CHAPTER 2

COMPANIES AND LIMITED LIABILITY PARTNERSHIPS

Table of Contents

Companies as taxpayers . . . . ¶2-100
Taxation of companies . . . . ¶2-320
Company losses . . . . ¶2-400
Payments to shareholders . . . . ¶2-500
Position prior to YA 2008 under the imputation system . . . . ¶2-515
Undistributed profits . . . . ¶2-600
Financial institutions, non-resident shipping and air transport
companies . . . . ¶2-700
Payment of tax by instalments . . . . ¶2-800
Limited liability partnerships . . . . ¶2-850

COMPANIES AS TAXPAYERS

¶2-100 General

A company is a juristic person, distinct from its shareholders (*Ochberg v CIR*). It is treated as a taxable entity separate from its shareholders, and a private company is as much a distinct tax entity as a public company.

¶2-110 What is a company?

In s 2(1) of the *Income Tax Act 1967* (ITA), a company:

> "means a body corporate and includes any body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia and a business trust".

Under the *Companies Act 2016* (CA 2016), a company:

> "means a company incorporated under this Act or under any corresponding previous written law".

The definition under the ITA is very widely drawn and includes all companies of whatever origin, local or foreign, which carry on operations in Malaysia (see ¶12-100ff).

http://www.pbookshop.com

Section 2(1) of the ITA also states that a controlled company:

> "means a company having not more than fifty members and controlled, in the manner described by section 139, by not more than five persons".

Limited liability partnerships

The *Limited Liability Partnership Act 2012* (LLP Act 2012) provides for the setting up of LLPs which will enjoy some of the benefits enjoyed by companies and partnerships. The LLP Act 2012 (which was gazetted on 9 February 2012 and came into operation on 26 December 2012) allows an additional vehicle for carrying on a business other than operating through a sole proprietorship, a partnership or a company (see ¶2-850).

Law: s 2.

¶2-120 Residence of a company

A company is said to be resident if the control and management of its business are exercised in Malaysia (see s 8(1)(b)). Control and management do not necessarily mean the carrying on of a business. Consequently, the locale of trading activities or the physical operations is not necessarily the place of control and management. The question of where, for income tax purposes, the management and control of a company abide, is one of pure fact to be determined by a scrutiny of the course of the business or trading (*De Beers Consolidated Mines Ltd v Howe*).

The place where a company's central management and control are situated will usually be where the directors meet to do the business of the company, ie where they hold their board meetings (*Koitaki Para Rubber Estates Ltd v FC of T*). It is the directors' actions and not the shareholders' actions which usually indicate the residence of a company because it is in fact the directors who manage the affairs of the company (*American Thread Co v Joyce*).

Thus, a company can have all its trading operations in Malaysia and yet be a non-resident here if its directors' meetings are held outside Malaysia. Further, when determining the residence of a company, it does not really matter where it is registered or where it has its registered office. A company registered in Australia may be resident in Malaysia or a company registered in Malaysia may be resident abroad. A company incorporated in Singapore has been held to be resident in Australia for income tax purposes, because it was completely managed and controlled by its Australian managing director in Australia (*Malayan Shipping Co Ltd v FC of T*).

Section 8(1)(b) clearly states that a company trading in Malaysia will be deemed resident if at any time during the basis year the management and control of its business or any one of its businesses are exercised in Malaysia. A possible inference from this is that even if one directors' board meeting of a company operating in Malaysia is held here, the company would be deemed resident. This is notwithstanding that all the other meetings were held outside Malaysia. Thus, a taxpayer company carrying on trading activities in Malaysia must ensure that all its board meetings are held abroad if it wishes to be labeled a non-resident.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

The Revenue has issued Public Ruling No 5/2011 on "Residence Status of Companies and Bodies of Persons" to explain the determination of the residence status of companies and bodies of persons. The Public Ruling is effective from YA 2011.

Among the key points of interest are:

- Key factor to ascertain the residence status of companies is management and control.
- "Management and control" refers to the controlling authority which determines the policies to be followed by the company and is considered to be exercised where the directors meet to conduct the company's business/affairs irrespective of where the company might be incorporated. The following are irrelevant:
  - place of operations;
  - appointment of local directors; and
  - control by shareholders, and residence status of a director.
- As for investment holding company, the management and control of its affairs includes the management and important decisions in respect of investments.

A company, like an individual, may change its residence (*Bullock v Unit Construction Co Ltd*). It can be resident in Malaysia for one year and not resident in another. However, once a company has been established as resident in Malaysia for a basis year, then until it is proved otherwise to the satisfaction of the Director General of Inland Revenue (DGIR), that company will be held to be resident for all future basis years.

A company's residence is determined by reference to the circumstances in the basis year and not by reference to the year of assessment. For the purpose of determining residence, the basis year is the year ended the previous 31 December, notwithstanding that the company makes up its accounts to a different date. It should also be noted that, where a company's management and control are exercised in Malaysia for part of a year, it is nevertheless deemed resident for the full year.

Example

Gold Star Ltd is incorporated in Taiwan and has business offices in both Taiwan and Malaysia. It makes up its accounts to 30 June. Up to 30 June 2017, management and control of the company were exercised in Taiwan. On 1 July 2017, management and control of the company were transferred to Malaysia.

