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HIGHLIGHTS OF 2015/2016 TAX CHANGES

¶100 2016 Budget Proposals and Finance Act 2015

Budget 2016 was presented by the Minister of Finance on 23 October 2015 and the proposed changes range from simple variations in number or value to more complex formulae and tax treatment. In addition, there were also some radical amendments to certain tax principles which had been relied upon almost from the time Income Tax was introduced to Malaysia. One particular welcome item is in respect of Reinvestment Allowance where for the first time in several years, the proposal is beneficial rather than restrictive.

The proposed amendments take effect from varying dates — some from YA 2016, some from the passing of the Finance Act, and others from the date the relevant Statutory Order is issued.

Highlights of Budget 2016 include the following:

PERSONAL INCOME TAX

1. Changes in income tax rates; introduction of new income bands

In the main, the respective tax rates (Sch 1) for individuals up to chargeable income of RM400,000 are unchanged. However, beyond this level, three new income bands have been introduced. For the first time in perhaps more than 40 years, an individual with chargeable income exceeding RM600,000 will see an increase in the tax rate.

Chargeable Income Band	Present Tax Rate	Proposed Tax Rate	% Reduction
1 – 5,000	0	0	-
5,001 – 20,000	1	1	-
20,001 – 35,000	5	5	-
35,001 – 50,000	10	10	-
50,001 – 70,000	16	16	-
70,001 – 100,000	21	21	-
100,001 – 250,000	24	24	-
250,001 – 400,000	24.5	24.5	-
400,001 – 600,000	25	25	-
600,001 – 1,000,000	25	26	1
Above 1,000,001	25	28	3
Non-Residents			
The tax rate on Non-Residents will increase from 25% to 28%			

Table 1 (Monthly Tax Deduction table) of the Schedule of the Income Tax (Deduction from Remuneration) Rules 1994 has been amended in line with the above changes.

2. INCREASE IN PERSONAL RELIEFS AND DEDUCTIONS

a. **Spouse Relief**

This relief, under s 45A and 47 has been increased from RM3,000 to RM4,000.

The change is to be effective from YA 2016.

b. **Relief for Parental Care**

A new relief under s 46(1)(o) taking effect from YA 2016, provides for relief of RM1,500 in respect of each parent, subject to certain conditions, including:

i. The taxpayer should not have claimed relief under "expenses for parents' medical treatment".

ii. Where more than one child makes the claim, the relief amount would be apportioned accordingly.

iii. The parent should be resident in Malaysia and aged 60 years or more.

iv. The parent should not have annual income exceeding RM24,000.

Some clarification from Inland Revenue would be useful; for example whether this relief would still be available for those who may have claimed medical expenses for parents but would not reach the maximum even with this new relief.

c. **Relief for Children below 18 years of age**

The present relief of RM1,000 available under s 48(2)(a) has been increased to RM2,000 with effect from YA 2016.

d. **Relief for Children aged above 18 years and undergoing tertiary education**

With effect from YA 2016, this s 48(3)(a) relief which presently is RM6,000 will be raised to RM8,000.

e. **Relief for Tertiary Education**

Individuals who pursue tertiary education in selected fields or at certain levels are allowed relief of RM5,000 under s 46(1)(f). From YA 2016, this will be increased to RM7,000.

f. **Relief for Contribution to SOCSO**

A new relief under s 46(1)(n) will be available from YA 2016 to employees who contribute to SOCSO. They will be allowed relief of up to RM250.

3. PENALTIES

a. **Failure in Furnishing a Tax Return**

At present, the penalty provisions for a failure to submit a return form are not founded on the number of such offences. With the amendment through a new s 112(1A), where the failure is for two years or more, the taxpayer could be subject to the following:

i. A fine between RM1,000 and RM20,000, or

ii. Imprisonment of up to six years, or

iii. Both.

iv. A special penalty of up to three times the tax charged in any (estimated) assessment raised by the Director General.

Guidelines on this amendment would be helpful. For example, what would be the treatment would be where the taxpayer submits the return form after the due date but before the Director General has raised an assessment.

b. **Failure in Providing Correct Particulars**

In cases where a person fails to provide correct particulars as required in any return form, there is presently no provision for a penalty to be imposed. Under the new s 120(1)(h), such a failure would constitute an offence punishable by a fine of between RM2,000 and RM20,000 or imprisonment to a term of up to six months, or both.

This applies to individuals, companies, trusts, and limited liability partnerships.

c. **Failure to Deduct Tax from Payments to Non-Resident Entertainers**

The usual consequence of any failure to comply with withholding tax requirements is that the payment expense would not be allowed as a deduction and further, a penalty would be imposed. However, the former result does not apply in respect of any payment made to a non-resident entertainer.

Through a new s 39(1)(q), the relevant sum to the non-resident would not be allowed as a deduction. Further, if the payment is included as an expense in the accounts for the relevant year without the withholding tax being paid by the due date for submission, the relevant return would be treated as incorrect and a penalty under s 112 would be imposed.

4. EMPLOYMENT

a. **Basis Period of Employment Income Chargeability**

The basic principle regarding the treatment of employment income is that when the relevant amount is received, it shall be liable to tax for the period receivable, except for bonus and directors' fees which would be liable for the year of receipt. From 2016, through an amendment to s 25, all employment income will be liable to tax for the year it is received in.

The Income Tax (Deduction from Remuneration) Rules 1994 has been amended in line with the above changes.

Nevertheless, except for certain related-party amounts, liability will only arise when the income is actually received.

b. **Gratuity**

Under certain circumstances, gratuity will be fully exempt. If those conditions are not fulfilled, it would be fully liable. With the proposed new para 25D to Sch 6, a radical change will be introduced to the treatment of gratuity that is not exempt. Under this amendment, where gratuity is taxable, the relevant employee will enjoy an exemption of RM1,000 for each completed year of service.

This change is perhaps to compensate for the fact that with effect from YA 2016, gratuity will be liable in full in the year of receipt and not spread over five years and thereby being possibly liable at a lower rate of tax.

5. REINVESTMENT ALLOWANCE

a. Special Reinvestment Allowance

For the first time in years, an amendment in respect of reinvestment allowance brings with it a benefit. In this case, it offers a possible three-year extension to those who have already reached the 15-year limit within which to claim reinvestment allowance.

The relaxation with the introduction of para 2B of Sch 7A is as follows:

Year of Assessment in which the 15-year period ends:	Proposed extension to:
YA 2015 or earlier	YA 2016 – YA 2018
YA 2016	YA 2017 – YA 2018
YA 2017	YA 2018

b. Revision or Introduction of Definitions

To lend clarity or certainty to words regarding qualifying RA features, revisions have been made to the following:

automating	ceased to be used	disposed of
diversifying	expanding	size, shape
machinery	modernising	plant
simple		

c. Treatment of "Assets held for Sale"

The amendment to para 9 of Sch 7A comes in two parts:

i. The definition of "disposed of" will be widened to include "ceased to be used".

ii. This definition "ceased to be used" is to be extended to include an asset classified as "held for sale" under para 61A of Sch 3.

With this amendment where an asset is deemed to be disposed of by virtue of being "ceased to be used" for the business within five years of acquisition, any reinvestment allowance previously granted will be withdrawn.

6. OTHER AMENDMENTS

a. Debts from Services to be rendered or Use of Property

The tax case of *Clear Water Sanctuary Golf Management vs KPHDN* was in respect of debts for services or the enjoyment of property dealt with and the court ruled that such debts would form income only when the services had been rendered. Accordingly, the Inland Revenue Board (IRB) has proposed this change to the law to coincide with its stand.

The amendment to s 24(1) and the new s 24(1A) would see that any debts despite the relevant service or enjoyment not yet being rendered or dealt in would nevertheless constitute income for the period in which the debts arise.

Where any such amount is later refunded, it would be allowed as a deduction.

b. Interest on Money Borrowed

Interest expense is allowed as a deduction not when it accrues but in the year it is due to be paid. This would occur in a situation where interest may accrue in a certain year but needs to be paid only later. The new s 33(5), effective from YA 2016, requires the person to notify the Director General accordingly not later than 12 months after the end of the year of assessment in which the interest is due to be paid.

The Director General will then have the relevant assessment revised.

c. Amendments affecting Sukuk

i. Issuance of Sukuk Investments

The proposal extends deductions for expenses in respect of *sukuk* that complies with Sustainable and Responsible Investment.

This concession is to be available from YA 2016 to YA 2020.

ii. Income Tax Exemption

The amendments to para 33A(b), 33B and 35(b) of Sch 6 regarding the exemption of various Islamic Securities include:

- Substituting "Islamic Securities" with "Sukuk"
- Extending the scope of approval by the Securities Commission, and
- Replacing "Labuan Offshore Financial Services Authority" with "Labuan Financial Services Authority".

iii. Deductions on Sukuk Issuance Costs

Double and further deductions in respect of various issuance expenses are available to Sukuk investors.

The period of eligibility is extended by three years from YA 2016 to YA 2018.

d. Double Deductions for Research and Development

It is proposed that a deduction in respect of research and development expenses up to RM50,000 for each year of assessment be available to companies with paid-up capital not exceeding RM2.5 million. While the deduction would be automatic, the company would need to submit a R & D Project Application to the IRB.

This incentive would be available for YA 2016 to YA 2018.

Details of procedural requirements and the issue of "R & D Project Application" are not known at the moment.

e. Incentive Period for Real Estate Investment Trusts

Foreign institutional investors and other non-corporate investors, both resident and non-resident, who receive profit distribution from a REIT listed on Bursa Malaysia would be subject to a final tax at a concessionary rate of 10%.

The period during which this benefit can be enjoyed is extended from 1 January 2017 to 31 December 2019.

f. Capital Allowance on Small-Value Assets

Pursuant to para 19A(3) of Sch 3, a company with paid-up capital not exceeding RM2.5 million (conveniently referred to as a small and medium enterprise – SME) is allowed to claim capital allowance of 100% on assets costing not more than RM1,300. There is no limit to the total qualifying expenditure.

With effect from YA 2016, this concession would be available only to SMEs resident and incorporated in Malaysia.

g. Part of an Asset no longer used in the Business

To reconcile the determination of capital allowance with financial reporting standards in respect of any part of an asset which is no longer used for the business, a new para 61B in Sch 3 to take effect from YA 2016 is being introduced for the following circumstances:

(i) replacement of an old part with a new part

(ii) the new part is depreciated separately.

In such a case, the (old) part would be deemed to have been disposed of and its residual expenditure to be computed by reducing its qualifying expenditure by the capital allowance made.

Clarification from the IRB would be required regarding balancing charge or balancing allowance and the relevance of para 71, among other things.

h. Treatment of Goods and Services Tax under Sch 3, 7A and 7B

The revisions to the above schedules take effect from YA 2015 and in essence, cover the following treatment:

(i) Qualifying expenditure for capital allowance, reinvestment allowance, or investment allowance would not include any amount paid in respect of GST if the person is required to be registered under the GST Act but fails to do so or is entitled to credit the amount to his input tax.

