband	3,500	3,000
Wife	2,000	-
		<u>9,000</u>

Where his wife has total income and does not elect for joint assessment, the relief shall be:-

	<u>Husband</u>	<u>Relief</u> <u>Wife</u>
EPF + Life Insurance	6,000	3,000
Educational Policy or Medical Benefit	3,000	2,000
	9,000	<u>5,000</u>

16.3.3 Joint and Separate Assessment

ILLUSTRATION

Simon, a merchant from Venice, came to Malaysia, obtained a job as a construction worker, worked perseveringly and rose to the rank of project supervisor. He became a Malaysian citizen, got married and has six children all under the age of 18.

As fate would have it, poor scaffolding in one project resulted in him having a fatal fall which crushed his left leg, leaving him a dismal jobless handicap. Being a pious person, he took this blow of fate in stride, collected his compensation and registered as a disabled person with the Department of Social Welfare.

Most of the compensation was invested into a company conducting a tailoring business. His wife Helena was a manager in the company drawing a salary of 52,000 p.a. and contributed 7,000 to the EPF.

The balance was used to buy some rated convertible loan stock from which Simon received interest income of RM 14,000. This was utilized to settle his life premiums of 1,400, premium for an education policy for their first son of RM 1,000 and purchase a wheelchair for RM 5,600.

Let's compute the tax payable by the family as a whole under different scenarios and determine which one will produce the least amount of tax payable (or the maximum amount of refund!)

SCENARIO A: NO ELECTIONS ARE MADE i.e. SEPARATE ASSESSMENT WHERE MR. Simon CLAIMS CHILD RELIEF

	Simon (RM)	Helena (RM)
Total income	14,000	52,000
Less: Personal relief		
Self	8,000	8,000
Disabled self	5,000	-
Wheelchair	5,000	-
Child relief – 1,000 X 6	6,000	-
EPF / Life insurance premiums	1,400	6,000

	Simon (RM)	Helena (RM)
Education policy premiums	<u>1,000</u>	-
	26,400	14,000
Chargeable income	<u>NIL</u>	<u>38,000</u>
Tax payable:		
On the first 35,000	<u>NIL</u>	1,525.00
On the next 3,000 @ 13%		390.00
		1,915.00

**SCENARIO B:
SEPARATE ASSESSMENT - HELENA ELECTS TO CLAIM CHILD RELIEF**

	Simon (RM)	Helena (RM)
Total income	14,000	52,000
Less: Personal relief		
Self	8,000	8,000
Disabled self	5,000	-
Wheelchair	5,000	-
Child relief – 1,000 X 6	-	6,000
EPF / Life insurance premiums	1,400	6,000
Education policy premiums	<u>1,000</u>	<u>-</u>
	20,400	20,000
Chargeable income	<u>NIL</u>	<u>32,000</u>
Tax payable:		
On the first 20,000	<u>NIL</u>	475.00
On the next 12,000 @ 7%		<u>840.00</u>
		1,315.00
Less: Tax rebate		350.00
		965.00

SCENARIO C: JOINT ASSESSMENT - HELENA ELECTS TO JOIN SIMON

	Simon (RM)
Total income	66,000
Less: Personal relief	
Self	8,000
Disabled self	5,000
Wheelchair	5,000
Wife relief	3,000
Child relief – 1,000 X 6	6,000
EPF / Life insurance premiums	6,000
Education policy premiums	<u>1,000</u>
	34,000

Chargeable income	<u>32,000</u>
Tax payable:	
On the first 20,000	475.00
On the next 12,000 @ 7%	<u>840.00</u>
	1,315.00
Less: Tax rebate - self	350.00
- spouse	350.00
	<u>615.00</u>

SCENARIO D: JOINT ASSESSMENT – SIMON ELECTS TO JOIN HELENA

	Helena (RM)
Total income	66,000
Less: Personal relief	
Self	8,000
Wheelchair	5,000
Wife/ spouse	3,000
Disabled self/spouse	3,500
Child relief – 1,000 X 6	6,000
EPF / Life insurance premiums	6,000
Education policy premiums	<u>1,000</u>
	32,500
Chargeable income	<u>33,500</u>
Tax payable:	
On the next 13,500 @ 7%	475.00
	945.00
	<u>1,420.00</u>
Less: Tax Rebate	700
Tax Payable	<u>720</u>

Therefore, in this case, the best scenario for the Simon family is to opt for a joint assessment whereby Helena elects for her income to be aggregated with that of Simon.

Note: It should be noted that separate assessment is the automatic or default option and it is generally the most preferred option where the wife or husband has a total income. The personal relief for self of RM 8,000 is better than the wife or spouse relief of RM 3,000.

There is a benefit to income shifting to take advantage of the scale rates of tax which start low and then get gradually higher.

16.4 Dividends

The story of dividends has taken a nasty turn with the amendment to the ITA 1967 from YA 2008. Dividends are exempt in the hands of the recipient shareholders and shareholder companies. Tax on corporate profits is the final tax and there is no more Section 110 tax

credit as under the tax imputation system. However, there is a grace period of six years for companies to still adopt the old system. If companies have a large Section 108 credit they would not adopt the new single tier tax system as yet until they have exhausted their 108 tax credit account. We will now explore some situations as under the former tax imputation system.

In a group of companies where say the holding company has current year losses and the subsidiaries have Section 108 tax credit, dividends may be declared by the subsidiaries.

ILLUSTRATION

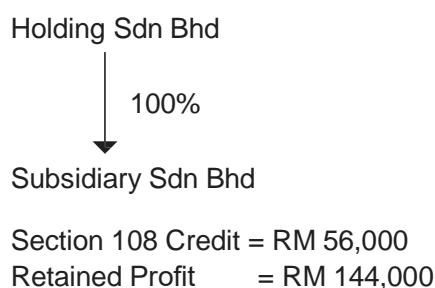
	RM
Management Holding Sdn Bhd [FYE 31 December 2006]	
Section 44(2) Losses (say)	(1,000,000)
Subsidiary A Sdn Bhd [FYE 31 December 2006]	
Section 108 Credit (say) @ 1-1-2006 (say)	300,000

Subsidiary A may declare the payment of dividends of RM 700,000 before 31 December 2006 to Management Holding Sdn Bhd. The tax payable/repayable for Management Holding Sdn Bhd for Y/A 2006 would be:

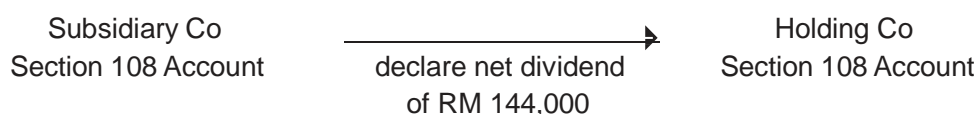
	RM
Dividend (Gross)	1,000,000
Aggregate Income	1,000,000
Less: Section 44(2) Loss	1,000,000
Chargeable Income	nil
Income Tax charged	nil
Less: Section 110 set off	280,000
Tax Repayable	280,000

Management Holding Sdn Bhd would receive from the Inland Revenue Board tax repayment of RM 280,000.

ILLUSTRATION



Where the Subsidiary is to be liquidated, Section 108 credit of RM 56,000 may be transferred to the Holding Company by declaring dividend to the Holding Company.

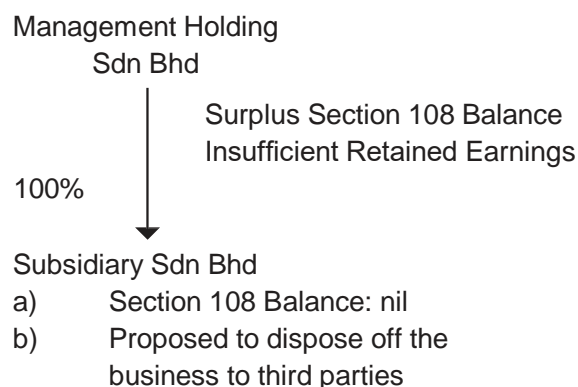


Balance B/F	RM 56,000		Balance B/F	RM x x
Dividend paid		→	IT charged	56,000
or credited	56,000			<hr/>
			Credit available	x x
				<hr/>
			Chargeable Income/	
			Gross Dividend	200,000
			Inc. Tax @ 28%	56,000
			Section 110	56,000
				<hr/>
			Tax Payable	Nil
				<hr/>

Balance c/f	Nil
-------------	-----

RM 144,000 x ²⁸

ILLUSTRATION



Subsidiary Sdn Bhd intends to dispose its business to an interested third party for substantial capital gains. It appears that the subsidiary would not be able to distribute these gains to the shareholders (Holding Sdn Bhd) due to insufficient Section 108 credit. The capital gains will be treated as a dividend income source and therefore a tax credit under its Section 108 account must be available.

Instead of the Subsidiary Company disposing off its business, the Holding Company should dispose off its share in the Subsidiary Company for a capital gain. The gains derived from the disposal of shares can then be distributed to the shareholders of the Holding Co as there is sufficient Section 108 credit.

Of course with the new amendments to the company tax system capital gains can now be distributed without any tax consequence. This is perhaps the best part of the amendments to the company tax in YA 2008.

16.3.3 Relief of Capital Expenditure

Capital allowances are only given to a person having a business source, and who has incurred the capital expenditure and used it for the purpose of his business.

Capital expenditure should be incurred by the end of the basis period for the year of assessment and not after the basis period for the year of assessment.

For example, if the company's year end is 31 December 2007, capital expenditure should be incurred on or before 31 December 2007. If the timing of the capital expenditure is brought into the earlier basis period then the relief for capital expenditure is brought forward. However most of the timing advantage with basis periods has been removed with current year tax system and pay as you go. Companies pay tax on a monthly basis and not as previously in the following year of assessment.

16.3.4 Tax Losses

Unabsorbed tax losses can only be used to set-off against the Aggregate Statutory Business Income of a company.

Current year business loss can be used to reduce the Aggregate Income of a person, that is, to be deducted from any other sources of income. Any amount unutilised shall be carried forward to reduce any future business source of income.

In the case of a company, a change of ownership of the Company would not affect the ability to carry forward such unutilised tax losses. It is only when the Company is being liquidated; that such losses would be completely foregone.

A new provision has been introduced under Section 44A that provides group Relief for companies.