Gold Star Ltd would be deemed resident in Malaysia for YA 2017. Its accounts for the year to 30 June 2017 would form the basis for the 2017 assessment even though management and control were exercised outside Malaysia during that period. As a resident, Gold Star Ltd would be taxed on income derived in Malaysia.

A company resident in Malaysia is liable to tax not on its total income, if this is meant to be global income, but on its income accrued or derived in Malaysia. Any offshore income remitted into Malaysia is not taxable. In the case of a non-resident company, only its Malaysian source income is liable to tax. Offshore income, even if remitted here, is not exposed to tax. The global income rule, however, applies to banks, shipping, air transport enterprises and insurance companies resident in Malaysia.

Law: s 8(1)(b).

http://www.pbookshop.com

¶2-200 Form C requirements

Under the self-assessment system for companies which took effect from YA 2001, the tax return (Form C) requires detailed disclosure of information such as the amount of tax payable, exempt income, the previous year's income and relevant details of the preparer of the tax return. No accounts or tax computation need to be submitted together with Form C. However, Form C has been designed in such a way as to also reflect the essential elements of the balance sheet and profit and loss accounts.

Effective from YA 2009, dividend warrants are not required to be submitted even if the company is in a tax-repayable position. Companies are required to continue to submit the application forms for tax incentives such as the reinvestment allowance and double deduction for the promotion of exports to the Technical Division of the Inland Revenue Board (IRB). Relevant accompanying worksheets and attachments have to be completed and maintained by the taxpayers and these will need to be disclosed to the IRB upon its request.

The worksheets and attachments include the following:

- Computation of statutory income for businesses and partnerships;
- Computation of statutory income for pioneer businesses;
- Computation of statutory income for approved service projects;
- Computation of statutory income for companies enjoying investment tax allowance;
- Computation of statutory income for companies enjoying reinvestment allowance, investment allowance for service sector and infrastructure allowance;
- Computation of statutory income for operational headquarters;
- Computation of exempt statutory income for resident shipping businesses under s 54A;
- Computation of statutory income for sea and air transport businesses of non-residents;
- Computation of statutory income of insurance companies;
- Computation of statutory income for *takaful* business;
- Computation of statutory income for a company entitled to claim allowance for increased exports — manufacturing/agricultural;
- Computation of statutory income for a company entitled to claim exemption of income on value of increased exports;
- Computation of statutory income for a company entitled to claim exemption of income on value of increased exports of qualifying services;
- Computation of statutory income for a company entitled to claim exemption of income on value of increased exports — Malaysian international trading companies;
- Computation of statutory income for companies enjoying industrial adjustment allowance;
- Computation of statutory income for a regional distribution centre company/international procurement centre company;
- Computation of statutory income for a company which carries out an approved business under a special incentive scheme (pre-package);
- Computation of statutory income for dividends;
- Computation of statutory income for interests/royalties;
- Computation of statutory income for rents;
- Adjusted losses for businesses and partnerships;
- Adjusted losses for businesses enjoying pioneer status incentive;
- Adjusted losses for businesses carrying on approved service projects;
- Adjusted losses for operational headquarters;
- Adjusted losses for resident shipping businesses under s 54A;
- Past years' income;
- Current year's payment to non-residents (withholding tax);
- Information on five directors of the company;
- Information on five main shareholders of a controlled company;
- Computation of adjusted income of businesses;
- Computation of adjusted income of life insurance businesses;
- Computation of adjusted income of general insurance businesses;
- Tax deducted under s 110;
- Claim for s 132 relief;
- Claim for s 133 relief; and
- Details of property and rental income.

http://www.pbookshop.com

¶2-220 Computation of chargeable income

Gross income		
	Less:	Allowable expenses
	Less:	Double deduction of expenses
	Less:	Special deductions [s 34, 34A, 34B, 34C and 34D of the ITA]
Adjusted income		
	Add:	Balancing charges
	Less:	Capital allowances and balancing allowances (up to adjusted income; excess to be carried forward except for listed investment holding companies)
Statutory income	(s 42)	
	Less:	Exemption of income for pioneer companies/investment tax allowance
	Less:	Reinvestment allowance
	Less:	Previous years' business losses (not applicable for listed investment holding companies)
	Add:	Statutory income made up of franked dividends (prior to YA 2008)
	Add:	Statutory income from non-business sources (eg interests, rent, royalties, discounts)
	Add:	Recoveries of prospecting expenditure (Sch 4)
Aggregate income	(s 43)	
	Less:	Current year business losses [s 44(2)]
	Less:	Prospecting expenditure
	Less:	Pre-operational business expenditure (Sch 4B of the ITA)
	Less:	Proportion of permitted expenses for investment holding companies (YA 1993 onwards — s 60F of the ITA) except listed investment holding companies (YA 2006 onwards — s 60FA)
	Less:	Trust annuity (s 63(5) of the ITA)
	Less:	Approved donations [s 44(6), 44(6A), 44(8), 44(9), 44(10), 44(11), 44(11B) and 44(11C) of the ITA]
	Less:	Business *zakat* [s 44(11A)]
	Less:	Group relief — Current year adjusted loss transferred from a "surrendering company" (YA 2000 to YA 2005 — Sch 4C of the ITA) (YA 2006 onwards — s 44A of the ITA)
	Less:	Carry-back losses — Immediately preceding and not exceeding RM100,000 (YA 2009 and YA 2010 — s 44B of the ITA)
Total income	(s 44)	
	Add:	Statutory income made up of franked dividends deemed as total income (YA 2008 to YA 2014)
Chargeable income	(s 45)	

http://www.pbookshop.com

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

In the above flow chart, the inclusion of dividends after Total Income has been determined under s 44 will no longer apply with effect from YA 2015. This is due to the implementation of the Single-Tier Tax System under which dividends are exempt.