(ii) Adjustments to qualifying expenditure shall only be made at the end of the period of adjustment allowed under the GST Act. In the case of a disposal of the asset, any adjustment resulting in additional or reduced qualifying expenditure will be made to the residual expenditure in the year of assessment the disposal was made.

i. Changes in s 60I Definitions

The section relates to special purpose vehicles (SPVs) established for the issuance of Islamic securities and the amendments are in respect of the following:

(i) replacing "Islamic Securities" with "Sukuk"

(ii) amending the relevant part of the definition of SPVs from "approved by the Securities Commission or the Labuan Financial Services Authority" to "lodged with the Securities Commission or approved by the Labuan Financial Services Authority".

j. Filing of (Employers') Form E

The amendment to s 83 through the introduction of a new s 83(1B) taking effect for the year ending 31 December 2016 and subsequent years will require the Form E to be submitted by way of e-filing or electronic submission. The option for manual filing will thus be no longer available.

k. Furnishing Estimate or Revised Estimate of Tax

From YA 2018, persons who are required under s 107C(1) to furnish an estimate or wish to furnish a revised estimate of tax under s 107C(7) will have to do so through electronic submission.

The new s 107(C)(7A) is in line with the Inland Revenue Board's move towards wider reliance on e-communication.

l. Mutual Administrative Assistance Arrangement Rules

Under s 154, the Minister is given powers regarding double taxation or tax information exchange arrangements under s 132 or s 132A. Budget 2016 widens such powers to include making rules in respect of mutual administrative assistance arrangements.

This came into force when the *Finance Act 2015* was passed, ie on 31 December 2015.

7. INVESTMENT INCENTIVES

a. Tour Operating Companies

Tax exemption incentives for tour operators catering for local and foreign tourists have been available but expire in YA 2015.

With the proposed amendment, the period of exemption will be extended from YA 2016 to YA 2018.

b. Companies in Approved Food Production Projects

Incentives in the form of tax exemption are available to both companies that invest in approved food production products and those that actually carry out such production operations.

Proposed amendments include:

i. Extension of the exemption to applications received up to 31 December 2020.

ii. Widening of qualifying production projects to include planting of coconuts, mushrooms, and cash crops, rearing of deer and honey bees, and planting of animal food crops.

c. Tax Exemption Period for Managing Syariah-compliant Funds

Syariah-management companies that fulfil set conditions can enjoy exemption from tax up to YA 2016.

The proposed amendment will extend the exemption period to YA 2020.

d. Increased Exports Allowance to Small and Medium Enterprise

To stimulate the development of companies with paid-up capital not exceeding RM2.5 million, the determination of the export allowance will be made more generous from YA 2016 to YA 2018, as follows:

i. 10% of the value of increased exports will be exempted where the goods exported attain 20% value added. The previous threshold was 30% value added.

ii. 15% exemption of the value of increased exports will be available where the goods exported reach at least 40% value added. Previously, the minimum was 50%.

e. Incentives for Independent Conformity Assessment Bodies

ICABs are companies that provide service to see whether their clients' products or services reach international specifications or safety standards. Such companies do not presently enjoy any tax incentives.

Budget 2016 proposes a wide range of incentives, including:

i. For a new ICAB

Tax exemption of 100% of statutory income for five years, or

Investment Tax Allowance of 60% of qualifying expenditure for five years.

ii. For an existing ICAB

Tax exemption through Investment Tax Allowance of 60% of qualifying expenditure for five years.

In both cases, the exemption amount can be set-off against 100% of statutory income.

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OVERVIEW OF DUTIES, EXEMPTIONS, AND DEDUCTIONS, ETC

¶200 Due dates

Annual due dates for submission to Inland Revenue Board

Form E (return by employers)	31 March of the following year
Form B/BE (residents) **Form M** (non-residents) **Form P** (partnership)	30 April for persons with non-business sources only and 30 June for those with business sources
Form TA/TC (trusts) **Form C**	Within 7 months from the date following the close of its accounting period Effective from YA 2014, submission of Form C must be by way of electronic media (e-Filing) and based on audited accounts.

CHAPTER 7

WHAT IS INCLUDED IN ASSESSABLE INCOME?

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WHAT IS INCOME?

¶7-050 General — income not defined

The whole object of the *Income Tax Act 1967* (ITA) is to tax income and it is therefore an exercise of utmost importance for a taxpayer to distinguish the nature of a particular receipt or accrual. Money or money's worth to be taxable must not only be received from a specific identifiable source but it must be in the nature of *income* and not in the nature of *capital*. Income receipts normally would have a recurring characteristic whereas capital receipts are of a once-and-for-all-time nature. Thus, one can contend that capital is wealth retained and invested and income is wealth that is transferred and circulated.

"Income" has not been defined in the ITA and the expression has been often described by the courts with reservations. Its meaning is not exhaustive. It has been defined as a gain derived from capital, labour or both combined that is received by the taxpayer for his/her separate use, benefit and disposal (*Eisner v Macomber*). It is not necessarily a recurrent return from a definite source. It may consist of a series of separate receipts, as it does in the case of professional earnings (*Kamalakshya Narain Singh v CIT*). For income tax purposes, income from a business or employment or investment takes its limitation from the words "gains" and "profits". Thus, the tax on a business is a tax on the gains and profits it makes from its entire operations and is not a tax on its gross receipts.

Capital or revenue receipt?

Two identical transactions can yield a capital receipt in one case and an income receipt in another. An accountant who sells his/her car sells it on a capital account, whereas a car dealer who sells a car does it on a revenue account. The latter's receipts are of an income nature. It follows that the status of the recipient in such cases becomes all important.

Generally, the accounting treatment gives support to its nature but cannot be considered conclusive for tax purposes.

Since Malaysia does not cater for tax on capital gains or profits (except on certain properties), once a receipt is evaluated as one of a capital nature, it should be ignored for tax purposes (see ¶17-050ff).

In the case of a trade or business, all receipts which are normally related to the circulating capital or stock in trade of the business are considered of an income nature. Those related to fixed capital are of a capital nature. There are certain tests that can be usefully applied in varying degrees to a transaction in question:

- Does the receipt arise from the carrying on of the trade or business? Thus, if a receipt has little relevance with the business or falls outside the scope of its operations, it cannot give rise to a gain or profit from the trade. This does not, however, mean that the receipt will fall outside the scope of taxation. It may well be taxable under some other heading in s 4 of the ITA.
- Is it a capital or a revenue receipt?
- Are there any provisions in the ITA which require that the receipt in question is to be given special treatment? For example, is it specifically exempted or is it subject to tax at a reduced rate?

Insofar as personal services are concerned, the criteria are different. Briefly, all that flows from an employment will rank as income receipts unless specifically exempted.

Income referred to in tax legislation is taxable income, ie that income which is chargeable to tax under the tax laws of the relevant country.

Income is taxable only when it is received or, as in the case of businesses, when it becomes receivable. Further, tax can only be charged on and paid by the person receiving or entitled to the income. Hence, traders may pay tax on the balance of profits or gains and bring money owed to them into account but ordinary individuals are not assessable and do not pay tax until they get the money because until then it is not part of their income (*IR Commrs v Whitworth Park Coal Co Ltd*).

The concept of income is not *in vacuo*. The income bears its quality as income only if it is received by the taxpayer or it has accrued or has arisen to the taxpayer. It can also be income if it is fictionally deemed to be received by, or is deemed to have accrued or arisen to, a taxpayer.

¶7-055 Income "deemed" to derive from Malaysia

"Deemed to derive" means "deemed by the statutes" to derive. In other words, income in reality is not derived but the ITA requires it to be treated as income derived from Malaysia. Artificial derivements are provided in the Malaysian ITA and broadly fall under five concepts:

- *Artificial derivement*

  Such artificial derivement is provided in s 31 of the ITA. This section deems the "annual value" of property occupied by the taxpayer who owns it to be income derived although no income may actually be received or derived from such property. [CCH Note: s 31 was deleted by s 9 of the *Finance (No 2) Act 2002*.]

- *Artificial place of derivement*

  In such a case, the income is not in reality derived in Malaysia but the ITA requires it to be treated as if it was derived here.

  The fiction in s 15, eg fixes the place of derivement in Malaysia of certain types of interest and royalties.

- *Artificial chargeability of a person*

  Here, the income of someone else may be deemed to be the income of the person sought to be taxed.

- *Artificial year of taxability*

  Here, the income may be deemed to be the income of the previous year, ie the accounting year or year of remittance of offshore income, when actually it may be the income of a different year.

- *Artificial amount of derivement*

  This situation arises where the amount actually derived is artificially reduced. For instance, s 54 states that the profits of a non-resident shipping operation will be 5% of the gross earnings from outward shipments from Malaysia.

¶7-060 Charging section

Section 4 of the ITA is the charging section and sets out six main heading of income that are chargeable to tax:

- profits or gains from a trade, business, profession or vocation (s 4(a))
- profits or gains from personal services — employment (s 4(b))
- dividends, interest and discounts (s 4(c))
- rents, royalties or premiums (s 4(d))
- pension, charge or annuity or other periodical payments (s 4(e))
- gains or profits from other sources (s 4(f)).

For each year of assessment, tax is levied on the total of the income derived under the above headings.

Law: s 4.

¶7-065 Income of a non-resident person

In addition to the main six headings of income indicated in ¶7-060, there is a charging section for non-residents. Section 4A provides that income of a non-resident person from the following is chargeable to Malaysian tax:

- any consideration for services rendered by him/her or his/her 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 the non-resident
- any consideration for technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme, and
- rent or other payments made under any agreement or arrangement for the use of any movable property.

The Inland Revenue Board (IRB) has expressed the general view that any services involving the imparting or transferring of specialised and expert knowledge will be deemed to be of a "technical" nature.

Services provided by architects, computer programmers and engineers fall squarely within the scope of s 4A of the ITA, although the Revenue has indicated that routine day-to-day administrative work charged by a head office to a branch, or by a holding company to a subsidiary, will not be considered as specialised services. Similarly, fees or commissions paid to non-resident purchasing agents whose services are not specialised or technical in nature would not be included under s 4A of the ITA.

It is of interest to note that under the Malaysian–German tax treaty, s 4A source income would appear to be excluded. Consequently, payments to residents of Germany which fall within s 4A will not be subject to Malaysian withholding tax. Article 21 of the treaty states:

> "Items of income of a resident of a contracting state which are not expressly mentioned in the foregoing Articles of this Agreement shall be taxable only in that contracting state."

Notwithstanding the above, it is important to note that there is a "Technical Fees" Article in the new DTA with Germany. As such, s 4A payments to a resident of Germany which were previously exempted from Malaysian tax under Art 21 of the existing DTA will no longer be applicable once the new DTA comes into effect.

For the latest development with effect from 21 September 2002, see ¶12-810.

Law: s 4A.

ASCERTAINMENT OF TAXABLE INCOME

¶7-100 General

The basis or the concept of tax in Malaysia is territorial. In ascertaining the income that is to be subjected to tax, one has to start with the gross income. This means the total amount:

- not of a capital nature
- derived during the year of assessment

- from a source within Malaysia, and
- by any person.