Section 44A: "a company (referred to as a "surrendering company") may surrender not more than fifty per cent of its adjusted loss in the basis period of a year of assessment to one or more related companies, (referred to as a "claimant company". The companies have to be resident in Malaysia for that basis period. There are also several other conditions:

- Companies are related throughout the basis period
- Have paid up capital in respect of ordinary shares of 2.5 million ringgit at the beginning of the basis period.
- 12 months accounting period ending on the same day
- Make an irrevocable election
- The claimant company has a defined Aggregate Income for that year of assessment

Companies are related if 70 per cent of the ordinary shares of the surrendering company, either directly or indirectly is owned by the claimant company. Or 70 % of the ordinary shares of the claimant company is owned by the surrendering company. A third situation is if 70% of both the surrendering and claimant companies are owned by a third company resident in Malaysia.

The group relief is given as the last relief available to be set off from the Aggregate Income in arriving at the Total Income.

16.3.5 Investment Incentives

There are various incentives under the Promotion of Investment Act 1986 and Reinvestment Allowance incentive under the Income Tax Act 1967.

Almost all the incentives are mutually exclusive and in selecting the best investment

incentives, one has to compare the benefit that it may derive from the incentives available.

If a company is expected to make profit, pioneer status would be the best form of incentive. Should the company be capital intensive, Investment Tax Allowance may be the best form of incentive.

In the case of a company granted pioneer status and is loss-making, the company should give up pioneer status and apply for other forms of incentives, for example, Investment Tax Allowance.

Companies intending to apply for pioneer status should consider whether to use one company for all the promoted products or to use different companies for different promoted products. This is important as the amount to be transferred to an exempt account may be reduced for franking tax free dividend. However distribution of dividends for tax planning purposes has been thwarted by the single tier company tax system.

16.3.6 Bad Debts

Bad debts written off and specific provision for bad debts would rank for deduction if certain conditions are satisfied.

Where a trader decides to convert into a limited company, debtors which are doubtful should be written off or specifically provided before the take-over by the limited company.

If the debts had been taken over, both parties would not be able to claim for deduction of the debts which subsequently turn bad.

16.3.7 Hire Purchase versus Leasing

	<u>HirePurchase</u>	<u>Leasing</u>
Company enjoying tax incentives	✓	✗
Company not enjoying tax incentives	✗	✓

In the case of non-commercial vehicle, company not enjoying incentives may finance its acquisition by hire purchase than by way of leasing.

For example:-

Tradco Sdn Bhd., which prepares its accounts to December 31 annually, has received proposals for hire purchase and lease of a passenger car to be used in its business. The relevant details are as follows:

	Hire Purchase RM'000		Lease RM'000
Cash price	150	Cash price	150
Down payment	(80)	Security deposit	(80)
	<hr/>		<hr/>
	70		70
Interest @ 10% per annum	28	Interest @ 10% per annum	28
	<hr/>		<hr/>
	98		98
	<hr/>		<hr/>
Instalments @ RM 24,500 per annum	98	Lease rentals @ 24,500 per annum	98
	<hr/>		<hr/>

The down payment/security deposit (to be paid from internal funds), and the first hire purchase installment/lease rental will be paid in January 2001. The car, which qualifies for annual allowance of 20%, will be sold at the end of the 4th year. The market value at that time is estimated to be around RM 30,000.

Required

Advise the company; showing calculations, which proposal is more tax beneficial assuming that no change in tax legislation on capital allowances and tax deduction from Y/A 2001 to Y/A 2004. [Ignore time value of money].

Year of assessment	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Tota</u>
<u>Qualifying expenditure</u>					
- Down payment	80,000				
- Installment (capital Portion) 70,000/4 years	17,500	2,500			
	<hr/>	<hr/>			
Maximum	97,500	2,500			
	<hr/>	<hr/>			
Capital allowance					
- initial (20 %)	19,500	500	-		
- annual (20 %)	19,500	20,000	20,000		
	<hr/>	<hr/>	<hr/>		
	39,000*	20,500*	20,000*		
	<hr/>	<hr/>	<hr/>		
Residual Expenditure	58,500	40,500	20,500	20,500	
Disposal value $\frac{100,000}{150,000} \times 24,000 = 16,000$				16,000	

Balancing allowances				4,500*	84,000*
Interest portion of instalments (28,000/4 years)	<u>7,000</u>	<u>7,000</u>	<u>7,000</u>	<u>7,000</u>	<u>28,000</u>
Total tax deduction in arriving at statutory income					<u>113,000</u>
<u>Lease</u>					
Lease rentals (Tax deductible) (Maximum = RM 100,000)	<u>24,500</u>	<u>24,500</u>	<u>24,500</u>	<u>24,500</u>	<u>98,000</u>

It appears to be more beneficial (from the tax point of view) to acquire the car under hire purchase than leasing.

16.3.8 Case Studies

CASE STUDY 1

Company XYZ is engaged in the following three businesses:

- a rubber estate which incurs yearly losses;
- a brick factory generating profits against which substantial accelerated depreciation allowances have been claimed;
- a profitable housing project with a large land bank, the cost of which is reflected under fixed assets in the accounts.

The Directors intend to transfer all the above three business undertakings of Company XYZ to three wholly owned subsidiaries at market value in consideration for shares.

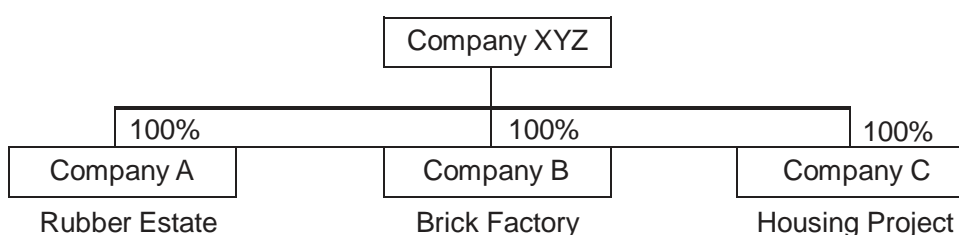
Advise the Directors on the tax implication of the above proposal.

SUGGESTED SOLUTION

Existing Plan

Company XYZ	-	Business I	-	rubber estate
	-	Business II	-	brick factory
	-	Business III	-	housing project

Proposed Plan



Tax Implications of the above proposal:

- 1) The current year's losses of the rubber estate are used to set-off against the income of the other businesses under the existing arrangement. After the transfer to a separate entity, Company A, such set-off would no longer be available.
- 2) Capital Allowances claimed for the brick factory business can be used to set-off against the adjusted income for the current and subsequent years of assessment until fully absorbed. This is possible under the existing plan.

After the transfer to Company B, this is not possible as the business operation of Company XYZ is deemed to have ceased and any unabsorbed capital allowances would be lost. The income of Company B from the brick-making business would be subject to tax as there would not be any relief for the unabsorbed capital allowance. The unabsorbed capital allowances in Company XYZ would be lost as it cannot be transferred to Company B.

- 3) The transfer of the land to Company C would suffer income tax as it is considered to be the stock-in-trade of Company XYZ (**Sharkey & Werhner**). The difference between the market value at the date of transfer and the original cost would be subjected to tax at the current corporate tax rate.

If Company XYZ can satisfy the conditions in Section 35(5), that is, to cease its business permanently, the transfer to Company C can be at a "Valuable Consideration", the price paid or the transfer value would be used as the stock value at the end of the relevant period.

- 4) RPGT would have been imposed on the transfer of real property from XYZ to the new subsidiaries unless such transfers are exempted from tax under paragraph 17 of Schedule 2.

CASE STUDY 2

A Ltd ("AA"), a leading manufacturer of electrical goods located in Hong Kong, owns the patent for a special energy saving lamp registered in Hong Kong and the United Kingdom.

B Sdn Bhd ("BB") is a wholly owned subsidiary of AA. BB has recently acquired the whole of the paid-up capital of C Sdn Bhd ("CC"), a fluorescent tube manufacturer, for a consideration of RM 500,000 which is substantially financed by a bank loan taken by BB. In order to provide CC with the funds to expand into the manufacture of the energy saving lamp patented by AA that is expected to be highly profitable, BB has obtained a further bank loan of RM1 million and advanced it to CC.

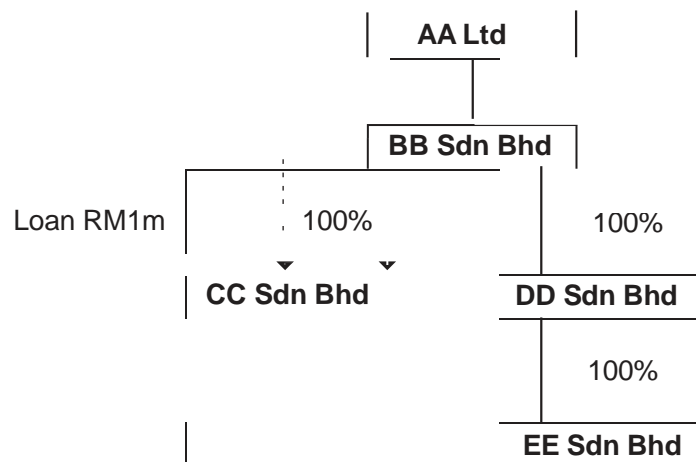
BB also owns the whole of the paid-up capital of D Sdn Bhd ("DD"), a contracting company which is currently incurring losses on its operations. DD in turn owns all the shares in E Sdn Bhd ("EE"), a company dealing in electrical goods. It is intended that EE, which has been very successful in its trading operations, will act as the sole distributor for the lamps to be manufactured by CC.

BB, CC, DD and EE are all resident in Malaysia for tax purposes.

Required:

Explain the steps the group comprising AA and its subsidiaries should take to achieve tax benefits or minimum tax disadvantages under existing tax legislation.

SUGGESTED SOLUTION



Tax disadvantages:

- 1) Interest (loan) paid by BB Sdn Bhd would not qualify for deduction.
- 2) Interest incurred to finance the investment in CC Sdn Bhd may not qualify for deduction.
- 3) Business loss in DD Sdn Bhd is not utilised while profit earned by EE Sdn Bhd was being fully assessed without any loss relief.

Proposed Tax Planning areas:

- 1) BB Sdn Bhd to charge CC Sdn Bhd interest for the loan of RM1m. Interest paid by BB Sdn Bhd to the bank would then rank for deduction as there is Interest Income derived from such advances.
- 2) CC Sdn Bhd should declare dividend, to BB Sdn Bhd for the interest incurred by BB Sdn Bhd to qualify for deduction. A tax repayment of the tax credit (Section 110) may be possible. This is no longer a viable opportunity from YA 2008 as the single tier company tax system comes into place.
- 3) DD Sdn Bhd should be appointed as the sole distributor instead of EE Sdn Bhd. Business loss can be set-off against the business income.
- 4) EE Sdn Bhd should declare dividend to DD Sdn Bhd where the current year business loss would set-off against the dividend income. Tax repayment would be possible. Again this tax planning opportunity is lost with the single tier company tax system.
- 5) CC Sdn Bhd should consider "transfer pricing" by paying royalty to A Ltd where the tax suffered is only 10% compared with the corporate income tax of 27% for the YA 2007.