TAXATION OF COMPANIES

¶2-320 Assessment of companies

A company in Malaysia is subject to income tax at 25% with effect from YA 2009 on its chargeable income. With effect from YA 2016, the tax rate of a company has been reduced from 25% to 24% (see ¶230).

For small and medium enterprises (SMEs), ie companies with paid-up capital of RM2.5 million and below, the first RM500,000 of chargeable income is subject to a tax rate of 20%, with the balance being taxed at 25% with effect from YA 2009.

For YA 2016, the income tax rate for SMEs is reduced from 20% to 19% in respect of chargeable income of up to RM500,000, with the balance being taxed at 24%.

With effect from YA 2017, the income tax rate for SMEs will be further reduced to 18% on the first chargeable income of RM500,000.

For YA 2017 and YA 2018 only, the income tax rate will be reduced based on the percentage of increase in chargeable income as compared to the previous year of assessment as follows:

% of Increase in Chargeable Income as Compared to the Immediate Preceding Year of Assessment	% Point of Reduction on Income Tax Rate
Less than 5%	Nil
Between 5%–9.99%	1
Between 10%–14.99%	2
Between 15%–19.99%	3
20% and above	4

The reduction in income tax rate based on the percentage of increase in chargeable income for YA 2017 and YA 2018 is provided under the Income Tax (Exemption) (No 2) Order 2017. To be eligible for the reduced income tax rate, the following applies:

- the business of the qualifying person has been in operation for not less than 24 months; and
- the qualifying person has earned chargeable income for two years with both of the years having an accounting period of 12 months with the same accounting year end.

The exemption is granted based on the incremental amount of chargeable income from the preceding year and is applicable for YA 2017 and YA 2018. The exemption given is computed based on the percentage of increased chargeable income and according to the formulae prescribed in the Order.

To enhance the competitiveness of SMEs and for the purpose of the imposition of income tax and provision of tax incentives, the Government has reviewed the definition of SME and, with effect from YA 2009, a company qualifies as an SME if

the company is a resident company in Malaysia with paid-up capital of ordinary shares of RM2.5 million or less at the beginning of the basis period of a year of assessment and such company does not control, or is controlled directly or indirectly by, a related company.

"Related company" means a company which has paid-up capital in respect of its ordinary shares of more than RM2.5 million at the beginning of the basis period for a year of assessment. It is interesting to note that the term "SME" does not exist in the ITA; it is merely a phrase used for convenience when referring to a company with paid-up capital of RM2.5 million or less.

The assessable income of a company is computed in accordance with the ordinary rules laid down in the ITA as applicable to other taxpayers. The basis period for a year of assessment is the financial year of the company. For example, for a company with a year end of 30 June, the basis period for YA 2015 would be the year ended 30 June 2015. Thus, a company has the facility to choose a financial year which best suits its business. It also has the facility to change its financial year, if it so desires (for sole proprietorships and partnerships, the accounting year has to be a year ended 31 December).

Income tax is charged under s 4 of the ITA in respect of any trade or business carried on in Malaysia. Such an income tax liability may be suffered by a resident or a non-resident company. A non-resident company will suffer tax only in respect of the profits the Malaysian trade or business generates. This could arise where the non-resident company carries on a business in Malaysia through a branch or agency and the profits are within the chargeable profits of the company.

Law: s 21, 120(1)(h); Income Tax (Exemption) (No 2) Order 2017.

¶2-340 Business of a company

There are, generally, no limitations to an individual's capacity to carry on a trade or business. This is not so in the case of a company. To ascertain the trade or business of a company, one has to refer to its constitution or memorandum of association. Generally, the constitution of a company is extensive and exhaustive and provides for a multitude of activities that a company can indulge in. Nevertheless, a company is formed for a specific purpose or purposes and its main powers are contained in the first few sections of its memorandum. These earlier sections spell out the activities of the company which are to be carried out in the course of its business. These activities represent the true business of a company. Thus, every act done by a company, empowered by its memorandum, need not necessarily be classified as one done in the course of the company's business. For income tax purposes, it is the professed objects of the company that ought to be kept in view when dealing with affairs of capital and affairs of revenue. However, where a company deviates from its objectives as stated in its memorandum of association, the resultant income could still be taxable should the company's activities fall within the definition of "business" or "adventure in the nature of trade".

A company's sole purpose for existing is to generate profits and it is to this end that its activities are directed. In deciding whether the activity or activities generate capital or revenue profits one has to consider all the facts surrounding such activities.

The memorandum cannot always be conclusive against or in favour of a company. What a company professes to do and what it really does can be completely two different things and for this reason the facts in each case have to be carefully examined. In fact it is not uncommon for a company to engage in more than one business (see ¶7-300ff). The test to ascertain what business is being carried on by a company is to look at the nature and purpose and the substance of the transaction in question as expressed in the company's memorandum of association (*I Investments Ltd v Comptroller General of Inland Revenue*).

Law: s 4.

COMPANY LOSSES

¶2-400 Losses

A trading loss is computed in the same way as trading income would have been computed. Losses are calculated for an accounting period and then related to basis periods.