Thus, the following four factors to be considered when determining tax liability are:

(1) *Quality* — If the income is of a capital nature and it does not fall within the taxpayer's gross income.

(2) *Time* — Only those amounts that are physically received by the taxpayer during a particular year of assessment are subject to tax in that year.

(3) *Source* of income — Here, we pose the questions: What did the taxpayer do or suffer to earn the income; and did he/she earn it in Malaysia?

(4) *Incidence* — Here, we need to determine who is the person or legal entity upon whom the liability for tax falls.

In ascertaining the income of a person for the purposes of tax one has to take the gross income and from this make all the qualifying deductions as prescribed in the ITA (see ¶9-050ff). In addition, all income which is exempt from tax is to be excluded (see ¶8-100ff).

Source of income

The Malaysian ITA does not define "source" and consequently each commercial activity has to be carefully examined to determine the source from which income is generated. With Malaysia's taxation concept being territorial, if the originating cause of an income in question is not within the jurisdiction of Malaysia, it falls outside the tax net.

In Malaysia's first landmark case regarding the source of income, ie *Ketua Pengarah Hasil Dalam Negeri v Cardinal Health Malaysia 211 Sdn Bhd* (2011), the Court of Appeal affirmed that interest income derived by the taxpayer from loans made to an overseas entity (in the Netherlands) was foreign-sourced and therefore not subjected to Malaysian income tax. The taxpayer won before the Special Commissioners of Income Tax, the High Court and lastly the Court of Appeal.

At each level, the Malaysian courts and the Special Commissioners affirmed Commonwealth case law, in particular the Privy Council cases *CIR v Hang Seng Bank* (1989) and *CIR v Orion Caribbean Ltd* (1999). Although the Malaysian exemption and the counterpart Hong Kong legislation in *Hang Seng Bank* and *Orion Caribbean* are not identical, the Malaysian courts were persuaded to apply the principles arising from each case, as the present case revolved around the question of what the taxpayer had done to earn the interest income.

The DGIR had argued that the interest income was in fact sourced in Malaysia, as the funds lent were generated from the business activities of the taxpayer in Malaysia and transmitted from the taxpayer's bank account in Malaysia. Applying Lord Bridge's dicta in the *Hang Seng Bank* case, the Court of Appeal affirmed the judgment of the High Court that the source of the interest income was located "where money was lent", and it followed that what had been done to earn the income was the placement of the funds in the Netherlands. Therefore, the interest received by the taxpayer from its related Dutch company was foreign-sourced income and hence exempted from income tax under the Income Tax (Exemption) (No 48) Order 1997.

As the issue of foreign-sourced interest income had never been litigated previously, the case of *Ketua Pengarah Hasil Dalam Negeri v Cardinal Health Malaysia 211 Sdn Bhd* (2011) was crucial in setting an important precedent.

¶7-110 Tax-free income

Technically, there is no such thing as "tax-free income". If an amount is liable, then the appropriate tax has to be paid. Where the receipt of income, eg remuneration, dividends and interest, is tax free (ie borne by the employer in the case of employment), the amount of tax involved must be added to the income and the total would constitute gross income.

¶7-120 Gross income

"Gross income" is referred to as the total income for the basis period derived from all the sources indicated in ¶7-060. Thus "Gross Income" refers to a specific source and also to the total from all sources.

Law: s 4, 5(1)(b).

¶7-130 Adjusted income (loss)

After applying all expenses and outgoings incurred wholly and exclusively in producing the gross income and excluding receipts which are not liable, the result is the adjusted income or loss, as the case may be. However, it must be noted that the concept of "loss" applies to a business source only. For any other source, should the allowable expenses exceed the income, the surplus does not constitute a loss, it is simply disregarded for tax purposes.

Law: s 5(1)(c), 33.

¶7-140 Statutory income

Capital allowances as provided in the ITA are then deducted from the adjusted income and the balance is referred to as statutory income. Should the capital allowances exceed the adjusted income, the statutory income would be nil and the surplus capital allowances would be carried forward to the following year. Since capital allowances are applicable to only business sources, adjusted income from non-business sources would also be statutory income.

Law: s 5(1)(d), 42.

¶7-150 Aggregate income

The next step is to apply all unutilised business losses carried forward if any, from earlier basis years which could not be absorbed to the statutory business income, and to add all the non-business sources of income. The residue is referred to as the aggregate income.

Law: s 5(1)(e), 43.

¶7-160 Total income

From the aggregate income are deducted items like the adjusted loss for the basis period (if any), abortive prospective expenses, donations to approved institutions and the Government, group relief (applicable for companies), and carry back losses under s 44B. The balance is total income.

Law: s 44.

¶7-170 Chargeable income

The final step is to deduct personal relief, ie individual, wife and child relief, life assurance, and the other relief and deductions available to an individual. The result would be chargeable income and to this amount the tax rates relevant to the person concerned are applied. Since companies are not entitled to personal relief, their chargeable income will be the total income.

Law: s 5(1)(f), 46–50.

¶7-180 Calculation of chargeable income

Example

		RM	RM	RM	Section
	Business income (rubber trading)		80,000		24
Less:	Business expenses wholly and exclusively incurred	45,000			33
	Bad and doubtful debts	1,500			34
	Contributions to approved scheme	1,000			34
	Stock adjustments	1,500	(49,000)		35
	Adjusted income (see ¶7-130)			31,000	
Less:	Capital allowances (Sch 3)			(7,500)	
	Statutory income (see ¶7-140)			23,500	42
Less:	Balance of unabsorbed business loss b/forward, say,			(4,500)	43(2)
				19,000	
	Employment		10,000		24
Less:	Rent for accommodation and furniture		(1,000)		38
	Adjusted/statutory employment income			9,000	
	Interest, discounts			7,500	27
	Rents, royalties, premiums			8,500	27
	Pensions, annuities, etc			2,000	27

CHAPTER 9

BUSINESS DEDUCTIONS

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WHAT ARE BUSINESS DEDUCTIONS?

¶9-050 General

The general scheme of Pt III of the *Income Tax Act 1967* (ITA) is that, in ascertaining adjusted income, certain express deductions [s 33(1)] and certain express or implied prohibitions of deductions [s 39(1)] must be taken into account. There are three main sections governing the question of "expenses", ie:

- Section 33: This relates to all sources of income and is guided by the principle that allowable expenses need to be incurred in the production of income.
- Section 34: This section is in respect of determining adjusted income from a business.
- Section 39: This is the restrictive section that prohibits expenses, sometimes even those allowed by s 33 and 34, unless they meet certain specific conditions.

For non-business sources, the adjusted income would constitute statutory income from that source. Where it is a business source, capital allowances have to be taken into account to arrive at statutory income.

Expenses that are deductible

The general deduction formula is provided in s 33(1) of the ITA:

> ". . . 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 . . ."

Expenses that are not deductible

On the other hand, s 39(1) of the ITA is the negative complement of s 33(1) of the ITA:

> "Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source . . . no deduction . . . shall be allowed in respect of . . ."

These two sections provide, on the one hand, what may be deductible and, on the other hand, what may not be deductible. Between them, they are the tests for determining what kind of expenses will be admitted and what kind of expenses will not be admitted.

¶9-060 Conditions of deductibility

The following conditions should concur in order that a particular item of expenditure may qualify for deduction under s 33 and 39:

(1) *A deduction should not be specifically prohibited by any provisions in the ITA.*

Section 39 is the negative complement of s 33 and specifically prohibits deductibility of certain types of expenditure.

Case law

In *JSMT Agency v Ketua Pengarah Hasil Dalam Negeri* (1997) MSTC 2,867, payments made for the taxpayer's use of licences and permits granted to the statutory bodies by the Government to extract timber were deemed by the Special Commissioners as non-allowable deductions under s 39(1)(g). The principle here is that while the payments for the use of the licences passed the test set in s 33, of being incurred in the production of income, they were specifically barred by s 39.

There are also some other sections in the ITA which prohibit certain types of expenditure or which prohibit expenditure in excess of laid down limits or which provide conditions to deductibility. Some of these are:

- s 49(2) (conditions to pension and provident funds), and
- Sch 6 para 15 (compensation for loss of employment) (see ¶8-360).

(2) *The expenditure must be in respect of the business activities carried on by the taxpayer.*

The expenditure which gives rise to the income must be in respect of the activities carried on by the taxpayer and the profits of which are to be computed and assessed (*CIT v Ashok Leylands Ltd*). Thus, expenditure incurred by a taxpayer in extending his qualifications to enable him to fly helicopters was disallowable as it was incurred by him to undertake a new business and therefore constituted capital expenditure (*Case U14*).

To rank for deduction the expense must be incurred for the business which is carried on in the accounting year and the profits of which are under assessment. Thus, expenditure incurred prior to the commencement of business, or after the termination of the business, would not meet this condition. Further, the expense must be for the business carried on by the taxpayer, ie the taxpayer's business. For example, loss or expenditure incurred by a subsidiary or for the purpose of the subsidiary will not normally be allowed to the parent company.

(3) *The expenditure must be incurred in the accounting year.*

For an expense claim to hold up, it should have been incurred in the relevant accounting year. Expenses or losses incurred prior to commencement of the relevant accounting year may not be admitted (*CIT v Chitnavis*).

If a taxpayer does not debit a legitimate expense in the accounts of a year in which it is incurred but keeps it in a suspense account, he/she cannot claim such an expense if he/she chooses, after, say, three years, to debit it to a profit and loss account. By the same token, an expense incurred subsequent to the relevant accounting year will not rank for deduction. The House of Lords has held that expenditure is deductible in the year in which it is made and not in the year in which it becomes necessary (*Naval Colliery Co Ltd v IR Commrs*). Thus, an anticipated loss or expense in a future year or accounting period, however inevitable it may be, eg bonuses, loss on contracts, doubtful debts or any contingent liabilities, cannot be treated as a loss or expense of the current year in which it has not crystallised.

In the case of a contingent liability, this is not an expense in respect of which a deduction can be claimed unless the liability is definite, to be discharged in the future. A deduction shall only be allowed in respect of the liability to pay retiring benefits or deferred remuneration to employees in the future, provided the liability is accurately estimated, eg on an actuarial valuation (*Owen v Southern Railway of Peru Ltd*).

Case law

In the Court of Appeal case of *Exxon Chemical (Malaysia) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (2006) MSTC 4,204, the taxpayer had set up an unapproved retirement and resignation benefit plan for its employees which would provide for a lump sum payment to employees who have served for at least 11 years. It was held by the Court of Appeal that the sum which the taxpayer was under an obligation to pay should be allowed for a deduction as established in a Privy Council decision of a Hong Kong case (*Commisioner for Inland Revenue v*

Lo & Lo (1984) 1 WLR 986). Although this was contrary to the Revenue's argument that the monies for the plan were never incurred and that they existed for mere contingencies, the Court held that the words "expenses wholly and exclusively incurred" in s 33(1) of the ITA would include a sum which the taxpayer would be under an obligation to pay. In this case, the taxpayer could not have lawfully resisted the employees' claim for the benefit. This case is contrasted with the case of *Owen v Southern Railway of Peru Ltd* (1954) 35 TC 602 which involved benefits of a statutory scheme as opposed to a voluntary scheme.