16.4 Conclusion

The chapter has discussed different aspects of Tax Planning. Among the points discussed are:

Tax Avoidance is legal Tax Planning, Tax Planning for Individuals and Dividends which includes Relief of Capital Expenditure, Tax Losses, Investment Incentives, Bad Debts, and Hire Purchase versus Leasing. The different aspects have been explained to provide a comprehensive knowledge on tax planning.

Self Assessment

- Q1** Express Sdn Bhd and its wholly owned subsidiary Concorde Sdn Bhd are both resident in Malaysia for tax purposes. Express Sdn Bhd expects to incur a loss of RM 300,000 in its business for the financial year ending 31 December 2007. For the same financial year, Concorde Sdn Bhd expects to derive a profit of RM 250,000 from its plantation business.

Advise how Express Sdn Bhd and Concorde Sdn Bhd could minimise the group's tax liability for the Year of Assessment 2007.

Suggested Answers

- A1** Concorde Sdn Bhd would be subject to tax on its business profits i.e. RM 67,500. However, the losses expected to be incurred by Express Sdn Bhd would be carried forward. Even though the group is expected to make an overall loss of RM 50,000 the tax liability would amount to RM 67,500.

Option One (A situation prior to YA2008)

To minimise the group's tax liability, Concorde Sdn Bhd would declare a dividend to Express Sdn Bhd before 31 December 2007. This will enable Express Sdn Bhd to recover the tax payable by Concorde Sdn Bhd.

Express Sdn Bhd (Year of Assessment 2007)

	RM
Gross Dividend Income	250,000
Less: Business Loss	300,000
	<hr/>
Loss c/f	50,000
	<hr/>
Income Tax Chargeable	nil
Less: Section 110 set off (RM 250,000 @ 27%)	67,500
	<hr/>
Tax Repayment	(67,500)
	<hr/>

Therefore, the net effect for the group would be a nil tax liability.

Option Two

Another possible option could be for Express Sdn Bhd to charge management fees to Concorde Sdn Bhd, if it can be established to be providing such services.

Option Three

With the availability of group relief perhaps Express Sdn Bhd can become the „surrendering company" and Concorde Sdn Bhd the „claimant company" and utilize 50% of the loss belonging to Express Sdn Bhd. However, there are several conditions that must be met first like a paid up capital of RM 2,500,000 and 70% ownership requirement.

Appendix A

Taxation of Agents

Taxation of Agents

Life Insurance or Unit Trusts

Introduction

The financial services industry is dominated by self-employed professionals who in the main have a tied agency contract with a principal company. Financial planning is a process that all agents can employ to improve the delivery system. But how should an agent structure himself to be tax efficient. He can be in employment or in business or he can form a partnership or even a sendirian Berhad. We will explore some of the issues pertaining to an agent, be it insurance or unit trusts.

Employment or being self-employed as an agent

Income of a life insurance/unit trust agent carrying on life insurance/unit trust business shall be assessed as a business source of income as the definition of a business includes "a profession, vocation and trade and every manufacture, adventure or concern in the nature of trade, but excludes employment".

As an individual carrying on a life insurance/unit trust agency business, the chargeable income will be taxed on a gradual scale rates ranging from 0% to 28%.

Business Income	-	Life Insurance	A
	-	Others	B
Other Income	-	Non-Business	C

Aggregate			D
Income Donation			(E)

Total Income			F
Personal			(G)
Relief			_____
Chargeable Income			H

Tax @ 0% to 28%

Life insurance/unit trust agents may operate their business by way of a private limited company (as permitted by certain life insurance/unit trust management companies) instead of as a sole-proprietorship.

The chargeable income of a private limited company will be assessed at the flat corporate tax rate of 27% as at YA2007 and 26% in YA 2008.

Gross Commission Receivable	A
Deductible Expenses	(B)
Directors' Remuneration (Paid to the agents who act as directors)	(C)
Capital Allowances	(D)
	<hr/>
Chargeable Income	E @ 27 %(YA2007)

The agents who act as directors cum shareholders will be assessed to tax on their remuneration (salary, fees, commission etc) and dividend (if any) paid by the private limited company. From YA 2008 the dividends will not be taxed on the recipients. The tax paid on the company profits will be the final tax. It is usual for individual directors to pay most of their income as salary and bonus as; personal income will be taxed at graduated scale rates instead of a flat corporate tax rate.

Tax Advantages of Operating by Way of a Limited Company

CASE STUDY 1

Anthony and Adrian intend to commence a business by way of a limited company.

Suggest with tax reasons to them why it is more advantageous for the business to be conducted by way of a limited company.

SOLUTION TO CASE STUDY 1

(a) **Section 108 Account Balance**

The income tax paid by the company (unlike the income tax paid by the individual partners) is available for franking, i.e. when the company pays out dividends, the tax portion of these dividends is deducted from the Section 108 account.

The dividend which is received by the shareholder is the net amount after tax. For his income tax purposes, the net dividend is grossed up and a tax credit given for that proportion of grossing up. Should his tax liability be less the shareholder obtains a tax refund.

However, this tax treatment will disappear from YA 2008. Under the single tier company tax system there will no tax on dividends and there will not be any tax repayments based on the difference between the individual scale rates and the flat corporate tax rate.

(b) **Employees Provident Fund Contributions (EPF)**

For the company the employer's share of the EPF contribution for the directors qualify for tax deduction, unlike that of a partnership. The maximum amount deductible is 19% of the remuneration of the employee. This is a very powerful incentive as in financial planning terms this contributes greatly to retirement funding.

(c) **Cost of Incorporation**

Cost of incorporating a company whose authorised capital does not exceed RM 2.5 million will qualify for tax deduction. Cost of registration of a partnership does not qualify for deduction.

(d) **Benefits In Kind (Directors/Partners)**

The full cost of benefits in kind is tax deductible for the company but not for the partnership. As in the case of motor cars and other benefits, the amount assessed on the employee is much lower than the actual cost of the benefit.

(e) **Loss Relief**

A partner can only utilise partnership losses himself, it cannot be transferred. In the case of a company, which is a separate legal tax entity, a change in ownership will not affect the

company's ability to carry forward its business loss and offset against all future business income. However, recent amendments have made it necessary that there should not be more than 50% change in ownership for losses and capital allowances to be carried forward. The shareholders must be substantially the same or at least 50% unchanged in the beginning and end of the basis period. [Section 44(5A)]

(f) Retirement Relief

Retirement gratuities are tax exempt. Therefore, directors may entitle themselves to receive lump sum payments upon retirement from the business. The following conditions must be met:-

- (i) Age 55 years old.
- (ii) 10 years service with the same company or group of companies.
- (iii) or retire contractually at the age of 50 to 55 with 10 years of service with the same company

Employment or Self-Employed

Where a person performs services in business on his own account, that person is self-employed, and the income derived shall be treated as income from a profession or business. Most common example are the life insurance and the unit trust agents.

The tax advantages of a self-employed person compared to employment are:-

1. Only business losses from a trade, profession or vocation can be deducted against any source of income, that is, against the Aggregate Income of a person. Any amount unutilised can be carried forward to set-off against future business income.
2. Capital allowances on capital expenditure incurred on plant and machinery are only granted to persons carrying on a business.
3. Deductions of certain expenses, such as bad debts, accounting fees, etc, are only available to persons who are carrying on a business.

Whether a person is self-employed or is being employed, the following broad test may be applied:-

1. The 4W's test:-
Do you control: What you do?
 Whether you do it?
 Where you do it?
 And when you do it?
2. Are you responsible for the losses as well as taking profits from that source?
3. Do you risk your own capital investment?
4. Are you the person who is ultimately responsible for how the business is run?
5. Are you able to hire/employ other people on the terms and conditions of your choice?

If your answer is "Yes" to the above, then you are normally considered to be self-employed instead of being employed.

Self-Employed Accounting Records

The Income Tax Act 1967 does not provide a formula as to how the income of a person is to be recorded. The general rule is the income of a trade, profession or business is to be ascertained by applying the ordinary principles of commercial accounting.

Section 78 of the ITA 1967 empowers the Director-General to prescribe the form of records that a taxpayer must keep to enable the Inland Revenue Board to ascertain the income and expenditure of an operation. The term “records” include among other things, books of accounts, receipts, invoices etc.

A set of accounts is normally accepted by the Inland Revenue Board if:-

1. The accounts prepared comply with the generally accepted principles of accountancy;
2. The accounts prepared comply with statutory provisions; and
3. The accounts must provide information to enable the tax authorities to ascertain the taxable profit of the business.

The tax authorities would normally accept the income computed based on the method of accounting that the taxpayer regularly employs, which show the true profits of his business.

Where a taxpayer prepares his accounts based on “cash basis”, the tax authorities may make the relevant adjustments for tax purposes to bring the accounts to “accrual basis”.

Cash Basis versus Accrual Basis

The “cash basis” can be described as a record kept for actual receipts and actual payments, that is, when monies are actually collected or disbursed.

Under the “accrual basis”, the net profit or loss is ascertained after taking into account all income and all expenses relating to the accounting period notwithstanding that such income or expenses has not been received or disbursed respectively.

The tax authorities normally would only accept accounts based on “accruals basis”. Professional agency firms normally prepare their accounts based on “cash basis”. The tax authorities can however insist that the accounts filed together with the tax return be prepared on “accruals basis”.

EXAMPLE

Mr Bee carries on a profession [FYE 31-12-2007] and received RM 80,000 in 2007 which included RM 15,000 for services rendered in 2006. An amount of RM 10,000 in respect of work performed in 2007 has not been received by 31 December 2007.

The amount of income to be assessable based on the “cash basis” of accounting shall be RM 80,000 for 2007.