Where two basis periods overlap with reference to the loss for an accounting year, that part of the basis period which is common to both periods is ignored in arriving at the adjusted loss for the second basis period (s 44(3)).

Example 1

A business commenced on 1 January 2016 and made up its accounts to 30 June 2016, and to 30 June in subsequent years. The results were:

	RM
From 1 January 2016 to 30 June 2016	17,000 (loss)
For the year to 30 June 2017	13,000 (loss)

The adjusted loss for the first basis year for YA 2016 would cover the period from 1 January 2016 to 31 December 2016, ie:

	RM
Loss (from 1 January 2016 to 30 June 2016)	17,000
Loss (from 1 July 2016 to 31 December 2016 (1/2 of RM13,000))	6,500
Loss for basis year (for the year to 31 December 2016)	23,500

The adjusted loss for the year to 30 June 2017 would normally be the loss for YA 2017 but for the provisions of s 44(3). Consequently, the period common to the two basis periods, ie the period from 1 July 2016 to 31 December 2016, would be ignored. The result would be the following:

		RM
	Loss (for the year to 30 June 2017)	13,000
Less:		
	Loss for 6 months to 31 December 2016	(6,500)
	Adjusted loss for basis period	6,500

Current losses

Where a company incurs a loss in the basis period for a year of assessment, the ITA in s 44(2) provides that such a loss may be deducted from any other income that the company may have generated (interest, rent, etc) in the same basis period. Effectively, the general position is that a basis year loss can be offset against income from all other sources. However, such loss cannot be offset against dividend income in view of s 53

http://www.pbookshop.com

of Pt II of the Transitional Provisions, which states that statutory dividend income of a company is deemed to be total income or part of the total income of that company for that basis year. This restriction applies to companies only.

Example 2

The results of the operations for the year ended 30 September 2015 for a company were:

	RM
Statutory income from Business A	60,000
Unabsorbed loss from Business A b/f	(12,000)
Loss from Business B	(69,000)
Dividend income	10,000**
Interest income	8,000
Rental loss	(6,000)

The total income of the company would be computed as follows:

	RM	RM
Statutory income from Business A	60,000	
Less: Unabsorbed loss b/f [s 43(2)]	(12,000)	
Section 43(1)(a)	48,000	
Interest income	8,000	
Rental income	*	
	56,000	
Less: Loss from Business B [s 44(2)]	(69,000)	
Loss c/f	13,000	
Total income		Nil

*Where rent or other non-business source is concerned, any excess of expense over income does not constitute a loss and is disregarded.

**With effect from 1 January 2014, dividends are no longer liable.

Example 3

For the year ended 31 December 2014, a company had the following results:

	RM	RM
Adjusted business loss		(100,000)
Dividends		10,000
Interest		6,000
Rent		23,000
Aggregate of all income except dividends	29,000	
Less: Basis year loss	(100,000)	
Loss c/f	(71,000)	
Total income		NIL
YA 2015		
Loss b/f to be allowed against business income, if any		71,000

Carry forward of unabsorbed losses

Under s 44(2), the loss or aggregate of losses suffered by a person in the relevant year may be offset against the aggregate income from all sources, except in the case of companies where the loss cannot be offset against dividend income. Where the basis year loss exceeds the aggregate income, the excess is carried forward to the following year.

Losses brought forward can, under s 43(2), be deducted from the aggregated statutory business income the person may have in the relevant year. Again, should the loss brought forward exceed the aggregated statutory business income, the excess will be carried forward accordingly to be deducted from the aggregated statutory business income in the following year(s).

Example 4

YA 2014	RM	RM
Adjusted loss		(118,000)
Interest		16,000
Dividends		36,000
Rent		23,000
Aggregate income (excluding dividends)		39,000
Less: Basis year loss [s 44(2)]		(118,000)
Net aggregate income		Nil
Loss c/f	79,000	
Total income		NIL

YA 2015	RM	RM
Statutory business income		52,000
Interest		26,000
Dividends		44,000
Rent		35,000
Aggregate business income		52,000
Less: Loss b/f [s 43(2)]		(79,000)
Net aggregate business income		Nil
Loss c/f	27,000	
Interest		26,000
Rent		35,000
		61,000
Total income		61,000

Note: The above sequence of declaring income follows the order stipulated in Form C.

http://www.pbookshop.com

Change in shareholders

With effect from YA 2006, unabsorbed business losses are allowed to be carried forward and set off against income of the following year(s) where the DGIR is satisfied that more than 50% of the shareholders of the company on the last day of the basis period in which the loss is ascertained are the same as on the first day of the basis period in which such losses are to be utilised.

On 7 December 2007, the Ministry of Finance (MOF) issued guidelines that provide that carried forward loss of a company with a substantial change in ownership, meaning a change of more than 50% in share ownership, is permitted as long as the company was not a dormant company. The revised guideline took effect from YA 2006. A clarification has also been subsequently provided by the MOF on the definition of a dormant company. A company is deemed to be dormant if it does not have any significant accounting transactions in the financial year before the substantial change of 50% or more in the shareholding excluding the following common minimal expenses incurred by the company:

- filing of the annual return of the company;
- secretarial fees for filing the annual return;
- tax filing fees;
- audit fees; and
- accounting fees.

Furthermore, the MOF has indicated in its re-issued revised policies and guidelines that the level of shareholding to be considered when determining "substantial change" of shareholding in "dormant" companies is at the direct shareholding level.