To summarise, an expenditure which is deductible for income tax purposes is one which is towards a liability actually existing at that time. The putting aside of money which may become expenditure on the happening of an event is not expenditure. There is a clear distinction in income tax law between actual liability *in praesenti* and a liability *de futuro*, which for the time being is only contingent. The former ranks for deduction, the latter does not.

(4) *The expenditure must be incurred wholly and exclusively in the production of income.*

The requirement under s 33 is that the expenditure must be "wholly and exclusively" incurred but not that it should be "necessarily" incurred. To stretch the issue, an expenditure laid out wholly and exclusively for the business will qualify for deduction although it may be unnecessary. See further ¶9-070.

(5) *It should not be in the nature of personal expenses of the taxpayer.*

Section 39(1)(a) states quite explicitly that domestic or private expenses are not deductible in computing taxable income.

Personal expenses include expenses on the person of the taxpayer or expenses to satisfy his/her personal need such as clothes, food, children's education, reciprocal entertainment, recreation, etc. In the negative form they represent all expenses not related to the business, profession or employment.

Medical expenses incurred by a taxpayer are not wholly and exclusively incurred in connection with his/her professional work even though he/she becomes ill as a result of working in unfavourable conditions and cannot earn an income if he/she is ill (*Norman v Golder*). Similarly, expenses incurred by a taxpayer in taking courses to improve his/her sales skills were non-deductible because they were private in nature and mainly geared to developing the personal abilities of the taxpayer (*Case V13*).

Further examples of personal expenses are those incurred by the taxpayer in clubs and hotels, rent for residence, for holiday making, in respect of income taxes, for legal expenses, for medical and dental treatment, for tuition fees, in pursuit of a hobby, in respect of church contributions, etc.

(6) *The expenditure should not be of a capital nature.*

As capital receipts are an inherent limitation on the income concept, so is capital expenditure an inherent limitation on deductibility. One of the most vexed questions in the computation of business income is whether a particular

expenditure is revenue or capital expenditure. If it is revenue it is deductible, if capital it is not. The line of demarcation is not always easy to determine; it is very thin and each case has to be decided on its own facts and circumstances (*Heather v P-E Consulting Group*).

There is in fact no rule of thumb for determining whether a particular expenditure is capital or revenue. As a guideline, the word "capital" connotes permanency and capital expenditure is, therefore, closely akin to the concept of securing something tangible or intangible, property, corporeal or incorporeal rights, which will be of a lasting or enduring benefit to the enterprise in issue. Revenue expenditure, on the other hand, is operational in perspective and solely intended for the furtherance of the enterprise. This distinction, however, is susceptible to modification under certain circumstances. The aim, object and purpose of the expenditure all have a bearing on whether the expenditure is capital or revenue (*CIT v Ashok Leylands Ltd*). The payment may in fact be a revenue payment from the point of view of the payer and a capital payment from the point of view of the receiver and vice versa (*Racecourse Betting Control Board v Wild*).

In Hong Kong, the Privy Council held that although the interest payments of a loan made to purchase a tram depot would *prima facie* be deductible, nevertheless they were not deductible as they fell within the specific prohibition of "expenditure of a capital nature" under s 17(C) of the *Inland Revenue Ordinance* (Hong Kong) (*Wharf Properties Ltd v Commissioner of Inland Revenue*).

Law: s 6A, 33, 39, 44(6), 46–49, Sch 6 para 15.

¶9-070 "Wholly and exclusively"

The basic rule of deductibility under s 33 of the ITA is that only expenditure which is of a revenue nature and which is wholly and exclusively incurred in the production of income ranks for deduction.

Practice tip

Although the ITA does not strictly provide for the "deduction" formula to be applied differently to different sources of income, in practice, certain rigid rules and bases are consistently applied by the Inland Revenue Board (IRB). These are discussed throughout this chapter.

What does "wholly and exclusively" mean?

The first adverb "wholly" in the above phrase refers to the quantum of the expenditure, ie the sum of money spent. The second adverb "exclusively" refers to the motive or object behind the expenditure. Thus, unless such motive or object is solely in the production of income, the expenditure will fail the deductibility test.

However, this does not necessarily mean that, where the sole object is income production, the expenditure will be disqualified because some other objective is also attained, being inherent in the business activity itself.

The rigidity of the words "wholly and exclusively" is often disturbing to taxpayers. What is wholly and exclusively laid out to produce income is a question of fact, and the circumstances of each taxpayer have to be considered on their own merits.

The words have been extensively considered by the judiciary, but definitive principles are difficult to formulate. However, these factors go some way in determining whether the amount expended was done so "wholly and exclusively" in the production of gross income:

- The source of income.
- The character of the taxpayer.
- The connection between the expenditure and the income.
- Whether the expenditure is remunerative.
- The benefits that have arisen to the claimant.
- Whether any part of the expenditure is inadmissible.
- The treatment of the expenditure in the accounts.
- The IRB's standards of reasonableness.

Law: s 33(1).

¶9-072 What was the object of the expenditure?

Object vs effect of the expenditure

When ascertaining the character of an expenditure or loss, a distinction should be drawn between the object and the effect of the outgoing. An outgoing made with the object of producing gross income may be deductible, notwithstanding that it has a non-income-producing effect.

The importance of the taxpayer's intention

In applying the concept of "wholly and exclusively", the motives of the taxpayer must be addressed:

- Why did the taxpayer incur the expenditure?
- What were his/her objectives in making the outlays?
- Must these objectives be limited to the particular conscious motive in the taxpayer's mind?

Case law

This area of probing into the taxpayer's mind dominated the decision of the House of Lords in *Mallalieu v Drummond* (1983) BTC 380 where a barrister was not allowed a deduction for the replacement, laundering and cleaning of the clothes she had to wear in court because her secondary, though unconscious, motive was the provision of clothing for warmth and decency that she needed as a human being.

As a result of the *Mallalieu* decision, the following questions emerged:

- What is the extent of probing one need do when considering why/reason the taxpayer incurred the expenditure?
- Have the old and well-tested understanding of the law, that the subjective test of the conscious purpose of the taxpayer is paramount, been extended to include the subconscious motive test?
- Should or can the courts ignore an incidental benefit accruing from an expenditure?

Generally, it is accepted that, where a taxpayer's intention in incurring an expense is to procure a business benefit and a personal benefit incidentally arises, a deduction is still merited. However, where both the business benefit and the personal benefit are present in the taxpayer's mind when incurring the expense, the duality rule applies.

The *Mallalieu* case, however, cuts across this accepted tax concept. The decision here suggests that, if there is a conscious business motive X and a subconscious personal motive Y, the whole of the expenditure will not rank for deduction.

Case law

The dual-purpose question was also considered in the case of *MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co* (1986) STC 491. In this case, the removal expenses of partners were paid by the firm and the Court had to determine whether the expenses were deductible and whether the private interests of the partners were incidental to the business interests of the partnership. It was held that, if any expenditure incurred by a sole trader or practitioner was treated as having a dual purpose, it follows that such expenditure would also have a dual purpose if it was incurred by a partnership. The Court held that there should be consistency in the treatment of the profits of a partnership firm and those of a single business.

¶9-074 Is the expense "incurred" during the basis period?

Meaning of the term "incurred"

A general definition of the word "incur" is "to become, through one's own action, liable or subject to" (Oxford English Dictionary).

The word "incurred" does not only mean paid; an expenditure can be incurred without actually being disbursed. Thus, where a trader keeps his/her accounts on an accrual basis, he/she takes into account all the liabilities he/she has become subject to and these are allowable as deductions, notwithstanding the fact that the disbursements have not actually been effected. For example, at the end of an accounting year, a taxpayer may owe money for services rendered to him/her (such as staff emoluments and advertisement charges) during the year. The debts rank for deduction as the liability has been incurred. On the other hand, where a provision is made for expenditure which will crystallise only in a period subsequent to the accounting period under review, the expenditure does not rank for deduction against

the profits that are being assessed. Examples of this type of provision are leave pay and retiring benefits. Where, however, there is an absolute liability to pay at the end of the year in which the provision is made, the expenditure is deductible. Examples of these types of provision are directors' fees, bonuses and commissions.

The broad working rule, which emerges as a guide to the crediting or debiting in a tax computation of subsequently maturing credits or debits, is to enquire in which accounting period the right or liability was established and to carry the item into the account in that year. In the case of credit items, and similarly in the case of expenses, if the title to the sum arose in one accounting period, the fact that the precise amount of the credit is not fixed until later will not prevent the eventual receipt being credited in the earlier year [*Bernard v Gahan* (1928) 13 TC 723].

Case law

In an Australian case, *Alliance Holdings Ltd v FC of T* 81 ATC 4637, in relation to deductibility and receivability, the taxpayer had borrowed money from the public secured by deferred interest debenture stock on which no interest was payable to the debenture holders until the maturity date of the debenture.

The Court held that the contract that existed between the taxpayer and the stockholders constituted an obligation on the part of the taxpayer to repay to the stockholders the money lent and the interest thereon at the rate stated. The obligation was created at the time the contract was made. The debt, however, was not payable until some time in the future. In respect of the deductions claimed by the taxpayer, there was in each relevant tax year a present liability to pay the determined interest at a future date. In those circumstances, the claim of the taxpayer was allowed.

The decision appeared to suggest that the year of taxability of the interest in the hands of the stockholders would coincide with the year in which the finance company "incurred" the expense, raising the question, "Would the interest be taxable when received or the maturity date?"

The word "incurred" in s 33(1) of the ITA covers all expenditure for which a liability has been incurred during the basis year. Whether or not the liability has been actually discharged in that year is not relevant.

"Incurred" really means money actually paid out or money for which a legal liability to pay has arisen. A mere diminution in the value of an asset does not mean a "loss" has been "incurred".

The expenditure must be incurred in the accounting year

For an expense claim to hold up, it should have been incurred in the relevant accounting year. Expenses or losses incurred prior to commencement of the relevant accounting year may not be admitted [*CIT v Chitnavis* 6 ITC 453].

If a taxpayer does not debit a legitimate expense in the accounts of a year in which it is incurred but keeps it in a suspense account, the expense cannot be claimed if, for example, the taxpayer chooses to debit it to the profit and loss account after three years.

Further, an expense incurred subsequent to the relevant accounting year will not rank for deduction. Expenditure is deductible in the year in which it is made and not in the year in which it becomes necessary [*Naval Colliery Co Ltd v IR Commrs* (1928) 12 TC 1017]. Thus, anticipated losses or expenses in a future year or accounting period, however inevitable, eg bonuses, losses on contracts, doubtful debts or any contingent liabilities, cannot be treated as losses or expenses of the current year in which they have not crystallised.