Under the “accruals basis”, the income to be assessable for 2007 shall be:-

	RM
Amount received in 2007	80,000
Fees received in 2007 in respect of work done in 2006	(15,000)
Amount outstanding	10,000
	<hr/>
	75,000

Taxation of Life Insurance/Unit Trust Agent as a Sole Proprietor

Where the life insurance/unit trust agent carries on his business, the income to be assessed shall be:-

Gross Income	
Commission from Life Insurance/Unit trust Co	A
Tax Deductible Expenses	(B)
	<hr/>
Adjusted Income	C
Capital Allowances	
Relief given on Qualifying Capital expenditure	(D)
	<hr/>
Statutory Income	E

If the agent has other sources of income in addition to the above, then the income to be chargeable to tax shall be:-

Business Income as above	E
Other Business Income, if any	F
Other Sources of Income, e.g. dividend, rental etc	G
	<hr/>
Aggregate Income	H
Current year business loss, if any	(I)
Approved Donation	(J)
	<hr/>
Total Income	K
Personal Relief	(L)
	<hr/>
Chargeable Income	M
	<hr/>
Individuals will be taxed from 0 % to 28%	N
Tax Rebates, if any	(nil)
	<hr/>
	N
[Section 110 tax credit	
27% of Gross Dividend, if any, before YA 2008]	(P)
	<hr/>
Tax payable	Q

The tax collectors (Collection Branch) would normally issue “CP38SA” to individual taxpayers who carry on business and were chargeable to tax in the preceding year. Individual business owners pay on a bi-monthly basis under the Pay As You Go tax collection system.

Taxation of Life Insurance/Unit Trust Agents who operate their business by way of a private limited company (permitted by certain life insurance/unit trust companies)

A private limited company is a separate entity as well as a separate chargeable person from the shareholders. The commission received by the company shall be assessed to tax after charging outgoings and expenses for purposes of generating the gross commission income.

Co A Sdn Bhd [YA2006]

Gross Income, say	400,000
Tax Deductible overheads	(120,000)
Directors' Remuneration	
A 80,000	
B 80,000	(160,000)
Adjusted Income	120,000
Capital Allowances	20,000
Chargeable Income	100,000

Chargeable Income/Accounting Profit	100,000
Tax Payable	28,000
Net after tax	72,000

Distribute Dividend
Of say RM 36,000

S108 Account

Cr	28,000
Dr	14,000

	18,000	18,000
	<u>A</u>	<u>B</u>
Employment Dividend	80,000	80,000
Net Dividend x $\frac{100}{72}$	25,000	25,000
Total Income	105,000	105,000
Personal Relief say	15,000	15,000
Chargeable Income	90,000	90,000
Taxed at graduated scale rate, say	N	N
Section 110 credit		
28% of RM 25,000 [before YA 2008]	(7,000)	(7,000)
Tax Payable	P	P

Relief for Capital Expenditure – Capital Allowances

Where a person carries on a business and has incurred qualifying capital expenditure for purposes of his business he/she is entitled to claim for capital allowances in respect of the qualifying assets, for example, motor vehicles, office equipment, furniture and fittings, computers, etc.

The amount of relief to be claimed would depend on the types of qualifying assets. An initial allowance of 20% shall be given in the year of acquisition in addition to the yearly annual allowance, for example:-

Asset:	Typewriter
Cost:	RM 1,000
Acquired:	2007
Prescribed Rate:	10% [Office equipment]

The relief to be given effective from Y/A 2007 shall be:-

Y/A 2007

Qualifying Cost	1,000
Initial Allowance - 20%	(200)
Annual Allowance - 10%	(100)
Residual Expenditure	700

Y/A 2008

Annual Allowance	(100)
Residual Expenditure	600

Y/A 2009

Annual Allowance	(100)
Residual Expenditure	500

The annual allowance of RM100 will be given for each year until the Residual Expenditure is NIL.

The prescribed rates for annual allowances are:

RELIEF FOR CAPITAL EXPENDITURE - CAPITAL ALLOWANCES

ASSET	A	AA
Imported heavy machinery used in building & construction sector and primary industry (mining, logging & forestry)	10	10
Plant & machinery	20	14
Motor vehicles & heavy machinery	20	20
Computers / IT assets	20	40
Others [furniture and fittings/Office equipment]	20	10
Construction of any works, roads, structures & buildings	30% or 20%	As above
provision of control equipment <ul style="list-style-type: none"> <input type="checkbox"/> equipment & facility used for collecting wastes <input type="checkbox"/> for limiting pollution of the environment <input type="checkbox"/> for indicating/recording/warning of excessive pollution of the environment <input type="checkbox"/> for securing more efficient use of the equipment equipment for providing natural gas refuelling <input type="checkbox"/> at natural gas refuelling outlets transport companies operating buses using natural gas	40	20
Working of a tin mine or extraction of timber from a forest	60% or 20%	As above

CASE STUDY

MR ABC STATEMENT OF INCOME AND EXPENDITURE YEAR ENDED 31 DECEMBER 2007

	RM	RM
INCOME		
Commission		170,000
EXPENDITURE		
Bank Charges	60	
Car Maintenance (N1)	18,000	
Commission Paid (N2)	27,000	
Entertainment	8,000	
HP Interest	2,925	
EPF - Staff	1,440	
Rental	4,800	
Salaries & Allowance	12,000	
Stationery & Printing	4,500	

Depreciation	(N3)	19,100	
Tax Seminar Fee		1,000	
Tax Submission Fees		500	
Newspaper and Periodicals		1,080	
Telephone	(N4)	6,520	
			106,925
Net Income for the year			63,075

Notes:-1. Car Maintenance

	RM
Petrol	6,400
Parking	4,200
Insurance & Road Tax	2,490
Repairs	4,910
	18,000

2. Commission Paid

Names, Identity Card Number and the amount paid to each recipient is accepted by the tax authorities.

<u>Depreciation</u>	<u>Cost</u>	<u>Depreciation</u>
Hand phone	2,000 #	400
Computer	4,500 *	900
Motor Vehicle	189,000 #	17,800
		19,100

* Acquired in 2007

Acquired in 2005

4. Telephone

An arbitrary amount of RM 1,200 has been estimated by the tax authorities to be for personal calls.

The taxable income shall be:-

	RM	RM
Net Income as per statement		63,075
Private Use of Car (Say)	6,000	
Entertainment	4,000	
Depreciation	19,100	
Tax Seminars	1,000	
Tax Submission Fees	Ni	
Telephone	1,200	
		31,300

Adjusted Income	94,375
Less: Capital Allowance	9,567
Statutory Income	84,808
Capital Allowances	
Hand phone 10% x RM 2,000	200
Computers (20% + 40%) x RM 4,500	2,700
Motor Vehicle 20% x RM 50,000 x 2/3	6,667
	9,567

The above statutory income of RM 84,808 shall be included together with Mr ABC other income for purpose of ascertaining his tax liability.

TAX ADJUSTMENTS TO BE MADE AND PARTICULARS TO BE FURNISHED WITH TAX COMPUTATION

Guidelines issued by the Inland Revenue Department on tax computation are:

A. TAX ADJUSTMENTS

1 Capital expenditure charged to the profit and loss account

EXAMPLES:

- a) Incorporation expenses of companies with authorised capital exceeding RM 2.5 million
- b) Expenditure relating to changes in authorised and paid-up capital.
- c) Expenditure (Including professional fees) in connection with the acquisition or disposal of fixed assets including stocks and shares.
- d) Renovation and improvements.

2 Expenditure not incurred in the production of income

EXAMPLES:

- a) Remuneration (including EPF contributions) and other benefits to partners and proprietors.
- b) Personal and domestic expenses in whatever manner charged (e.g. local or overseas travel, motor vehicle maintenance).
- c) Expenses relating to maintenance of shareholders' register and issue of dividends in whatever manner charged.
- d) Basic expenses such as annual reports for distribution to shareholders for annual general meetings and extraordinary general meetings.
- e) Stock Exchange listing expenses.
- f) Expenses prior to commencement or in connection with cessation of business.
- g) Provisions for doubtful debts, stocks, retirement benefits, leave passage, exchange losses, future expenses, etc.
- h) Legal fees - capital or private.

- i) Miscellaneous and sundry expenses - capital or private.
 - j) Donations and subscriptions (except those allowed).
- 3 Expenditure specifically disallowed or restricted by law
- EXAMPLES:
- a) Lease rental of motor vehicles in excess of RM 50,000 (or RM 100,000) for each vehicle.
 - b) Interest restriction.
 - c) Entertainment expenses (other than those specifically allowed).
 - d) Expenses relating to leave passage.
 - e) Payment to unapproved scheme or contribution to approved scheme in excess of 19% of the employee's remuneration.
- 4 Other Items
- EXAMPLES:
- a) Bad debts.
 - b) Profit/loss on disposal of fixed assets/investments and other capital transactions.
 - c) Exchange gains/losses arising from capital transactions.
 - d) Extraordinary items.
 - e) Renewals of implements and utensils.
- 5 Deduction for qualifying mining expenditure - Schedule 2
- 6 Additional and special deductions given as incentives:
- EXAMPLES:
- Deduction for promotion of exports/tourism/research and development/training.
- 7 Incentives under Promotion of Investments Act 1986/Income Tax Act 1967:
- EXAMPLES:
- Exempt pioneer income, investment tax allowance, abatement of income, industrial adjustment allowance and reinvestment allowance, etc.
- 8 Computation of Capital Allowances
- 9 Deductions in respect of qualifying prospecting/farm/pre-operational business expenditure - Schedules 4, 4A and 4B.

PARTICULARS RELATING TO TAX ADJUSTMENTS

- a) In respect of each tax adjustment, the basis for such adjustment should be shown supported by analysis, copies of subsidiary accounts, receipts, etc., as appropriate.
- b) In respect of incentives claimed, copies of approval letter, pioneer certificate, and exempt account should be attached.
- c) In respect of bad debts written off (exceeding RM5,000 for companies and RM1,000 for others), particulars of the debtor, nature of the debt and reasons for writing off should be given.
- d) In respect of capital allowances, schedules to show additions, hire-purchases, disposal/write-off should be attached.

B ADDITIONAL PARTICULARS

Contract/sub-contract payments (above RM30,000), commissions and rental (above RM10,000) and other contractual payments to residents (excluding management fees).

- a) Name, address, IC no. and amount in respect of each recipient.
- b) Type/nature of contract/commission and location/nature of asset rented, as applicable.

2 Contract payments to non-residents.

Receipts by non-resident contractors - Section 107A.

- a) Location, nature and duration of project.
- b) Name, address, tax reference no./IC no. of non-resident contractor or the payer, as applicable.
- c) Total contract sum and the service portion thereof.
- d) Contract sum and the service portion thereof payable/receivable for the relevant basis period, as applicable.
- e) Particulars of withholding tax showing:
 - date of paying/crediting of contract sum due.
 - date of payment and amount of withholding tax.
 - receipt number(s).