Carry-back losses

For YA 2009 and YA 2010, current year business losses of up to RM100,000 for YA 2009 and YA 2010, respectively will be allowed to be carried back to the immediately preceding year as a deduction after the utilisation of group relief under s 44A in arriving at the total income of a person. Thus, a loss of up to RM100,000 incurred in 2010 can be carried back to YA 2009 and similarly a loss in YA 2009 to YA 2008.

This tax treatment is thus applicable to all businesses, including sole proprietors and partnerships.

The provisions for the carry-back losses will not apply if the basis periods for YA 2009 or YA 2010 and the basis period for the year of assessment immediately preceding YA 2009 or YA 2010 do not end on the same day. The amount of adjusted loss must not exceed RM100,000 or the defined aggregate income for the year of assessment immediately preceding YA 2009 or YA 2010, whichever is the lower.

Further, the above treatment is not applicable if a person:

- has pioneer company status or has been granted approval for the investment tax allowance under the *Promotion of Investments Act 1986* (PIA 1986);
- is exempted from tax under s 54A (shipping profits), 127(3)(b) or s 127(3A), or tax paid or payable is remitted under s 129;
- has made a claim for the reinvestment allowance under Sch 7A;

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

- has made a claim for deduction for investment in an approved food production project;
- has made a claim for deduction for cost of acquisition of proprietary rights;
- has been granted a deduction on cost of acquisition of a foreign-owned company;
- has made a claim for a deduction under any rules made under s 154 and it is mentioned that the provision of s 44B is not applicable;
- is an investment holding company under s 60FA;
- carries on insurance business under s 60, inward reinsurance business under s 60A or offshore insurance business under s 60B;
- carries on *takaful* business under s 60AA; or
- is an individual who does not have a business source.

The above will not have any effect on the s 108 balance.

Law: s 40, 41, 43, 44, 44B.

PAYMENTS TO SHAREHOLDERS

¶2-500 Dividends

The only way shareholders can receive a share of a company's profits (except on a winding up or reduction of capital) is in the form of dividends. Such dividends could be declared from capital gains or other non-taxable profits. However, the company needs to have an appropriate s 108 balance, ie the balance is at least equivalent to the tax credit available in the dividends paid.

A bonus or scrip issue by a company is not deemed a dividend distribution and is a non-taxable distribution.

¶2-510 Single-tier tax system

From the time the ITA was implemented in 1968, the imputation system applied generally to dividends paid by a company to its shareholders. In this system, taxes paid by a company were imputed as a tax credit into dividends paid. Such dividends were called "franked dividends". To simplify and enhance the efficiency of tax administration, a radical change in the treatment of dividends was introduced with effect from 1 January 2008. This was the single-tier tax system under which the tax paid by a company would be a final tax, meaning that there would be no spillover effect on shareholders, and dividends paid by it would no longer be liable to tax. Further, the dividends would not carry any tax credit to be set off against any tax that the shareholder would be charged with. Thus, the previous position where the tax credit embedded in the dividends would emanate from the company's balance in the s 108 account would no longer apply from the effective date.

However, recognising that any s 108 balance would constitute a potential benefit to shareholders should dividends be paid, the implementation of the new system was accompanied by the transition period. Under this six-year period (from 1 January 2008 to 31 December 2013), companies having a s 108 balance as at 31 December 2007 could, under certain conditions stipulated in the transitional provisions, continue to pay dividends which would be treated as previously being liable to tax and carrying a tax credit.

http://www.pbookshop.com

The key features of the transitional provisions are as follows:

- The s 108 balance on 31 December 2007 would be the amount from which credits would be available in dividends paid in the transitional period. After the cut-off date, this balance could never increase, even if additional taxes were paid for YA 2007 or earlier years. It could, however, be reduced through credits included in dividends paid or reductions in assessments for 2007 or earlier.
- For a company to be entitled to include a tax credit in dividends it paid, it had, apart from having a s 108 balance, to pay such dividends in cash and to ordinary shareholders.
- Where a company had no s 108 balance on 31 December 2007, it would automatically fall into the single-tier system from 1 January 2008.
- Similarly, all companies incorporated on 1 January 2008 or later would be single-tier companies.
- Should a company during the transitional period use up its s 108 balance by paying dividends, it would fall into the single-tier system.
- A company could also make an irrevocable election to disregard or give up any s 108 balance it had. It would become a single-tier company on the date following the date it made the election.
- Any loss that a company may suffer in the basis year would have no bearing on any dividend it may receive; the dividend would constitute the company's total income or part of it.
- On 1 January 2014, all companies, including those who may still have a s 108 account balance, would fall into the single-tier tax system. Accordingly, all dividends paid by a company would no longer carry any tax credit and would not be liable to tax in the hands of the recipient.

Effectively, a company could in the transitional period pay the following dividends:

- Franked dividends, which would be liable to tax in the hands of the recipient but would come with a tax credit. For shares in a company not listed in Bursa Malaysia, the shareholder is required to own the shares for 90 days or more to be entitled to the tax credit.
- Exempt dividends, where the dividends are paid from any exempt income account, such as pioneer or shipping income, that the company may have.
- Single-tier dividends, which are dividends not paid in cash or paid to non-ordinary shareholders, or dividends paid after the s 108 has been used up or disregarded.