In the case of a contingent liability, this is not an expense in respect of which a deduction can be claimed, unless the liability is definite and to be discharged in the future. A deduction shall only be allowed in respect of the liability to pay retiring benefits or deferred remuneration to employees in the future, provided that the liability is accurately estimated, for example, on an actuarial valuation [*Owen v Southern Railway of Peru Ltd* (1956) 36 TC 602].

An expenditure which is deductible for income tax purposes is one which is towards a liability actually existing at the time. The putting aside of money which may become expenditure on the happening of an event is not expenditure. There is a clear distinction in income tax law between actual liability *in praesenti* and a liability *de futuro*, which for the time being is only contingent. The former ranks for deduction; the latter does not.

Case law

Pursuant to a statutory obligation to apply for strata titles, the taxpayer took steps to apply for strata titles for the town houses by approaching three licensed surveyors. Despite undertaking efforts to apply for the titles, the taxpayer did not complete the application process as it faced cash-flow problems. The taxpayer then treated the sum of expected expenditure as incurred for the purposes of applying for strata titles for the town houses and deducted the sum under s 33(1) of the ITA, including professional fees and disbursements paid to the licensed surveyors.

The Special Commissioners held that the survey fees should be allowed for deduction under s 33(1) of the ITA as they were expenditure that was certain and definite, and determined according to the sales prescribed in the Licensed Land Surveyors (Amended) Regulations 1997. It has been recognised by the accounting and legal principles that such expenditure should be matched against the corresponding income (and deducted), provided that the appellant was under a legal obligation to incur the expenditure and the expenditure was sufficiently accurate (*ME Holding Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (2011) MSTC ¶10-013).

¶9-076 Is the expense incurred in the production of income?

The deductibility of expenditure is restricted by the use of the words "in the production of gross income" in s 33 of the ITA. In addressing the meaning of these words, it has been said that "the answer . . . is to be found in a recognition of the fact that it is necessary, for income tax purposes, to look at a business as a whole set of operations directed towards producing income".

It is generally accepted that the words "in the production of income" do not mean that before any expenditure ranks for deduction it must be established that it has produced income in the year in which it is incurred. It is sufficient for a taxpayer to

show that the outlay was for the purpose of earning income, whether in the year under review or a future year. There must be a good connection between the expenditure incurred and the earning of the income of the trade.

Purpose of expenditure

It is necessary to evaluate the closeness or remoteness of an expenditure to the income-earning operations and the purpose of the expenditure. Generally, if an expenditure is closely related to the current income-earning operations of a taxpayer, it may be said to have been incurred in the production of income. The former Malaysian Board of Review held that the words "in the production of income" are not the same as "in order to produce income"; hence, expenses incurred by a Supreme Court judge on his judicial robe acquired when he was appointed a judge were not deductible [*Re AB* (1960) FB XXIII].

Case law

The link between expenditure and the income produced was considered by the Singapore Court of Appeal in *Andermatt Investments Pte Ltd v Comptroller of Income Tax* (1995) 2 MSTC 7,287. The Court held that interest incurred on an overdraft facility taken out by a taxpayer to pay for the shareholding of a company was not deductible as there was no direct link between the money borrowed and the income produced. The income consisted of dividend income from the shares, which ceased to exist following the liquidation of the company, and rent from property owned by the company. The purchase of the shares did not in itself vest the property owned by the company or the rental income from that property to the taxpayer as it was brought about by an act of the shareholders in voluntarily winding up that company.

Effect of expenditure

Notwithstanding that an expenditure may not have a connection with the current income-earning operations of a taxpayer, but may be closely connected with its future income-earning operations, which are not dissimilar to the current income operations, the expenditure may rank for deduction. The phrase "incurred in the production of the income" does not necessarily mean that before a particular expense can be deducted it must be shown that it produced any part of the income for any particular year [*Sub-Nigel Ltd v CIR* (1948) 15 SATC 381].

Case law

1. In *Liquidator bagi YF Development Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (1996) MSTC 2,526, the Special Commissioners held that expenditure incurred in building unsold units of a multistorey complex was deductible as it did not matter whether the expenditure produced or increased profits, so long as all the expenses were incurred in the production of the gross income.

2. In *NBT Bhd v Ketua Pengarah Hasil Dalam Negeri* (1997) MSTC 2,825, the taxpayer was involved in logging, the export of logs, manufacturing and plantation activities. The taxpayer stocked imported spare parts for its machinery and mobile equipment to ensure continuous logging activities. Machinery and heavy equipment which had been replaced or whose lifespan had expired and which were still in stock were written off. The Special Commissioners found that the amount written off for the unused parts were not deductible as it was not expended for the repair of the machinery or equipment for the production of income as required under s 33(1) of the ITA. Instead, the spare parts were kept in stock as reserves.

All expenses attached to the performance of a business operation performed *bona fide* for the purpose of earning income are deductible, whether such expenses are necessary for its performance or attached to it by chance or are incurred *bona fide* for the more efficient performance of such operation, provided that they are so closely connected with it that they may be regarded as part of the cost of performing it.

Case law

This principle was applied in *Port Elizabeth Electric Tramway Company Ltd v CIR* (1935) 8 SATC 13. The taxpayer was a transport company. One of the taxpayer's drivers died after an accident and the taxpayer was obliged to pay compensation and legal costs incurred in contesting the claim of the deceased's representatives.

As the employment of drivers were necessary for carrying on the business of the company and as this employment carried with it as a necessary consequence a potential liability to pay compensation if such drivers were injured in the course of their employment, the Court considered that the compensation paid by the company was to be regarded as being so closely connected with the income-earning act from which the expenditure arose as to form part of the cost of performing it. The compensation was therefore allowed as a deduction. Regarding legal costs, the Court held that these could only be deducted if they were so closely connected with the earning of the income as to be regarded as part of the cost of earning it. In this case, they were expended in resisting a demand for compensation and, as this was not an operation entered into for the purpose of earning income, the company's legal costs were consequently disallowed.

The expenditure must be in respect of the business activities carried on by the taxpayer

The expenditure which gives rise to the income must be in respect of the activities carried on by the taxpayer, and the profits of which are to be computed and assessed [*CIT v Ashok Leylands Ltd* (1969) 72 ITR 137]. Thus, expenditure incurred by a taxpayer in extending his qualifications to enable him to fly helicopters were disallowed as it was incurred by him to undertake a new business and therefore constituted capital expenditure (*Case U14*).

To rank for deduction, the expense must be incurred for the business which is carried on in the accounting year and the profits of which are to be under assessment. Thus, expenditure incurred prior to the commencement of business, or after the termination of the business, would not meet this condition. Further, the expense must be for the business carried on by the taxpayer, ie the taxpayer's business. For example, loss or expenditure incurred by a subsidiary or for the purpose of the subsidiary will not normally be allowed to the parent company.

CHAPTER 14

THE ADMINISTRATIVE PROVISIONS

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ADMINISTRATION OF INCOME TAX

¶14-050 General

This chapter deals with the administrative machinery by which income tax is levied and collected. First, there are sections which deal with the income tax authorities, both executive and judicial. Secondly, there are the "calling of returns" sections which "set in motion" assessment proceedings. Penalties are eligible for failure to make returns or for making negligent or fraudulent returns. Thirdly, there are provisions which deal with the assessing of total income, the determination of tax payable and the collection and repayment of tax. Fourthly, there are the various provisions which deal with offences and penalties. Lastly, there are the provisions that deal with the procedure for appeals to the Special Commissioners and the High Court.

Generally, the fundamental objectives of the Inland Revenue Board (IRB) are to administer the law or laws, as passed by Parliament, to ensure that they are carried into effect and to make the tax system work. In the course of achieving these objectives, it is suggested that the philosophy of the administrators should be to:

- encourage and assist voluntary compliance with the requirements of the law
- maintain a dialogue with taxpayers and their advisers

- maintain public confidence in the integrity of the tax system
- deter tax evasion
- administer the tax laws fairly, uniformly, impartially and without unwarranted rigidity
- create a climate of public trust for their fairness, impartiality and firmness, and
- refrain from assuming the role of "protectors of the revenue".

ADMINISTRATION

¶14-100 Executive authorities

The care and management of tax is in the hands of the Director General of Inland Revenue (DGIR) who is appointed by the Minister of Finance. With effect from 1 August 1997, the chief executive officer of the IRB is appointed as the Director General. There are also one or more Deputy Directors General, Assistant Directors, Assessing Officers and other officers who assist in the administration of the *Income Tax Act 1967* (ITA).

The powers conferred on the Director General by the ITA are very wide and include the power:

- to call for the submission of returns and all information relevant thereto (s 77 and 77A) — it is not necessary that the IRB, in a notice requiring information to be furnished, must specify the purpose for which the information is required provided it is clear that the information is required for the purposes of the ITA (*Ong Lock Mui v PP*)
- to require taxpayers to attend personally before him and to produce books, accounts, etc (s 78)
- to call for statements of bank accounts, assets and all sources of income (s 79)
- of search and seizure of books, documents, objects, articles, materials and things (s 80)
- to have full and free access to all land, buildings and places, and all books, documents, objects, articles, materials and things of a taxpayer (s 80(1))
- to require the keeping of records and books of account (s 82 and 82A)
- to make advance assessments or additional assessments (s 92)
- to prevent a taxpayer from leaving the country (s 104)
- to approve or withdraw approval of any pension or provident funds (s 150)
- to give directions and initiate rules and regulations for special treatment of:
  - hire purchase transactions
  - transactions under which a debt is payable by instalments
  - lease transactions in respect of movable property
  - debts or stock in trade transactions (s 35(1)).

The Director General may delegate to his subordinates all or any of the powers vested in him for purposes of administering the taxation machinery efficiently.

From 20 March 1998, the IRB may act as a collection agent for and on behalf of any body for the recovery of loans due for repayment under written law.

The introduction of the self-assessment system in stages (beginning with companies in 2001) and the implementation of the current year assessment were made to streamline the tax administration system.

With effect from 1 January 2007, a specific provision was introduced to allow a taxpayer to request from the Director General an advance ruling on the tax treatment of an arrangement to be undertaken by the taxpayer.

Law: s 35(1), 77, 77A, 78, 79, 80, 82, 82A, 92, 104, 138A, 138B, 150, 154(1); *Income Tax (Amendment) Act 1997*; *Inland Revenue Board of Malaysia (Amendment) Act 1997*; *Inland Revenue Board of Malaysia (Amendment) Act 1998*.

¶14-120 Self-assessment

Prior to 2001, Malaysia adopted an official assessment system whereby taxpayers were assessed to income tax by the IRB based on the tax returns filed by them, and a relevant notice of assessment was issued to them.

In the 1999 Budget, it was announced that the official assessment system will be changed to the self-assessment system in stages as follows:

Type of taxpayer	*Year of implementation*
Companies	2001
Businesses, partnerships and cooperatives	2003
Salaried individuals	2004

Under the *Income Tax (Amendment) Act 2002*, the implementation of the self-assessment system for businesses, partnerships and co-operatives was deferred to the year 2004 instead of 2003 as announced earlier.