3 Management fees to residents

- a) Name, address, IC no. and amount in respect of each recipient.
- b) Indicate relationship with recipient, if any.
- c) Basis for payment of fees supported by copy of management agreement, if any.

4 Professional/technical/management fees and rents to non-residents
(Special Classes of Income - Section 4A).

- a) Professional/technical/management fees
 - i) Name, address and amount in respect of the recipient.
 - ii) Nature of services rendered.
 - iii) Particulars of withholding tax showing:
 - date of paying/crediting of fees due.
 - date of payment and amount of withholding tax
 - receipt number(s).
 - iv) If the whole or part of any payment is considered not to be a payment under section 4A, state reasons and attach a copy of the relevant agreement.
- b) Rental in respect of moveable property:
 - i) Nature of moveable property
 - ii) Particulars as in (a) above as applicable.

5 Expenses charged by head office/parent company

- a) In respect of direct expenses, state the nature of the expenses charged, basis of charging and how it has benefited the branch/subsidiary.

- b) Whether Section 109B is applicable and if so, give particulars as in 4(a) (iii).
 - c) In respect of common expenses allocated to the branch/subsidiary, give an analysis of the expenses and state the basis of allocation and how it has benefited the branch/subsidiary.
- 6 Overseas trips (not required for public companies)
 - a) Names and designations of persons involved.
 - b) Dates, destination and purpose of the trip.
 - c) Details of expenditure, indicating non-business element.
- 7 Partnerships

Where a partnership business has ceased, submit copy of notification to Registrar of Businesses (Form C) and a copy of the realisation account and particulars of person(s) taking over the business.
- 8 Real Property Gains Tax [Prior to YA 2007]
 - a) Particulars of acquisition/disposal of assets which are chargeable assets under the Real Property Gains Tax Act 1976 if such acquisition/disposal has not been notified. (Note: RPGT has been repealed from April 2007)
 - b) Form CKHT 19 (giving particulars of a real property company) if applicable.

C SPECIAL INDUSTRIES

- 1 Housing Development
 - a) For new projects/schemes:
 - i) Copy of the approved layout plan and expected date of completion of each phase.
 - ii) Location of the property being developed.
 - iii) Cost/market value of the land and its use at the time of acquisition.
 - b) For all projects/schemes:
 - i) Details as in (a) above if not provided, previously or if there have been any changes.
 - ii) Analysis of cost of development of each phase on a cumulative basis.
 - iii) Computation of profits on progress payments basis if the method of accounting is other than the percentage of completion method.
- 2 Leasing
 - a) Computation of income from leasing operations as required by the Income Tax Leasing Regulations 1986.
 - b) Identify special purpose/leaseback assets, if any.

Self Assessment

- Q1** Mr Zee is employed by ABC Insurance Co, as their accountant. Is he entitled to claim capital allowances on the following assets:-
- a) Honda Civic cost RM 92,000.
 - b) Computer cost RM 4,800?
- Q2** Mr BIZ carries on business as agents for XYZ Life Insurance Co. Is he entitled to claim capital allowances on the following assets:-
- a) Honda Accord cost RM 130,000.
 - b) Hand phone cost RM 3,000?
- Q3** What are the tax advantages of a self-employed person as compared to employment?

Suggested Answers

- A1** Capital Allowances is only given to a business source of income. No relief for Mr Zee as his source of income is that of employment.
- A2** Mr BIZ is entitled to claim capital allowances on the following:-
- a) Honda Accord, restricted to a qualifying cost of RM 100,000.
 - b) Hand phone of RM 3,000.
- A3** The tax advantages of a self-employed person compared to employment are:-
1. Only business losses from a trade, profession or vocation can be deducted against any source of income, that is, against the Aggregate Income of a person. Any amount unutilised can be carried forward to set-off against future business income.
 2. Capital allowances on capital expenditure incurred on plant and machinery are only granted to persons carrying on a business.
 3. Deductions of certain expenses, such as bad debts, accounting fees etc are only available to persons who are carrying on a business.

Review Test

For Q1 & Q2

Axis S/B (y.e 31/12) purchased a Proton Perdana for its marketing director for RM 108,000 on 15/3/06 and furniture worth RM 5,000 on 12/4/07. (The AA rate for motor vehicle & furniture is 20% and 10% respectively.)

Q1 The claim for capital allowances in YA 2006 for the company is

- a) RM 20,500
- b) RM 21,500
- c) RM 40,000
- d) RM 41,500

Q2 The claim for capital allowances in YA 2007 for the company is

- a) RM 20,500
- b) RM 21,500
- c) RM 40,000
- d) RM 41,500

Q3 To qualify for deduction under the **Income Tax (Deduction for Incorporation Expenses) Rules 2003**, the company's authorised share capital should not exceed

- a) RM 250,000
- b) RM 1 million
- c) RM 2 million
- d) RM 2.5 million

Appendix B

Accounting Principles and Service Tax

Accounting Principles and Treatment [Insurance Premiums & Proceeds Received and Service Tax on Business Insurance]

Introduction

Studying tax has to be incorporated with an understanding of accounting principles. IRB will automatically assume that generally accepted accounting principles will be adopted by all persons having a business source. Special emphasis is given in this chapter to accounting principles as it relates to insurance premiums and insurance proceeds.

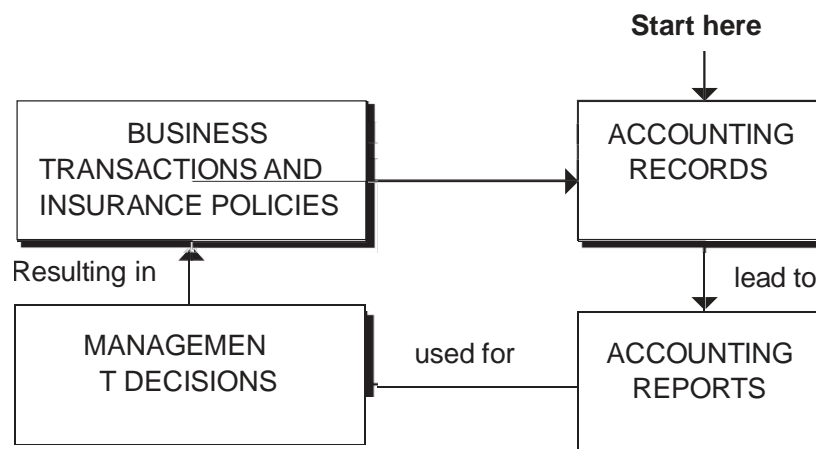
Accounting Assumptions and Concepts

Accounting is the use of information rendered at the bookkeeping stage to produce reports and financial information to management, owners and others.

It is therefore important to keep accounts:

- To keep track of money by showing where it came from and how it has been spent.
- The complexity of modern businesses makes it necessary to keep accounts in order to keep track of the company's activities and assets.
- Where the owners are not involved in the day to day running of the business, the accounts will indicate to them how successfully the managers are performing.
- The accounts produce information which may be useful to various groups of people such as investors, tax authorities etc.

Decision making within a business is based on the accounts and reports for the relevant course of action or for a business transaction. It can be summarised into a simple -cyclell.



Fundamental Accounting Assumptions

Certain fundamental accounting assumptions underlie the preparation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed, together with the reasons.

The following are recognised by the International Accounting Standards Committee as fundamental accounting assumptions.

a) **Going Concern**

The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations.

b) **Consistency**

It is assumed that accounting policies are consistent from one period to another.

c) **Accrual**

Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as when it is received or paid) and recorded in the financial statements of the periods to which they relate.

Accounting policies encompass the principles, bases, conventions, rules, and procedures adopted by management in preparing and presenting financial statements. There are many different accounting policies in use even in relation to the same subject. Judgement is required in selection and applying those which, in the circumstances of the enterprise, are best suited to present properly its financial position and the results of its operations.

Three considerations should govern the selection and application by management of the appropriate accounting policies and the preparation of financial statements:

a) **Prudence**

Uncertainties inevitably surround many transactions. This should be recognised by exercising prudence in preparing financial statements. Prudence does not however, justify the creation of secret or hidden reserves.

b) **Substance Over Form**

Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.

c) **Materiality**

Financial statements should disclose all items which are material enough to affect evaluations or decisions.

Useful Information

Characteristics of useful information are:-

a) **Relevance**

The information provided must be helpful and of interest to the user concerned.

b) **Comprehensibility**

Information should be set out in such a way that significant features are easily understood and assimilated.

- c) **Reliability**
Users must have sufficient confidence in financial statements to rely on them as a basis for decision making.
- d) **Completeness**
A company's accounts should present a rounded picture of its economic activities.
- e) **Objectivity**
Information presented should be objective, neutral and unbiased towards the interests of the various user groups.
- f) **Timeliness**
Information should be supplied to users as soon as possible. As the time lag increases, the relevance of historic information to users will be reduced.
- g) **Comparability**
Information should be produced on a consistent basis so that valid comparisons can be made with previous periods and with similar companies.

Basic Accounting Concepts

- a) **The Entity Concept**
Activities of a business enterprise are kept separate and distinct from its owners.
- b) **The Money Measurement Concept**
Money is the common denominator by which economic activity is conducted, and that the monetary unit provides an appropriate basis for accounting measurement and analysis.
- c) **The Going Concern Concept**
The entity is assumed to continue in operation for the foreseeable future. It has neither the intention nor the necessity of liquidation or of curtailing significantly the scale of its operations.
- d) **Historical Cost Concept**
Quantitative information recorded in monetary values is normally retained at its historical cost.
- e) **Dual Aspect Concept**
This states that there are two aspects of accounting, one represented by the assets of the business and the other by the claims against them. The concept states that these two aspects are always equal to each other.

$$\text{Asset} = \text{Capital} + \text{Liabilities}$$

Asset	Capital + Liabilities
Equal	Equal

Accounting Equation (Double Entry)

- What is the transaction?
- What are the two items affected?
- How are those items affected? (whether increased or decreased)
- Apply double-entry rule.

ILLUSTRATION: MrAxe

On 1-1-2007, Mr Axe started his business and deposited RM 18,000 into a bank account opened specially for his business.



BALANCE SHEET AS AT 1 JANUARY 2007

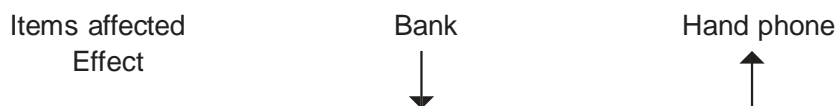
Assets	RM	Capital and Liabilities	RM
Cash at bank	<u>18,000</u>	Capital	<u>18,000</u>

DOUBLE-ENTRY

DR	BANK	RM 18,000
CR	CAPITAL	RM 18,000

THE PURCHASE OF A HANDPHONE BY CHEQUE

On 3-1-2007, Mr Axe buys a hand phone for RM 2,000.