Law: s 108 of the *Income Tax Act 1967*; s 47, 48, 49, 50 of the Savings and Transitional Provisions of *Finance Act 2009*.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

http://www.pbookshop.com

POSITION PRIOR TO YA 2008 UNDER THE IMPUTATION SYSTEM

¶2-515 The imputation system

Prior to YA 2008, Malaysia adopted the imputation system where the whole or part of the taxes paid by a company would be available to the shareholders as a tax credit in the dividends paid out. Thus, the total income tax paid by a company flowed to its shareholders. This system, among other things, removed the inequitable taxation on dividends.

The procedural steps were as follows:

(1) The company would pay tax at 28% on its profits for YA 2006 (see ¶230). The tax would be credited to a dividend franking credit (s 108) account.

(2) When the company declares a dividend, 28% tax would be deemed to have been deducted at source and this amount would be set off against the dividend franking credit.

(3) The shareholder would receive his/her dividend and the dividend voucher would state the company tax paid on that dividend.

(4) When preparing the tax return, the net dividend plus the company tax paid would be entered as income. That is to say, the gross dividend would be treated as assessable income.

(5) A credit equal to the company tax paid (28% of every RM1 of dividend income) would be allowed against the shareholder's personal or corporate tax.

(6) When the credit cannot be absorbed against the tax chargeable, the excess of credit would be refunded.

Example 1

YA 2006

A Sdn Bhd

	RM
(a) Business (loss)	(20,000)
(b) Dividends	80,000
Total income, including dividends (RM80,000)	60,000
Tax at 28%	16,800
Tax deducted at source from dividends (28% × RM80,000)	(22,400)
Tax refundable	5,600

Theoretically, the greatest benefit would be for shareholders who would have a tax rate below the prevailing company tax rate.

Example 2

The results of a company which commenced operations in 2004 and paid taxes accordingly were:

	Year ended		
	31 December 2004	31 December 2005	31 December 2006
	RM	RM	RM
Business profit	40,000	60,000	80,000
Interest	10,000	12,000	14,000
Chargeable income	50,000	72,000	94,000
Income tax thereon @ 28%/0%/28%	14,000	20,160	26,320

Section 108 account

	RM
Income tax payable for YA 2004	14,000
Add: Income tax payable for YA 2005	20,160
Section 108 balance as at 31 December 2005	34,160
Add: Income tax payable for YA 2006	26,320
Section 108 balance as at 31 December 2006	60,480

Example 3

Assuming that dividends were paid on 15 November 2007 as follows:

	RM
Gross dividends declared	10,000
Less: 28% tax deemed to have been deducted at source	(2,800)
Net dividends payable	7,200

Section 108 account

	RM
Balance as at 31 December 2006 (as before)	60,480
Less: Tax deemed deducted from dividends paid on 15 November 2007	(2,800)
Balance	57,680
(The tax payable for YA 2007 should be added to the balance of RM57,680, assuming that the company was not liable to tax for YA 2007)	
Section 108 balance as at 31 December 2007	57,680

Example 4

Assuming instead that dividends were paid on 15 November 2007 as follows:

	RM
Gross dividends declared	240,000
Less: 28% tax deemed to have been deducted at source	(67,200)
Net dividends payable	172,800

Section 108 account

	RM
Balance as at 31 December 2007 (as before)	57,680
Less: Tax deemed deducted from dividends paid on 15 November 2007	(67,200)
Balance (ie shortfall)	(9,520)

The shortfall of RM9,520 would be a debt due from the company to the IRB (s 108(7)). The Revenue would requisition the shortfall under s 108(5) on Form S and the debt would be payable on the service of Form S. [Note that s 108(5) and 108(7) have been substituted by the *Finance Act 2007*.]

To avoid a situation where a shortfall in the s 108 balance would arise, the company was to re-gross the available balance using the tax rate prevailing at the date the dividend was paid. In the example above, the maximum dividend the company could pay would be:

	RM
Available s 108 balance:	57,680
Tax rate for YA 2007	28%
Maximum dividend payable	206,000

By paying a dividend of RM206,000 and not RM240,000, the company would avoid the need to settle a shortfall of RM9,520.

Law: s 108.

¶2-520 Derivation of dividends paid

Dividends paid by a company that is not resident in Malaysia will be deemed to be not derived from Malaysia.

Law: s 108.

¶2-530 Rights of deduction of tax

A company resident in Malaysia on paying a dividend is required to deduct tax at the company's prevailing tax rate.

Where no deduction of tax is made, the dividend is deemed to be a dividend of a gross amount which after deduction of tax would be equal to the net amount paid.

Law: s 108.

¶2-540 Accounting for tax deducted or deductible

At the end of each assessment year two totals are struck for each resident company. One total (compared aggregate) represents the tax paid or payable by the company on its income and the other (compared total) represents the tax deducted or deductible from dividends paid to its shareholders. Where the compared aggregate total exceeds the compared total, the difference is carried forward for franking future dividends. Where the compared total exceeds the compared aggregate, the excess becomes a debt due to the DGIR.