The self-assessment system is essentially a process by which taxpayers are required by law to determine the taxable income, compute the tax liability and submit their tax returns based on tax laws, policy statements and guidelines issued by the tax authorities. The introduction of the self-assessment system would shift the responsibility of determining and computing the amount of tax liability to the taxpayer.

Basically, under the self-assessment system, tax returns would not be subject to detailed technical scrutiny by the IRB. However, there would be an expanded programme of checking and verifying tax returns on a post-assessment basis, particularly by way of tax audits and the implementation of a penalty system to enforce compliance with tax laws.

This change is aimed at relieving the increasing workload of the IRB to allow the IRB to concentrate on areas with high tax risks and revenues. This will have a significant impact on taxpayers who must now equip themselves in ensuring full disclosure, as a self-assessment regime is likely to be accompanied with severe penalties for noncompliance and under-declaration of income.

The *Income Tax (Amendment) (No 2) Act 1999* provided some guidelines on the self-assessment system for companies. The self-assessment system was implemented from YA 2001 onwards except for the penalty provisions which took effect from 1 January 2000. Further, to assist taxpayers to understand tax laws and procedure in view of their obligations and responsibilities under the self-assessment regime, the Director General from time to time issues public rulings and other guidelines.

SELF-ASSESSMENT FOR COMPANIES

¶14-123 Filing of tax returns

Every company is required to furnish to the Director General a tax return in the prescribed form for each year of assessment within six months from its financial year end. However, from YA 2002 onwards, an additional one-month extension will apply. The tax returns will be issued by the IRB on a quarterly basis based on the companies' financial year end:

Month of issue of tax returns	*Companies' financial year ends on*
April	31 January, 28 February and 31 March
July	30 April, 31 May and 30 June
October	31 July, 31 August and 30 September
January	31 October, 30 November and 31 December

Where the company is unable to comply with this requirement due to a change in its financial period, the company should furnish its tax return for that year of assessment together with the tax return for the year of assessment in which the accounts are closed, within six months from the date of the close of the accounts.

As a concession, the IRB had extended the filing deadline for an additional two months in YA 2001 and one month for YA 2002. With effect from YA 2003, the submission of the tax returns including Form R is required to be made within seven months from the end of the financial period.

The company is also required to show the chargeable income and amount of tax payable in its tax return. In addition, the tax return should contain such particulars as may be required by the Director General in respect of the company.

From YA 2001 onwards, the company is also allowed to furnish its tax return using an electronic medium or using electronic transmission, as stated in the *Income Tax (Amendment) Act 2000*.

¶14-124 Deemed assessment

The tax return submitted by the company, or any person, for that matter, is deemed to be a Notice of Assessment served on the company on the date the return is furnished. This amendment is effective from YA 2004. Accordingly, no notice of assessment will be issued by the Director General. Under s 90, where a person has submitted a return, three "deemings" would arise as follows:

- The Director General has made an assessment in accordance with the return submitted.

- The return is a notice of assessment.
- The deemed notice of assessment was served on the taxpayer on the date the return is submitted.

Example 1

Company XYZ had a financial year ending on 31 December 2011. The company submitted its tax return for YA 2011 on 31 July 2012.

The Director General would be deemed to have made an assessment based on the tax return submitted. The return would be deemed to be a notice of assessment and would be deemed served on the company on 31 July 2012.

Submission of estimated tax payable

Every company is required to furnish an estimate of its tax payable for each year of assessment in a prescribed form (CP 204) to the Director General not later than 30 days before the beginning of the basis period for that year of assessment. The Form CP 204 will be issued by the IRB to companies. In the event that the form is not received by a company, it is also available at all IRB offices.

In the Budget 2016, it was proposed that with effect from YA 2016, it is compulsory for company to furnish CP 204 through e-Filing.

The Director General will then issue the Notice of Instalment Payment (CP 205) together with the instalment remittance slip (CP 207) to the company. With effect from YA 2002, the Forms CP 205 and CP 207 will not be issued by the IRB, where the estimated tax payable is the same as or higher than that of the preceding year of assessment. Form CP 207 is available from the IRB and the instalments are expected to be settled by the taxpayer in accordance with the estimated tax submitted.

Example 2

Company A had a financial year ending on 30 June 2014. Its basis period for YA 2014 would be from 1 July 2013 to 30 June 2014 (12 months). It would be required to submit an estimate of its tax payable for YA 2014 by 1 June 2013 (ie 30 days before the beginning of the basis period).

However, a company which commences operations in a year of assessment is required to furnish the estimate of its tax payable within three months from the date of commencement of operations.

With effect from YA 2011, the above requirement will only apply if the basis period of the entity for the year in which operations first commence is not less than six months.

Also, a penalty of 10% of the tax payable will be imposed under the following conditions:

- no tax estimate is furnished by the entity and no direction to make payment by instalments had been given by the Director General

- no prosecution in relation to failure to furnish such an estimate has been instituted, and
- tax is payable by the company for that year of assessment.

Example 3

Company B had a financial year ending 31 December 2013. It commenced operations on 1 February 2013. Its basis period would be from 1 February 2013 to 31 December 2013 (11 months). It would be required to submit an estimate of its tax payable for YA 2013 by 30 April 2013 (ie within three months from the date of commencement of operations).

Form CP 204 for small and medium enterprises (SMEs)

In line with the Government's initiative to spearhead economic growth through small and medium enterprises (SMEs) in Malaysia, with effect from YA 2008, new SMEs are exempted from submitting their estimates of tax payable and making instalment payments for two years of assessment beginning from the date of commencement of operations. Full income tax payment has to be made only at the point of submission of the income tax return not later than seven months from the company's financial year end.

The IRB issued a letter on 9 June 2011 regarding the submission of Form CP 204 for SMEs indicating that it is unable to identify an SME when:

- imposing a penalty on underestimated tax liability pursuant to s 107C(10)
- issuing a notification of legal proceedings for offences committed under s 120(1)(f).

As such, the IRB has amended the Form CP 204 to allow a taxpayer to inform the IRB of its "SME" status without furnishing the estimate of tax payable. A similar amendment was made in the e-Filing version of the form. The amendment is effective from 3 March 2011. However, the SME that does not submit a Form CP 204 in the first year is requested to submit a Form CP 204 in the second year to establish that it is still an SME. Where a penalty under s 107C(10) is imposed or notification of legal proceedings under s 120(1)(f) is issued to an SME, the SME can refer to the IRB branch where its income tax file is maintained to apply for the waiver of the penalty.

However, an SME will not be entitled to the special treatment of not submitting its estimated tax payable if more than:

- 50% of its paid-up capital of its ordinary shares is directly or indirectly owned by a related company
- 50% of the paid-up capital of the ordinary shares of the related company is directly or indirectly owned by the first mentioned company, or
- 50% of the paid-up capital of the ordinary shares of the first mentioned company and the related company is directly or indirectly owned by another company.

"Related company" means a company which has paid-up capital in respect of its ordinary shares of more that RM2.5 million at the beginning of the basis period for a year of assessment.

With effect from YA 2014, where an SME first commences operations in a year of assessment and the SME has no basis period for that year of assessment and for the following year of assessment, the SME is not required to furnish an estimate of tax payable in a prescribed form for that year of assessment and for the two following years of assessment.

Example

An SME commences operations on 1 November 2014 and closes its first set of accounts on 31 January 2016 (15-month accounts).

Year of assessment	2014	2015	2016	2017	Legislation
Basis period	No	No	Yes	Yes	s 21A(4)(c)
Estimate of tax payable	Not required	Not required	Not required	Required	New s 107C(4A)(c)

This amendment is a consequence of the proposed amendment to s 21A(4) of the ITA on basis periods.

With effect from YA 2015, the eligibilty for such exemption must also fulfil the condition whereby the SME must be resident and have been incorporated in Malaysia.

It is interesting to note that the term "small and medium-scale enterprise" does not exist in the ITA. It is only a phrase used for convenience in place of the lengthier technical definition of such a company.

A company which fails to furnish an estimate of tax payable by the required date will be issued a direction by the Director General to make instalment payments. The Director General may also institute legal proceedings against the company for the failure to furnish an estimate.

With effect from YA 2011, the current requirement for a company, trust body or co-operative society (the entity) which first commences operations in a year of assessment in respect of submission of the estimate of tax within three months will only apply if the basis period of the entity for the year in which operations first commence is less than six months.

Also, a penalty of 10% of the tax payable will be imposed under the following conditions:

- no tax estimate is furnished by the entity and no direction to make payment by instalments is given by the Director General
- no prosecution in relation to failure to furnish such an estimate has been instituted, and
- tax is payable by the entity for that year of assessment.

Quantum of estimated tax payable

For YA 2001, the estimate of tax payable was to be not less than the amount of tax payable for YA 1999.

With effect from YA 2002, the estimate was to be not less than the revised estimate or the estimate of tax payable (where no revision was made) for the immediately preceding year of assessment.

Notwithstanding the above, if a company anticipates that the estimate of tax payable for a year of assessment is less than that of the preceding year, it may on valid grounds request for a lower instalment scheme. The request should be made at the time when the estimate of tax payable is furnished to the IRB and it will be considered by the IRB on a case-by-case basis.

In order to provide flexibility to companies, with effect from YA 2006, a company is allowed to estimate its tax payable to be not less than 85% of the preceding year of assessment's estimate or revised estimate (s 107C(3)). On 2 September 2008, the IRB issued Guideline 2/2008 to clarify the circumstances in which an application to submit a tax estimate lower than the abovementioned 85% threshold may be considered. Such applications on the basis of the following factors must be supported by documentary evidence:

- cessation of business
- income has been significantly reduced or no longer received due to:
  - income-generating assets have been sold
  - no new projects
  - loss of major clients or contracts
  - increase in operating costs resulting in significant reduction of profit margin
  - disturbance to business operations due to fire or natural disaster.
- companies under winding-up
- companies taken over by way of mergers and acquisitions
- companies having substantial carried forward losses/capital allowances
- change in accounting period resulting in shorter basis period, and
- companies have been granted tax incentives such as pioneer status or investment tax allowance.

For YA 2002–YA 2005, the estimate shall not be less than the revised estimate or the estimate of tax payable (where no revision was made) for the immediately preceding year of assessment.

For YA 2001, the estimate of tax payable shall not be less than the amount of tax payable for YA 1999.

Under s 107C(8), the DGIR may direct the instalment payments for estimates of tax payable for a year of assessment. Pursuant to Public Ruling No 7/2011 "Notification of Change in Accounting Period of a Company/Trust Body/Co-operative Society", the DGIR may direct as such under the following circumstances:

(a) failure to furnish the estimated tax payable at least 30 days before the beginning of the basis period of a year of assessment

(b) the estimated tax payable furnished by the taxpayer is less than 85% of the tax estimate/revised tax estimate for the preceding year of assessment

(c) when a change in accounting period is notified with a revised tax estimate for a year of assessment, other than in the sixth or ninth month of the basis period for that year of assessment.