BALANCE SHEET AS AT 3 JANUARY 2007

Assets	RM	Capital and Liabilities	RM
Hand phone	2,000	Capital	18,000
Cash at bank	16,000		
	<u>18,000</u>		<u>18,000</u>

DOUBLE-ENTRY

DR	HANDPHONE	RM 2,000
CR	BANK	RM 2,000

The purchase of a computer and the incurring of a liability

On 6-1-2007, Mr Axe buys a computer for RM 4,000 from GHL, and agrees to pay for them some time within the next two weeks.

**BALANCE SHEET AS AT 6 JANUARY 2007**

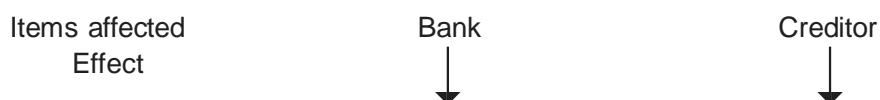
<i>Assets</i>	<i>RM</i>	<i>Capital and Liabilities</i>	<i>RM</i>
Hand phone	2,000	Capital	18,000
Computer	4,000	Creditor	4,000
Cash at bank	16,000		
	22,000		22,000

DOUBLE-ENTRY

DR	COMPUTER	RM 4,000	
CR	CREDITOR	RM 4,000	

THE PAYMENT OF A LIABILITY

On 15-1-2007, Mr Axe pays a cheque for RM 4,000 to GHL in payment of the amount owing.

**BALANCE SHEET AS AT 15 JANUARY 2007**

<i>Assets</i>	<i>RM</i>	<i>Capital and Liabilities</i>	<i>RM</i>
Hand phone	2,000	Capital	18,000
Computer	4,000		
Cash at bank	12,000		
	18,000		18,000

DOUBLE-ENTRY

DR	CREDITOR	RM 4,000	
CR	BANK	RM 4,000	

Assets

To record an INCREASE in an asset, DEBIT the asset account

To record a DECREASE in an asset, CREDIT the asset account

Liabilities

To record an INCREASE in a liability, CREDIT the liability account

To record a DECREASE in a liability, DEBIT the liability account

Capital

To record an INCREASE in capital, CREDIT the capital account

To record a DECREASE in capital, DEBIT the capital account

ASSET ACCOUNT		LIABILITY ACCOUNT		CAPITAL ACCOUNT	
+	-	-	+	-	+

DRAWINGS

The proprietor will want to take cash out of the business for his private use. These withdrawals are known as Drawings. Drawings reduce the amount of capital.

E.g. Proprietor takes RM 1,000 cash out of the business for his own use.

DR	DRAWINGS	RM 1,000
CR	BANK/CASH	RM 1,000

DOUBLE-ENTRY ➔ REVENUE AND EXPENSES**Revenue**

To record an INCREASE in revenue, CREDIT the revenue account

To record a DECREASE in revenue, DEBIT the revenue account

Expenses

To record an INCREASE in expenses, DEBIT the expense account

To record a DECREASE in expense, CREDIT the expense account

REVENUE ACCOUNT		EXPENSE ACCOUNT	
-	+	+	-

E.g. 1. Rent of RM 400 is paid in cash

DR	RENT	RM 400
CR	CASH	RM 400

2. Insurance premium of RM 2,000

DR	INSURANCE PREMIUM	RM 2,000
CR	BANK	RM 2,000

3. RM 4,000 cheque is received for commission earned

DR	BANK	RM 4,000
CR	COMMISSION RECEIVED	RM 4,000

Trial Balance

A trial balance is a list of the debit and credit balances in the ledgers and the cash book, extracted at a given date. If the records have been correctly maintained under the double-entry system, the total of the debit balances will equal the total of the credit balances.

TB Trial Balance as at 31 December 2007

	DR RM	CR RM
Bank	850	
Capital		1,000
Typewriter	400	
Printing & Stationery	230	
Creditor		200
Drawings	100	
Commission Received		380
	1,580	1,580

Purpose of the Trial Balance

1. To test the accuracy of the double-entry bookkeeping records.
2. The balances can be used in the preparation of the final accounts.
3. It is more convenient to view all balances in the trial balance rather than from the ledgers.

Accruals and Prepayments

The Accrual Concept

Revenue and costs are recognised as they are earned or incurred (and not as money is received or paid) and they are recorded in the financial statements of the periods to which they relate.

Accounts are prepared on an accruals basis, not on a cash basis. At the end of the accounting period, therefore, it is necessary to examine all the expense accounts and revenue accounts to ensure that the transfer to the profit and loss account is correct.

Accrued Expenses

Expenses that have been incurred during the period but have not yet been recorded or paid. As such they represent liabilities at the end of the period.

E.g. During the year ended 31 December 2007, the Electricity account appears as:

Electricity					
2007		RM	2007		RM
Feb 1	Bank	203			
May 3	Bank	146			
Aug 2	Bank	76			
Nov 4	Bank	120			

It is estimated that electricity to the value of RM155 had been consumed but not invoiced at that date. It would be recorded as follows:-

Electricity					
2007		RM	2007		RM
Feb 1	Bank	203	Dec 31	P&L	700
May 3	Bank	146			
Aug 2	Bank	76			
Nov 4	Bank	120			
Dec 31	Accruals	155			
		<u>700</u>			<u>700</u>
DR	ELECTRICITY		RM 155		
CR	ACCRUALS		RM 155		

Prepaid Expenses

A prepaid expense is an item paid or recorded in advance of its use or consumption in the business. The advance payment is treated as an asset on hand at the end of the period.

E.g. Insurance premiums have been paid as follows:-

28-2-2007 RM 210 for the period of 3 months to 31-03-2007
 31-08-2007 RM 420 for the period of 6 months to 30-09-2007
 18-11-2007 RM 420 for the period of 6 months to 31-03-2008

Insurance					
2007		RM	2007		RM
Feb 28	Cash	210	Dec 31	P&L	840
Aug 31	Cash	420	Dec 31	Prepayment	210
Nov 18	Cash	420			
		<u>1,050</u>			<u>1,050</u>
DR	PREPAYMENT		RM210		
CR	INSURANCE		RM210		

Accrued Income (Income in Arrears)

Revenue that has been earned during the period but has not yet been received. As such it represents asset at the end of the period.

Commission Receivable

2007		RM		2007		RM
Dec 31	P&L	1,490		Mar 31	Bank	300
				Jul 31	Bank	270
				Oct 3	Bank	520
				Dec 31	ABC Insurance Co	400
		<u>1,490</u>				<u>1,490</u>

Prepaid Revenue (Income in Advance)

Prepaid revenue is revenue received in advance before it has been earned. The account prepaid is considered a liability because it represents an obligation to perform a service in the future and hence the amount applicable to future periods is deferred to future periods.

E.g. Rental of RM 200 is receivable every quarter in advance

Rent Receivable

2007		RM		2007		RM
Dec 31	P&L	800		Jan 4	Bank	200
Dec 31	BAL C/D	200		Apr 2	Bank	200
				Jul 3	Bank	200
				Oct 3	Bank	200
				Dec 6	Bank	200
		<u>1,000</u>				<u>1,000</u>
				2008		
				Jan 1	BAL b/d	200

DR	RENT RECEIVABLE	RM200
CR	PREPAID REVENUE	RM200

Capital and Revenue Expenditure

Fixed Assets normally refer to property, plant and equipment, etc.

The major characteristics of fixed assets are:-

- They are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and may include items held for the maintenance or repair of such assets;

- b) Have been acquired or constructed with the intention of being used on a continuing bases; and
- c) Are not intended for sale in the ordinary course of business.

Capital Expenditure

Capital expenditure is expenditure, the benefit of which is not fully consumed in one period, but spread over several periods.

Capital expenditure is incurred where a person spends money to:

- 1) Buy a fixed asset e.g. Land and building, plant and machinery
- 2) Bring the asset to working condition and location for its intended use e.g. Site preparation, initial delivery and handling costs, special foundations for plant and professional fees (e.g. Architects, engineers, lawyers)
- 3) Add to the value of an asset or improve an asset to increase the future benefits from that asset e.g. Extension to factory.

Revenue Expenditure

Revenue expenditure is expenditure incurred in one period of account, the full benefit of which is consumed in that period.

Examples are replacements, repairs, renewals, depreciation of fixed assets, the current expenses of carrying on a business such as rent, rates, wages, carriage, and insurance.

Revenue expenditure is not concerned with adding to the value of fixed assets. Revenue items appear in the Trading and Profit and Loss Account.

Service Tax on Business Insurance

Service Tax is another form of consumption tax levied in respect of taxable services provided by any taxable person.

Charge to Tax

Service tax at a rate of 5% shall be levied on the charge, premium or value of services as determined below

- a) **Taxable Services**
 - i) The Charge levied or collected;
 - ii) The premium for insurance coverage;
 - iii) The charge or premium which would have been levied or collected in the ordinary course of business for providing such service to a person independent of the taxable person

Any taxable person who carries on the business of providing taxable services shall be chargeable to service tax.

Where a taxable person carries on business of providing taxable services such person is required to be licensed under the Service Tax Act, 1975.