http://www.pbookshop.com

CHAPTER 9

BUSINESS DEDUCTIONS

Table of Contents

What are business deductions? . . . . ¶9-050
Employee's deductions . . . . ¶9-200
Deductions from property income . . . . ¶9-300
Investment income expenses . . . . ¶9-350
Trading expenditure . . . . ¶9-360
Entertainment . . . . ¶9-390
Bad debts . . . . ¶9-400
Losses through theft, embezzlement or misappropriation . . . . ¶9-450
Reserves and provisions . . . . ¶9-460
Legal and professional expenses . . . . ¶9-470
Interest, taxes and contributions . . . . ¶9-500
Repairs, replacements, improvements and alterations . . . . ¶9-600
Costs of refresher courses and conference expenses . . . . ¶9-650
Head office and management expenses . . . . ¶9-670
Miscellaneous expense deductions . . . . ¶9-702
Trading losses . . . . ¶9-800
Error and mistake relief . . . . ¶9-830
Double deductions . . . . ¶9-860
Expenditure related to taxation . . . . ¶9-900
Farms . . . . ¶9-950

http://www.pbookshop.com

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 may be deducted 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.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

http://www.pbookshop.com

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

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

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.

http://www.pbookshop.com

- 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.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

http://www.ppbookshop.com

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 on 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

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

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.

In a continuing business, items of expenditure are commonly treated as belonging to the accounting period in which they are met [*Amalgamated Zinc (de Bavey's) Ltd v FC of T* (1935) 54 CLR 295].

Considerations for deductibility

These types of expenses may, subject to meeting the other criteria for deductibility, be considered to be incurred in the production of income:

- Expenditure that is closely connected to the income-producing operations.
- Expenditure that is incurred with the intention, at the time the outlay is made, of producing income. It is not relevant whether or not any income is in fact produced.
- Expenditure which is paid out in a year but which does not produce any income in that year.
- Expenditure which is incurred not to produce income but incurred to preserve the source of income.
- Expenditure which is relevant to the particular trading unit and which is permitted on ordinary principles of commercial trading.

¶9-078 Is the expense prohibited by any other provision of the law?

Section 39 is the negative complement of s 33 and specifically prohibits deductibility of certain types of expenditure. There are also some other sections in the Act which prohibit certain types of expenditure or which prohibits expenditure in excess of laid-down limits or which provide conditions to deductibility.

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) of the ITA, although these amounts would have qualified for deduction under the general rules of deductibility of s 33(1) of the ITA.

The sum must not be in the nature of personal expenses of the taxpayer

Section 39(1)(a) of the ITA provides 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 needs, such as clothing, food, children's education, reciprocal entertainment and recreation. 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* (1945) 26 TC 293].

Further examples of personal expenses are those incurred by the taxpayer for vacations, payment of income taxes, legal expenses, medical and dental treatment and tuition fees.

¶9-080 Apportionment of expenditure

An item of expenditure may be incurred and, if a taxpayer can establish that a portion of it is allowable under s 33 of the ITA, that person would be entitled to a deduction in respect of that portion [*Bean (Inspector of Taxes) v Doncaster Amalgamated Collieries Ltd* (1944) 27 TC 296; *Darngavil Coal Co Ltd v Francis* (1913) 7 TC 1].

The problem of apportionment is somewhat tied up with the words "wholly or exclusively". This is particularly so where expenditure has a dual aspect or dual motive. Where a taxpayer incurs an expense on an item which is for an allowable purpose under s 33 and for a non-allowable purpose under s 39, in practice, the rule of proration is applied. This is notwithstanding the fact that the words "wholly and exclusively" reject expenditure which has a dual motive.

The relevant expenditure is dissected and apportioned on a reasonable basis, with one part being allowed and the other part disallowed. Examples of such apportionment made by the DGIR are usually in the field of expenses relating to travelling, accommodation, interest, etc.

In practice, apportionment is also made in two other situations:

- Where the taxpayer has income under different heads of s 4. Expenses that are commonly incurred for earning all the income are apportioned among the relevant heads of income.
- Where the taxpayer derives income from a taxable source and a non-taxable source; for example, pioneer exempt income, where an apportionment of common expenses is made on a fair and agreed basis.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

http://www.pbookshop.com

Thus, where an expense is attributable to more than one object, it should be apportioned in accordance with all the facts which give rise to it, and to the extent that one of the purposes of the expense is truly for the production of income, it should be admitted. In practice, the DGIR does accept this position, and apportionment is often agreed upon with the taxpayer on a fair basis. Thus, in *Re B* (1951) FB IV, a Malaysian case, the taxpayer who travelled extensively in connection with his business was allowed 25% of his air fares as a business deduction under s 14(1), predecessor to the current s 33(1) of the ITA. The Comptroller took the view that the balance fell clearly within the prohibiting section [s 15, now s 39 of the ITA] as a private expenditure.

The DGIR, in apportioning expenditure which is attributable to more than one object, adopts in practice a "fair and just" basis. The actual apportionment is, of course, a matter of negotiation and agreement between the taxpayer and the DGIR.

Case law

In *SL Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (1997) MSTC 2,840, the taxpayer was involved in leasing and non-leasing businesses. In raising an assessment on the taxpayer's gross income, the IRB referred to its common expenses and the capital allowances of both businesses. Since the exact amount of the expenses and allowances could not be attributed to either business, the Revenue apportioned them by using a method based on a turnover where the gross income of the leasing was recognised. The Special Commissioners were of the view that s 33(1) of the Act provided that it was necessary to include the gross income when ascertaining adjusted income. Therefore, the Revenue's method had a legal basis as it had used the taxpayer's gross income in apportioning its common expenses and capital allowances.