Effective YA 2012, the directive payment is deemed to be the revised estimate of tax payable which will be used to determine the increased amount of tax under s 107C(10). This increased amount of tax is imposed if the difference between the actual and the original tax estimate/revised tax estimate exceeds 30% of tax payable.

Instalment payment scheme

The estimated tax payable must be paid in equal monthly instalments (determined according to the number of months in the basis period) by the 10th day of each month beginning from the second month of the basis period for the year of assessment.

With effect from 1 January 2015, the due date for making payment of monthly instalments has been extended from the 10th to the 15th day of the month.

Example 4

Company C's financial year end was 30 June 2013. Its basis period for YA 2013 was from 1 July 2012 to 30 June 2013.

The estimated tax payable of Company C would have to be settled by 12 monthly instalments. The first instalment would be due on 15 August 2012.

However, for a company which commences its operations in a year of assessment, the estimated tax payable must be paid in equal monthly instalments (determined according to the number of months in the basis period) by the 10th day of each month beginning from the sixth month of the basis period for the year of assessment.

Example 5

Company D commenced operations on 1 February 2013 with 31 December 2013 as the financial year end. Its basis period would be from 1 February 2013 to 31 December 2013 (11 months). Company D would be required to pay its estimated tax payable by 11 monthly instalments. The first instalment would be due on 15 July 2013.

All payments must be made using the prescribed remittance slips (CP 207). The payment of tax can be made in any of the following manner:

- by post, or
- via the payment counter. In addition to the IRB's payment counter, payment can also be made at any Bumiputra-Commerce Bank Bhd or Public Bank Bhd branches in Malaysia.

Where any instalment amount due and payable has not been paid by the due date or the date specified by the Director General, a 10% penalty will be imposed.

Revised estimate of tax payable

A revised estimate of tax payable may be furnished to the IRB in the sixth month of the basis period of a year of assessment. As a concession for YA 2001, the IRB allows

two additional revisions to the estimate of tax payable whereby the company has the option to choose to revise the estimate on either the third month, ninth month or 12th month of the basis period of a year of assessment. Following from the revisions, the remaining instalments have to be revised accordingly.

Example 6

Company E had a financial year ending on 30 June 2013. Its basis period would be from 1 July 2012 to 30 June 2013 (12 months). The estimated tax payable for YA 2013 was RM120,000. The monthly instalment of RM10,000 would commence from August 2012. A revised estimate of tax payable of RM190,000 was furnished on 26 December 2012. The remaining instalments would have to be revised as follows:

	RM
Revised estimate of tax payable	190,000
Instalments paid (August–December 2012), ie RM10,000 × 5	(50,000)
Balance of instalments payable	140,000
Thus, the monthly instalment payment for the remaining 7 months (ie RM140,000/7)	20,000

While a concession was also given in YA 2002 whereby the company was allowed an additional revision in the ninth month of its financial period, this concession will remain with effect from YA 2003. Thus, in addition to any revision made in the sixth month, the company will be allowed to revise the estimate in the ninth month of the financial period. The revision must be made by submitting the Form CP 204A. In the Budget 2016, it was proposed that with effect from YA 2016, it is compulsory for company to furnish Form CP 204A through e-Filing.

Pursuant to Public Ruling No 7/2011, when there is a change in accounting period, Form CP 204A should only be furnished together with the notification (Form CP 204B) if the change is notified in the sixth or ninth month of the basis period for that year of assessment.

Where the revised estimate exceeds the tax instalments paid for the year, the difference will be payable in the remaining instalments in equal proportion. Where the tax instalments paid for the year exceed the revised estimate, the remaining instalments will cease immediately. However, if the lower revised tax estimate is due to a change in accounting period (shortened) and the notification is notified after the end of the basis period, the revised estimate will not be accepted. The original monthly instalment shall continue until the date of notification of the change in accounting period via Form CP 204B is received by the DGIR. Whereas, where the accounting period is extended, the instalment to be paid for the extended accounting period is the original instalment. The monthly instalment for the extended period shall not be less than the monthly instalment for the original accounting period.

If the tax payable under an assessment for a year of assessment exceeds the revised estimate of tax payable or the estimate of tax payable (where no revision was made) by an amount of more than 30% of the tax payable under the assessment, the difference will be liable to a penalty of 10%.

Example 7

	RM
Tax payable under an assessment	500,000
Revised estimate of tax payable	(300,000)
Difference	200,000
30% of RM500,000	150,000
Excess	50,000
Penalty of 10% on excess	5,000

Payment of balance of tax

With effect from YA 2001, the balance of tax payable (after taking into account the monthly instalments paid) under the deemed assessment provision would be due and payable on the due date of the submission of the tax return (ie the last day of the sixth month from the date following the close of the accounting period) by the company. With effect from YA 2003, the extension of the submission of the tax returns within seven months from the end of the financial period also applies to the payment of the balance of the tax payable.

Where the company fails to pay the tax by the due date, the balance unpaid will be increased by 10% and will be recovered as if it were tax due and payable. Any balance remaining unpaid upon the expiration of 60 days from the due date will be further increased by 5%.

¶14-125 Utilisation of companies' income tax credit as set-off

A guideline (GPHDN 2/2010) issued by the IRB on 30 December 2010 states that any tax credit due to:

- excess of payment on the date an assessment arises
- tax discharged, and
- tax credit claimed under s 110 or 51 of the *Finance Act 2007*,

shall first be used to settle all income tax liabilities in the following manner:

- income tax arrears (inclusive of increases in tax) due and payable for current and previous years of assessment
- outstanding debts (inclusive of increases in tax) due and payable under s 108
- overdue instalments and increases in tax due and payable under s 107B and 107C.

Monthly tax deductions or instalment payments under s 107, 107B or 107C of the ITA for current year assessment and advance payments in respect of investigation or audit cases are not considered as tax credit.

The guideline also states that in line with s 111(4A), any excess tax credit may be utilised by the DGIR to set off RPGT arrears (inclusive of increases in tax) and petroleum income tax inclusive of overdue instalments and increases in tax due.

An application needs to be made to the Collections Branch to request any excess tax credit (after considering the above-stated set-offs) to be utilised to set off:

- non-overdue instalments for the current and subsequent years of assessment, or
- tax within the same group of companies.

For applications made to utilise the tax credit among companies within the same group (excluding associated companies), the following documents are to be furnished along with the application letter:

(1) Organisational structure indicating the relationship between the company with the excess tax credit and the recipient company within the same group.

(2) For a local company:

(a) board of directors' resolution bearing the company's common seal and signed by all the company's directors to authorise the transfer of the said tax credit, and

(b) certified true copy of Form 49 (s 141(6) of *Companies Act 1965* (CA 1965)) by the company's secretary with his/her full name and address.

(3) For a foreign company:

(a) deed of assignment, or

(b) board of directors' resolution pertaining as stated in (2)(a) above.

The date of utilisation of tax credit will be the date on which the application is received by the IRB together with the relevant documents mentioned above.

GPHDN 2/2010 replaces Guideline 2/2008 issued by the IRB on 2 September 2008.

¶14-126 Power of access to buildings and documents

To facilitate the IRB's tax audit work, the Director General or an authorised officer is expected to be provided with reasonable facilities and assistance in the exercise of his powers. See ¶14-220 for details.

In addition, with effect from 1 January 2000, the penalties imposed on persons who obstruct or hinder the Director General or his authorised officers from performing their duties under the ITA will be increased from a fine of not more than RM4,000 or imprisonment for a term not exceeding one year or both to a fine ranging between RM1,000 and RM10,000 or imprisonment for a term not exceeding one year or both.

¶14-127 Preparers of returns/advisers

With effect from 1 January 2000, the person who assists in or advises with respect to the preparation of any return that results in an understatement of the tax liability of another person will be liable, upon conviction, to a fine of not less than RM2,000 and not more than RM20,000 or to imprisonment for a term not exceeding three years or both unless he/she satisfies the Court that the assistance or advice was given with reasonable care, on the basis of an interpretation of the tax law, or the decision in any tax case or in a ruling and that interpretation is one at which any reasonable person with his/her knowledge and experience would have arrived. The person should have acted in good faith in the light of all information available after making reasonable inquiries.

The person should:

- examine specific claims for deductions, allowance, reliefs or rebates
- scrutinise written analyses or detailed statements for disallowable items in the accounts, and
- provide a written disclosure if a differing position or stand is taken in respect of any provision of the ITA.

The DGIR's Public Ruling No 8/2000 provides by way of illustration some examples to indicate the circumstances or situations where a person may be considered liable for prosecution. Extracts of the examples (which are not intended to be exhaustive and the title in respect of each example is intended as a description only and should not be regarded as a classification of the type of offence) are as follows:

Example 1: Omission of income

Mr A submitted a duly completed return for YA 2013 on his own behalf. He declared income from the carrying on of a restaurant business only. It was discovered during a tax audit that he had not declared his income from the business of selling imported gift items and souvenirs that he had been carrying on for the past five years.

Mr A could be liable to prosecution for wilful evasion (s 114(1)) for omitting his income from the business of selling imported gift items and souvenirs in his return for YA 2013 and relevant preceding years.

Example 2: Preparing or maintaining false books of account or other records

Mr B is an accountant employed by XYZ Sdn Bhd. He heads the accounting department. He also completes the income tax returns of the company. For a particular year, on the instructions of Mr C, a director of the company, he reclassifies certain entertainment expenses of the company (which are not allowable for income tax purposes) as purchases of goods and services. By doing so, he manages to understate the tax liability of the company by more than RM5,000. This is discovered during a tax audit.

The company may be liable to prosecution for wilful evasion (s 114(1)) or for making an incorrect return (s 113).

The director, Mr C, may be liable to prosecution for assisting another person (the company) to evade tax by authorising the preparation or maintenance of false books of account or other records (s 114(1)).

The accountant, Mr B, may be liable to prosecution for assisting another person (the company) to evade tax by preparing or maintaining false books of account or other records (s 114(1)).

Example 3: Final accounts prepared from estimated or fictitious figures

A sole proprietor, Mr C, who has not kept proper records or books of account, engages a bookkeeper to prepare the final accounts and to complete the income tax return. The final

accounts and the return are signed and submitted by Mr C. During a tax audit, it is discovered that no proper books of account have been kept by Mr C and that many of the figures in the final accounts are either estimated or fictitious, without any documents/records to support them.

The bookkeeper may be liable to prosecution for assisting in the preparation of Mr C's return that results in the understatement of his liability for the payment of tax (s 114(1A)).

Mr C may be liable to prosecution for making a false statement or entry in a return (s 114(1)) as well as for failure to keep sufficient records (s 82) (see Public Ruling No 5/2000).

To avoid any inference of dishonest intention, the bookkeeper should have made a disclosure in the final accounts that they are prepared from incomplete records and that figures shown in the final accounts which are not supported by proper records or documents are based on reasonable estimates that are justifiable or otherwise defensible by either the bookkeeper or Mr C, and, where appropriate, showing the basis for the estimates. Similarly, Mr C should have made such a disclosure in his tax computation. Failure to make a disclosure on the part of either person may be regarded as indicative of dishonest intention.