Taxable Persons and Services

Group A: Hotels

Taxable Person	Taxable Service
<p>I. Any person operating one or more hotels, any one hotel having more than 25 rooms excluding:-</p> <p>i. hostels for pupils or students of educational institutions;</p> <p>ii. hostels established and run or maintained by religious institutions or bodies.</p>	<p>a. Provision of rooms for lodging or sleeping accommodation in a hotel having more than 25 rooms.</p> <p>b. Provision or sale of food, drinks or tobacco products in a hotel having more than 25 rooms</p> <p>c. Provision of services in form of -corkagell, -towel chargell or -cover chargell in a hotel having more than 25 rooms.</p> <p>d. Provision of premises for meetings or for promotion of cultural or fashion shows in a hotel having more than 25 rooms.</p> <p>e. Provision of health services which are normally provided by health centres in a hotel having more than 25 rooms.</p> <p>f. Provision of massage services excluding massage services provided in barber shops, hair dressing saloons or beauty saloons, in a hotel having more than 25 rooms.</p> <p>g. Provision of parking spaces for motor vehicles where parking charges are imposed in a hotel having more than 25 rooms.</p> <p>Provision of golf course, golf driving range or services related to golf or golf driving range i.e. for –</p> <p>green / season pass</p> <p>caddy</p> <p>rental of golf buggy / turf mate</p> <p>rental of golf equipment</p> <p>guest</p> <p>complimentary play</p> <p>coaching</p> <p>absence</p> <p>competition entrance</p> <p>tournament</p> <p>lighting for night golfing</p> <p>night golfing</p> <p>practise range balls or driving range balls</p> <p>rental of golf shoes</p> <p>subscription</p>

Group B 1: Restaurants Located in Hotel Having More Than 25 Rooms

Taxable Person	Taxable Service
<p>I. Any person operating a restaurant, bar, snack bar, coffee house or any place which provides food, drinks or tobacco products, whether wholly eat-in or partly take-away, located in a hotel as mentioned under Group A of this Schedule.</p>	<p>a. Provision or sale of food, drinks or tobacco products in a restaurant, bar, snack-bar, coffee house or any place which provides food, drinks or tobacco products, whether wholly eat-in or partly take away, located in a hotel as mentioned under Group A of this Schedule.</p> <p>b. Provision of services in form of -corkagell, -towel chargell or -cover chargell in a restaurant, bar, snack-bar, coffee house or any place which provides food, drinks or tobacco products, whether wholly eat-in or partly take-away, located in a hotel as mentioned under Group A of this Schedule.</p> <p>c. Provision of parking spaces for motor vehicles where parking charges are imposed in a restaurant, bar, snack-bar, coffee house or any place which provides food, drinks or tobacco products, whether wholly eat-in or partly take-away, located in a hotel as mentioned under Group A of this Schedule.</p> <p>d. Provision of premises for meetings or for promotion of cultural or fashion shows in a restaurant, bar, snack-bar, coffee house or any place which provides food, drinks or tobacco products, whether wholly eat-in or partly take-away, located in a hotel as mentioned under Group A of this Schedule.</p>

Group B2: Restaurant Located In Hotel Having 25 Rooms or Less

Taxable Person	Taxable Service
<p>I . Any person operating one or more restaurants, bars, snack-bars, coffee houses or places which provide food, drinks or tobacco products, whether wholly eat-in or partly take-away, having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group and located in a hotel having 25 rooms or less.</p>	<p>a. Provision or sale of food, drinks or tobacco products in one or more restaurants, bars, snack bars, coffee houses or places which provide food, drinks or tobacco products, whether wholly eat-in or partly take-away, having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group and located in a hotel having 25 rooms or less.</p> <p>b. Provision of services in form of -corkagell, -towel chargell or -cover chargell in one or more restaurants, bars, snack-bars, coffee houses or any places which provides food, drinks or tobacco products, whether wholly eat-in or partly take-away, having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group and located in a hotel having 25 rooms or less.</p> <p>c. Provision of parking spaces for motor vehicles where parking charges are imposed in one or more restaurants, bars, snack-bars, coffee houses or any places which provides food, drinks or tobacco products, whether wholly eat-in or partly take-away, having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group and located in a hotel having 25 rooms or less.</p> <p>d. Provision of premises for meetings or for promotion of cultural or fashion shows in one or more restaurants, bars, snack-bars, coffee houses or any places which provides food, drinks or tobacco products, whether wholly eat-in or partly take-away, having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group and located in a hotel having 25 rooms or less.</p>

Group C: Restaurants Located Outside Hotel

Taxable Person	Taxable Service
<p>1. Any person operating one or more restaurants, bars, snack-bars, coffee houses or places which provide food, drinks or tobacco products, whether wholly eat-in or partly take-away, having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group and located outside a hotel excluding:</p> <p>i. a canteen located in an educational institution; or d. Provision of parking spaces for motor vehicles</p> <p>ii. a canteen operated by a religious institution where parking charges are imposed. or body.</p> <p>2. Any person operating one or more food courts and having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group.</p>	<p>a. Provision or sale of food, drinks or tobacco products.</p> <p>b. Provision of services in form of -corkagell, -towel chargell or -cover chargell.</p> <p>c. Provision of premises for meetings or for promotion of cultural or fashion shows</p> <p>d. Provision of parking spaces for motor vehicles where parking charges are imposed.</p>

Group D: Night-Clubs, Dance Halls, Cabarets, Health Centres, Massage Parlours and Pubs

Taxable Person	Taxable Service
<p>1. Any person operating any:</p> <p>i. night-club,</p> <p>ii. dance hall,</p> <p>iii. cabaret,</p> <p>iv. ealth-centre or massage parlour which is approved by the appropriate local authorities or which is lawfully registered and where applicable, which is approved by the appropriate local authorities and lawfully registered</p> <p>v. Place licensed under paragraph (a) or (b) of subsection (I) of section 35 of the Excise Act 1976 and which is stated in the licence in paragraph (I) of regulation 9 of the Excise (Sales of Intoxicating Liquors) Regulations 1977 as First Class Public House or First Class Beer House.</p>	<p>a Provision of dancing partners or social escorts.</p> <p>b. Provision or sale of food, drinks or tobacco products.</p> <p>. Provision of services in form of -corkagell, -towel chargell or -cover chargell.</p> <p>d Provision of health services which are normally provided by health centres Provision of massage services.</p> <p>f Provision of premises for meetings or for promotion of cultural or fashion shows.</p> <p>g. Provision of parking spaces for motor vehicles where parking charges are imposed</p>

Group E: Private Clubs,

Taxable Person	Taxable Service
<p>1. Any person operating one or more private clubs and having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group.</p>	<ul style="list-style-type: none"> a. Provision of sports or recreational services including the entitlement to use such services by club members for which membership subscription fees are charged other than golf. b. Provision or sale of food, drinks or tobacco products. <ul style="list-style-type: none"> . Provision of services in form of -corkagell, -towel chargell or -cover chargell. d. Provision of health services which are normally provided by health centres Provision of massage services excluding massage services provided in barber shops, hair dressing saloon or beauty saloons. f. Provision of premises for meetings or for promotion of cultural or fashion shows. g. Provision of parking spaces for motor vehicles where parking charges are imposed h. Provision of rooms for lodging or sleeping accommodation i. Provision of golf course, golf driving range or services related to golf or golf driving range i.e. for – <ul style="list-style-type: none"> green / season pass caddy rental of golf buggy / turf mate rental of golf equipment guest complimentary play coaching absence competition entrance tournament lighting for night golfing night golfing practise range balls or driving range balls rental of golf shoes subscription

Group E1: Golf Course and Golf Driving Range Other Than Those In Groups A and E,

Taxable Person	Taxable Service
Any person (including any person who operates any private club having a total sales turnover of RM300,000 or less or any hotel having 25 or less rooms) other than the Taxable Person In Groups A and E, operating any: golf course golf driving range	a. Provision of golf course, golf driving range or services related to golf or golf driving range i.e. for – green / season pass caddy rental of golf buggy / turf mate rental of golf equipment guest complimentary play coaching absence competition entrance tournament lighting for night golfing night golfing practise range balls or driving range balls rental of golf shoes subscription

Group F: Private Hospitals

Taxable Person	Taxable Service
1. Any person operating one or more private hospitals licensed under the Private Hospitals Act 1971 and having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group.	a. Provision of rooms for lodging or sleeping accommodation b. Provision or sale of food or drinks

Group G: Other Service Providers

Taxable Person	Taxable Service
Subheading I :- Any person who is an Insurance Company registered under the relevant laws for the time being in force. 2. Any person who deals in or provides telecommunication services who is registered under the Communication and Multimedia Act 1998 or licensed under the Communication and Multimedia (Licensing) Regulations 2000. 3. Any person who is given permission to act as an agent for transacting business relating to the import or export of any	a. Provision of all types of insurance policies to all business organisations. b. Provision of telecommunication services in the form of telephone, facsimile, telemail, paging, cellular phone or telex, bandwidth service or value added services (per the Fourth Schedule) c. Deleted d. Provision of services for clearing of goods from customs control

Taxable Person	Taxable Service
<p>goods or luggage under section 90 of the Customs Act 1967</p> <p>4. Any person who is licensed under Section 65 or 65E of the Customs Act 1967 and who is also given permission to act as an agent for transacting business relating to the import or export of any goods or luggage that is stored in the licensed warehouse or inland clearance depot</p> <p>Subheading II : Deleted</p> <p>2 Any person, government agency or semi-government agency who operates or provides one or more parking spaces for motor vehicles having a total annual sales turnover, whether combined or singly, of more than RM 150,000 of any one or more taxable services mentioned within this Group</p> <p>3. Any person who provides courier services having a total annual sales turnover, whether combined or singly, or more than RM 150,000 of any one or more taxable services mentioned within this Group</p> <p>4 Any person who operates one or more motor vehicles service or repair centres or both such centres having a total annual sales turnover, whether combined or singly, of more than RM 150,000 of any one or more taxable services mentioned within this Group.</p> <p>5 Any person who is Private Agency licensed under the Private Agencies Act 1971 having a total annual sales turnover, whether combined or singly, of more than RM 150,000 of any one or more taxable services mentioned within this Group.</p> <p>6. Any person who provides employment services having a total annual sales turnover, whether combined or singly, of more than RM150,000 of any one or more taxable services mentioned within this Group.</p> <p>Subheading III :</p> <p>1. Any person who is a Public accountant registered under the relevant laws for the time being in force having a total annual</p>	<p>e. Provision of parking spaces for motor vehicles where parking charges are imposed</p> <p>f Provision of courier delivery services for documents or parcels not exceeding 30 kilograms each</p> <p>g Provision of general servicing, engine repairs and tuning changing, adjusting and fixing of parts, wheel balancing, wheel alignment or body repairs including knocking, welding or repainting of motor vehicles.</p> <p>h Provision of guards or protection of the personal safety or security of another person or for the safety or security of the property or business of such other person.</p> <p>i Provision of all types of employment services.</p>

Taxable Person	Taxable Service
<p>sales turnover, whether combined or singly, of more than RM 150,000 of any one or more taxable services mentioned within this Group.</p> <p>2 Any person who is an Advocate and Solicitor registered under the relevant laws for the time being in force having a total annual sales turnover, whether combined or singly, of more than RM150,000 of any one or more taxable services mentioned within this Group.</p> <p>3. Any person who is a Professional Engineer registered under the relevant laws for the time being in force having a total annual sales turnover, whether combined or singly, of more than RM 150,000 of any one or more taxable services mentioned within this Group.</p> <p>4 Any person who is an Architect registered under the relevant laws for the time being in force having a total annual sales turnover, whether combined or singly, of more than RM150,000 of any one or more taxable services mentioned within this Group.</p> <p>5 Any person who is a Licensed or Registered Surveyors including Registered Valuers, Appraisers or Estate Agents licensed or registered under the relevant laws for the time being in force having a total annual sales turnover, whether combined or singly, of more than RM150,000 of any one or more taxable services mentioned within this Group.</p> <p>6. Any person who provides consultancy services having a total annual sales turnover, whether combined or singly, of more than RM 150,000 of any one or more taxable services mentioned within this Group excluding approved companies with status or definitions as research and development companies and contract research and development companies under section 2 of the Promotion of Investments Act 1986 and approved research institute under section 34B of the Income Tax Act 1967.</p> <p>7 Any person who operates one or more private veterinary clinics having a total annual sales turnover, whether combined or singly, of more than RM300,000 of any one or more taxable services mentioned within this Group.</p>	<p>j. Provision of accounting, auditing, book keeping, consultancy or other professional services.</p> <p>k Provision of legal services including consultancy service on legal matters.</p> <p>l Provision of engineering, consultancy or other professional services.</p> <p>Provision of architectural services including professional consultancy services.</p> <p>Provision of all types of surveying services including valuation, appraisal, estate agency or professional consultancy services</p> <p>o. Provision of all types of consultancy services excluding consultancy service relating to medical and surgical treatment provided by private clinics or specialist clinics.</p>

Taxable Person	Taxable Service
<p>8. Any person who provides hire-and-drive car and hire-car services having a total annual sales turnover, whether combined or singly, or more than RM 300,000 of any one or more taxable services mentioned within this Group.</p> <p>9. Any person who provides management services having a total annual sales turnover, whether combined or singly, of more than RM 150,000 of any one or more taxable services mentioned within this Group.</p> <p>Subheading IV :</p> <ul style="list-style-type: none"> . Any person, government agency or semi government agency who provides advertising services having a total annual sales turnover, whether combined or singly, of more than RM 300,000 of any one or more taxable services mentioned within this Group. 	<p>p. Provision of veterinary services.</p> <p>q Provision of hire-and-drive car or hire-car services with or without chauffeur licensed under the Commercial Vehicles Licensing Board Act 1987.</p> <ul style="list-style-type: none"> . Provision of all types of management services including project management or project coordination. <p>s. Provision of all advertising services</p>

Clarification on Service Tax Treatment

Insurance Companies registered under the relevant laws for the time being in force will be held to be prescribed profession establishments for service tax purposes.

Prescribed services would normally include the provision of all types of insurance policies to all business organisations.

Service tax applies to all risks which commence on or after 1 January 1992. If the policy is issued before 1 January 1992 but the risks commences on or after 1 January 1992, service tax is still applicable on such risks.

Business organisations mean all organisations registered under the law to do business. As such, business organisations shall include organisations such as companies, firms, sole-proprietors, government and semi-government agencies registered under:-

- i) Any Acts of Parliament;
- ii) Companies Act, 1965;
- iii) Societies Act, 1966;
- iv) Co-operative Societies Act, 1976; and
- v) Registration of Business Act, 1856

But exclude organisations not doing business.

Therefore, business organisations would also cover associations, trust funds, statutory bodies, co-operatives, professions and even charitable organisations if they were to engage in any business.

Those organisations not doing business will have to put up a written declaration of their status to the insurer and declare that they do not derive any income from any business activities so that the insurer will not charge service tax on their insurance premiums.

Policies on private property including motor vehicles which are the subject of hire purchase agreements and insured in the names of individuals are not subject to service tax. Policies on private residential properties of individuals which are the subject of mortgage/charge to financial institutions are not subject to service tax. The term individual and the term sole-proprietorship must not be confused. A sole-proprietorship is a business organisation.

In the case where a group policy is taken by a business organisation and the premiums are paid by the members of the scheme, i.e. the employees, such policies are not subject to service tax. Where in a group scheme in which the premiums are partly paid by the business organisation and partly paid by its employees, only the portion paid by the business organisation is subject to service tax. The business organisation is required to make a declaration to the insurer, upon inception of the policy, that the premiums are paid by the employees and should keep documentary proof that premiums were collected from the employees. -Key man insurance policy effected by a business organisation on the life of its key employee is subject to service tax. However, if the policy is subsequently assigned to the -key man upon his leaving the company and subsequent premiums are paid by the assignee, i.e. the key man, service tax would not be applicable on the premiums paid by the key man.

The charge to service tax will be on all gross premiums less any discounts, charged either monthly, quarterly or at other intervals contracted for between the insurer and the insured. No deduction is given for any re-insurance outwards (whether onshore or offshore) and commissions paid to agents.

Where policies are terminated, and when a refund is made to the policy holder, the amount of service tax that is attributable to the unexpired portion of the premium should be refunded to the insured.

To encourage the underwriting of offshore policies by insurers in Malaysia any inward insurance or inward reinsurance premiums will not be subject to service tax.

Insurance policies issued to cover properties which are located overseas whether owned by Malaysians or otherwise are not subject to service tax as these are considered to be export services.

Refund for Bad Debt

- Any person who is or has ceased to be a taxable person may make a claim to the Director General for a refund of the whole or any part of the service tax paid by him in respect of taxable service if:
- the service tax has been paid by such person on or after 1 January 2003;
- the whole or any part of the service tax payable to such person has been written off in his accounts as bad debts; and
- the Director General is satisfied that all reasonable efforts have been made by such person to recover the service tax.

Can claim a refund (min. RM 50.00) of service tax in respect of bad debts written off

- -Bad debt means the outstanding amount for the payment in respect of the provision of taxable service including service tax which is due to the person but has not been paid to, and is irrecoverable by the person.
- A debt is irrecoverable
 - if the customer
 - has been adjudged bankrupt
 - has been placed under receivership
 - has been voluntarily wound up or been ordered by the court to wind up
 - is facing a claim suit or bankruptcy suit in court for the amounts payable
 - has not paid the whole / part of the payment even after 12 months from the date the related sales tax was paid
 - the whole / part of the payment has been written off as bad debts
- If only part of the payment is bad, the refund of the service tax is computed as follows:

Service tax paid	-	$\frac{A}{B}$	X	C
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- A Payment received
 B Total of service value + service tax
 C Total service tax paid

- Refund must be made within 6 years from the date the service tax was paid
- Must submit
 - Invoice
 - CP No. 3 – proof service tax was paid
 - proof that all reasonable efforts to recover the debt
 - debt has been written off as bad debts
 - reason for recoverability
- Where a refund of service tax has been made by the Director General to a person and any payment in respect of the services for which the service tax is payable is subsequently received by the person, the person shall repay to the Director General an amount calculated in accordance with the following formula:

$\frac{A}{B}$	X	C
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- A Payment received
 B Total of service value + service tax
 C Total service tax paid

Intra Group Services

- Where a company in a group of companies provides any taxable service mentioned in item j., k., l., m., n., o. or r. of Group G to any company within the same group of companies, such service shall not be a taxable service.
- Two or more companies are eligible to be treated as companies within a group of companies if one company controls each of the other companies. A company shall be taken to control another company if -
 - (a) the first company holds -
 - (i) directly;
 - (ii) indirectly through subsidiaries; or
 - (iii) together directly and indirectly from subsidiaries, more than fifty percent of the issued share capital of the second company; or
 - (b) the first company holds -
 - (i) directly;
 - (ii) indirectly through subsidiaries; or
 - (iii) together directly and indirectly from subsidiaries, from twenty percent to fifty percent of the issued share capital of the second company and the first company has exercisable power to appoint or remove all or a majority of directors in the board of directors in the second company.
- Shares shall be treated as **not held** if the shares are held—
 - (a) through nominees;
 - (b) in a fiduciary capacity; or
 - (c) by virtue of provisions of debenture holding, trust deeds for securing debentures or money lending activities.
- Where a company is controlled by two or more companies, such company (s e c o n d company) shall be taken to be controlled by the first company which has the exercisable power to appoint or remove all or a majority of directors in the board of directors in the second company.
- Where a company provides any services to another person outside the group of companies, the same service provided to any company outside or within the group of companies shall be a taxable service

Self Assessment

- Q1** What are the fundamental accounting assumptions adopted in preparing financial statements?
- Q2** Accounting Equation on Double-entry.
- a) Payment of insurance premium of RM 1,000 by cheque.
 - b) Purchase of a hand phone for RM 1,500 by cheque
 - c) Commission of RM 10,000 received from ABC Insurance Co.
 - d) Insurance claims of RM 5,000 received from XYZ General Insurance Co.
- Q3** Would service tax of 5% be charged on motor vehicle policy insured by the following?
- a) Mr A, an individual who is employed by XYZ Co.?
 - b) Mr Bee, carrying on business under the name of Bee & Co.?

Suggested Answers

- A1** International Accounting Standards Committee adopts the following fundamental accounting assumptions:-
- a) Going concern.
 - b) Consistency.
 - c) Accrual.
- A2**
- | | DR | CR |
|----------------------|--------|--------|
| a) Insurance premium | 1,000 | |
| Bank | | 1,000 |
| b) Hand phone | 1,500 | |
| Bank | | 1,500 |
| c) Bank | 10,000 | |
| Commission received | | 10,000 |
| d) Bank | 5,000 | |
| Insurance claims | | 5,000 |
- A3**
- a) An individual would not be charged service tax on premium paid for his motor vehicle policy.
 - b) A sole-proprietorship is a business organisation, 5% of service tax shall be charged on the premium paid by such an organisation.

Review Test

Azman, a sole proprietor purchased a lorry for his business by cash from a bank loan and recognized an advance cash receipt from a customer. His double entries will entail:
(I – INCREASE, D – DECREASE, NC – NO CHANGE)

Q1 For the lorry:

	ASSET	LIABILITY	EXPENSE	CAPITAL	REVENUE
a.	I		I	NC	NC
b.	D		NC	I	NC
c.	NC		D	NC	I
d.	D		D	NC	NC

Q2 For the advanced cash receipt:

a.	D		NC	I	NC
b.	D		D	NC	NC
c.	NC		I	I	NC
d.	I		D	NC	NC

Q3 Taxable services provided by A S/B [A] to B S/B [B] would be exempt if:

- a) A owns 19% of B but has the power to appoint directors in B
- b) B owns 51% in A
- c) A owns 49% of B but does not have the power to appoint directors in B
- d) 12% of B's shares is owned by A and the rest is owned by A's 100% subsidiary

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