Example 4: Claim not supported by documents

A tax agent is engaged to prepare the tax computation for a company. The detailed statement for "sundry expenses" of RM80,000 provided by the company clearly indicates that a donation of RM10,000 is included therein. The tax agent makes an immediate request in writing for sight of the receipt, advising the company that only donations made to approved bodies or institutions under s 44(6) would be eligible for deduction. The company confirms in a letter that the donation had been made to an approved body and that it was in the process of obtaining a receipt for it. In view of the impending due date for the submission of the return and relying on that confirmation, the tax agent makes the relevant adjustments for the donation in the tax computation. It is discovered during a tax audit that there has been an understatement of the company's liability for the payment of tax as the donation had been made to a non-approved body, about which the company has neglected to inform the tax agent subsequently.

The company may be liable to prosecution for making a false claim in the return (s 114(1)) or for making an incorrect return (s 113).

No action should be taken against the tax agent since he has performed his duties with reasonable care by calling for the receipt and advising the company accordingly, and the understatement arises primarily because of his reliance, in good faith, upon the written confirmation given by the company.

Example 5: Claim for deductions or incentives not supported by documents

A tax agent is engaged to prepare a company's income tax return for a particular year of assessment. A director of the company provides a statement (confirmed by him) containing details of research and development (R & D) expenses incurred by the company and instructs the tax agent to make a claim for double deduction for the R & D expenses. The tax agent advises the director of the requirements and conditions for a valid claim under s 34A of the ITA and, being satisfied with the director's confirmation that the company is eligible for the double

deduction, forwards the claim in the appropriate form duly completed and signed by the director of the company. During a tax audit, it is discovered that there is insufficient documentation to support the claim. The figures upon which the claim is based are found to be estimated and some of the expenses included are not related to the research project.

The company may be liable to prosecution for making a false claim in the return (s 114(1)) or for making an incorrect return (s 113).

The director of the company may be liable to prosecution for assisting in the preparation of a return that has resulted in the understatement of the company's liability for the payment of tax (s 114(1A)).

No action should be taken against the tax agent as he has acted in good faith and the understatement of the company's liability for the payment of tax essentially arises from the misrepresentation on the part of the company's director.

Example 6: Non-disclosure by person on whose behalf a return is prepared

A tax agent completes a return on behalf of an individual who has verbally confirmed that his wife has no income. After the return form has been signed by the individual, it is dispatched on his behalf by the tax agent. Rent of RM12,000 received by the individual's wife is not included in the return as this has not been disclosed to the tax agent.

The individual or his wife may be liable to prosecution for evasion of tax by deliberate omission of income in the return (s 114(1)).

No action should be taken against the tax agent as no inference of dishonest intention can be drawn against him.

Example 7: Mistake or error in return

A tax consultancy firm is engaged to complete a return on behalf of a company. The tax computation indicating a tax liability of RM144,144 and the duly completed return are submitted to the company for review and approval. The return is later furnished to the IRB by the firm on behalf of the company. In the return, the tax liability is erroneously stated to be RM141,414. Nevertheless, settlement of tax liability is made by the company on the basis of the correct figure; the return is accompanied by a cheque for RM24,144 (RM144,144 less RM120,000 previously paid by instalments). The understatement is not detected until a tax audit is carried out two years later.

Since the correct amount of tax is paid despite the error in the return, there should be no inference of dishonest intention. No action should therefore be taken against either the company or the firm.

Both the company and the tax consultancy firm should have exercised care and diligence in checking and ensuring that the return is correctly completed.

If settlement of tax had negligently been made on the basis of the incorrect figure, action may be considered against the company under s 113 for making an incorrect return.

If there is evidence to indicate that the understatement is made other than unintentionally (eg there have been previous or subsequent incidents of a similar nature in the same case and/or a pattern of frequent occurrences of a similar nature in a number of other cases), then action may be considered against the tax consultancy firm under s 114(1A).

The *Income Tax (Amendment) Act 2000* seeks to make changes to the ITA in view of the self-assessment system and current year basis of assessment.

¶14-128 Basis periods

In line with the public rulings on basis periods which were issued on 1 March 2000, the ITA seeks to provide for companies with non-business sources of income to be assessed based on the basis period instead of the basis year for a year of assessment. This will be of significance to an investment holding company which may have a financial year that ends on a day other than 31 December. This amendment is effective from YA 2001.

Overlapping of basis periods

Where there is an overlapping of basis periods, the dividend income received in the basis period for the immediately preceding year of assessment will only be taxed once. Correspondingly, a claim for deduction under s 110 can only be allowed for the relevant year of assessment in which the dividend income is taxed.

¶14-130 Filing of prescribed forms

With effect from YA 2001, the Director General may allow any form prescribed under the ITA to be furnished on an electronic medium or by way of electronic transmission.

With effect from YA 2014, the electronic filing of income tax returns in accordance with s 152A of the ITA is compulsory for companies pursuant to a new s 77A(1A). In addition, a company's return furnished to the Director General has to be based on accounts audited by a professional accountant together with a report made by the said professional accountant in accordance with s 174(1) and 174(2) of the CA 1965. Notwithstanding this, the IRB has clarified on 19 March 2014 that where a company is exempted from filing audited accounts with the Companies Commission of Malaysia, the company is not required to comply with s 77A(4). Instead, the company will only be required to submit its tax return based on information in its final accounts.

¶14-131 Record-keeping

Time period

In line with the requirements in the CA 1965 for companies to keep records for seven years, the time period for record-keeping is limited to seven years from the end of the year to which any income from the business relates.

Example 1

A company had a financial year ending on 31 December 2007.

The company would be required to keep its records for this financial year up to 31 December 2014.

Where the taxpayer did not submit the returns within six months from the financial year end for a year of assessment, the records would need to be kept for seven years after the end of the year in which the return is furnished.

Example 2

A company had a financial year ending on 31 December 2007. If the company submitted its returns on 31 May 2009 instead of by the due date of 31 July 2008, it would be required to keep its records (for the financial year ending 31 December 2007) up to 31 December 2016.

Electronically readable form

A taxpayer who keeps records electronically must retain them in an electronically readable form and ensure that they are readily accessible and convertible into writing. Further, if the records have been originally kept in a manual form and subsequently converted into an electronic form, they must be retained in their original (manual) form.

The term "records" includes:

- books of account recording receipts and payments or income and expenditure
- 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 any other records as may be specified by the Director General.

Place of retention

In line with the CA 1965, all records that relate to any business in Malaysia must be kept and retained in Malaysia.

The above will be effective from YA 2001.

Penalties

With effect from 1 January 2001, the penalties for failure to maintain proper records of the business operations will be increased to a fine of not less than RM300 and not more than RM10,000 or to imprisonment for a term not exceeding one year or to both.

¶14-132 Issuance and appeal against assessment

Issuance of an assessment

With effect from YA 2001, where a company fails to submit a return for a year of assessment, the Director General may issue an assessment based on his best judgement of the company's chargeable income.

Appeal against an advance assessment

In line with the current year basis of assessment, with effect from YA 2000 (CYB), an appeal against an advance assessment can be made within three months of the year of assessment following the year of assessment for which the advance assessment is made.

¶14-133 Malaysian tax imputation system

With effect from 1 January 2001, the s 108 imputation system was replaced with a matching of tax payments and tax deducted from dividends based on the financial year end of a company. The details of the mechanism are discussed below.

Compared aggregate consists of the following:

Balance of s 108 credit brought forward

Add: Tax **paid**

Add: Tax set-off under s 110

Less: Tax refund under s 111

The term "tax paid" refers to any payment of tax made by the company in the basis period for a year of assessment whether or not paid through instalments under s 107C less payments (if any) in respect of:

- the tax payable for YA 2000 (CYB) and prior years of assessment
- any penalties imposed under s 112(3) or 113(2)
- any increase in tax under s 103, 107B or 107C, or
- any excess or any increase on the excess under s 108.

The tax set-off under s 110 is restricted to the amount of the tax on the chargeable income of the company less any rebate under s 6B or any relief under s 132/133.

The tax refund under s 111 refers to the refunds made by the Government in respect of overpayment of taxes. Section 108(14A)(c) was introduced to take effect on 1 January 2001 for the remission of tax under s 129 of the ITA to be taken into account in the computation of compared aggregate and compared total. [Note that s 108(14A)(c) has since been substituted by the *Finance Act 2007*.]

Compared total

This refers to the total tax which the company was entitled to deduct and is deemed to have been deducted from the dividend paid, credited or distributed to its shareholders in the **basis period** for that year of assessment.

Where the compared total exceeds the compared aggregate, the excess amount becomes a debt owing to the Government and payable at the end of the sixth month from the date following the close of the accounting period. No requisition notice will be issued by the Director General. If the debt is not paid by its due date, a penalty of 10% is payable.

Where the compared aggregate exceeds the compared total, the excess is carried forward for franking future dividends.

The Director General may issue a requisition notice (which may include a penalty not exceeding the amount of that shortfall) under the following circumstances:

- If the company fails to furnish the statement or provide the requisite information and the Director General is of the opinion that the company has distributed dividends in the basis period for that year of assessment, and

- If a company which is not entitled to deduct tax from a dividend, issues to any of its shareholders a certificate which purports to show that tax has been deducted.

The Director General may, in his discretion, for any good cause shown, remit the whole or any of the amount of debt due under the appropriate circumstances, and where the amount remitted has been paid, it will be repaid. This is deemed to have effect from YA 2001.

Further, where the following circumstances arise:

- instalment payment under s 107C, and
- refund of tax under s 111,

the Director General may revise the compared total, the compared aggregate or the s 108 balance including repayments of the debt arising from the shortfall and requisition notices issued as he deems appropriate.

In addition, if a person fails to render a statement (Form R), a fine of between RM200 and RM2,000 or imprisonment for a term of six months or both may be imposed upon conviction.

The Form R is required to be submitted to the IRB within six months following the close of a company's accounting period. For YA 2001 and YA 2002, the deadline for submission was the same as the submission of the Form C, which was eight months and seven months respectively from the close of the company's financial year. With effect from YA 2003, the extension of the submission of the Form C within seven months from the end of the financial period also applies to the submission of the Form R.

The entire concept of the s 108 balance, Compared Aggregate, Compared Total, and even the Form R would no longer be relevant after 31 December 2013 with the full application of the Single-Tier Tax System (see ¶14-136).

¶14-134 Set-off for tax deducted

With effect from YA 2001, the Director General is allowed to make an assessment or additional assessment on the shareholder of the company where the dividend had been distributed although the company had made no payment or insufficient payment in respect of:

- instalment payments under s 107C, and
- shortfall under s 108.

The shareholder will be assessed on the net amount of the dividend received with no corresponding s 110 set-off given to him/her when computing the tax payable for the year of assessment.

Although this proposal seeks to counteract any tax benefits obtained by the shareholder, there appears to be a double taxation on the income of the company since the outstanding taxes of the company remains as a debt owing to the Government.