¶9-082 Expenditure need not be profitably laid out

It is a fallacy to suppose that a deductible expenditure must not only be incurred in the production of income but must also be profitably laid out. It is not a requirement that there must be the presence of income or a receipt on the credit side to justify a claim for expenses. Thus, should a trader lease premises for business purposes for a term of years, and it turns out during the term that he has no use for the premises or a part thereof, he must nevertheless fulfil the contract he entered into and pay the rents [*IRC v Falkirk Iron Co Ltd* (1933) 17 TC 625]. Another example is where a long-term contract has been entered into for the employment of a person at an agreed salary but his/her services have become redundant due to recession. The deductibility of the salary will not be prejudiced if he/she continues to be paid in accordance with the contract. The fulfilment of contracts are one of the purposes of any business.

There are also expenses incurred for business where the returns do not crystallise in the year of the expenditure; for example, rubber and oil palm plantations which take six years to mature. The expenses for maintaining such businesses justify a deduction. Other examples are where a business expansion takes place in the initial years producing negative income, advertising expenses, repairs, etc.

¶9-084 Reasonableness or magnitude of expenditure

There are no provisions in the ITA which cater for non-capital, non-personal expenditure to the extent that it is unreasonable in the circumstances and should not therefore be admitted. The jurisdiction of the DGIR is, therefore, confined to deciding the reality of the expenditure, namely whether the amount claimed as a deduction is factually incurred and whether it is wholly and exclusively incurred for the purpose of producing income [*Ronpibon Tin NL v FC of T* (1949) 78 CLR 47; *KFY Co Ltd v Director General of Inland Revenue* (1990) 1 MSTC 409; 2,147]. The reasonableness of an expense must be judged having regard to the business needs of the taxpayer and the benefit derived by him/her. Although the magnitude of an expense is an important consideration, it is not conclusive where its deductibility is concerned. Magnitude is a relative term: what is large for one taxpayer may well be insignificant for another.

The reasonableness or magnitude of an expenditure can be probed into only for the purpose of determining whether, in fact, the amount is spent. Thus, the DGIR cannot substitute his views as regards reasonableness of the amount claimed. He can, however, disallow expenditure which he thinks is not real or is not incurred in the course of business. A taxpayer is entitled to conduct his/her business as he/she thinks fit. It is not for the DGIR to say that a taxpayer ought to have spent less, or acquired a product at a lesser price, and on that basis disallow part of the expenditure [*Carlton Hotel (P) Ltd v CIT* (1974) 94 ITR 311; *CIR (NZ) v Europa Oil (NZ) Ltd* 70 ATC 6012].

Accordingly, there can be no income tax principle that prohibits properly deductible expenditure under s 33, under whatever category, on the grounds that it is unreasonable or excessive.

¶9-150 Principles governing deductions

The following are some broadly accepted principles governing deductions recognised by revenue departments:

- *Commencement and cessation of business*. A taxpayer incurring expenses before starting a new business or after terminating his/her business cannot claim such expenses. These expenses fall outside the scope of the deduction formula. The commencement or cessation date of a business is determined by the nature of the business and the surrounding facts (see ¶9-755).
- *Existing business*. Any loss or expenditure or allowance in respect of any business will only rank for deduction if the business existed during the accounting year.
- *Language of the Act*. The Court is not concerned with deductions which may be considered proper from an accountant's point of view or from the point of view of a prudent trader, but merely with the deductions which are permissible according to the language of the Act. Regard, therefore, must be made to the Act alone in order to ascertain whether the deductions sought to be made are permissible (*Sub-Nigel Ltd v CIR*).

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

http://www.pbookshop.com

- *Accounting entries*. The manner in which accounts are maintained or the method of accountancy that is adopted by a business cannot override the substantial character of a transaction. In other words, the name given to a transaction is not conclusive as to its true character.
- *Commercial expediency*. An expense incurred, not out of necessity nor with the intent of an immediate or direct benefit, but voluntarily, on the grounds of commercial expediency and in order to facilitate the carrying on of trading operations, will qualify for deduction.
- *Third party benefits*. Where an expenditure is incurred in the production of income or for the purpose of carrying on a business it does not matter whether or not it endures incidentally for the benefit of a third party.
- *Deductions to relate to the year of expenditure*. Normally, all expenses relating to the year in which they are incurred are deductible in respect of that year only. Notional expenditure such as provisions or reserves to meet contingent obligations will not rank for deduction.
- *Deferred benefits*. Where an expense is incurred it is not necessary that the benefit arising from it must be immediate. The benefit may extend into future years. In other words, when arriving at the adjusted gross profits of a business one has to take the profits and the expenses as a whole, for the year under review. Expenditure must not be split up and allocated over the period of years to which the benefit is to continue.
- *Anticipated losses*. A clear distinction must be made between an actual liability in the present and a liability in the future. The former, if representing an expense, is deductible; the latter not deductible.
- *Investments*. No deductions are available to taxpayers in respect of depreciation of an investment. This is a capital loss.
- *Breach of the law*. The committing of an offence is not regarded as incidental to the carrying on of a business. Accordingly, fines and penalties incurred for breaching the law will not qualify for deduction.

¶9-160 Prohibited deductions (s 39(1))

Section 39(1) in relation to s 33(1) is the negative section in that it sets out all outgoings and losses which do not rank for deduction from assessable income. This could give rise to situations where even expenses which meet the requirements set in s 33 may not, pursuant to s 39, be allowable. In such cases, s 39 will prevail. Nevertheless, it is important to read and construe the two sections together when considering what is and what is not a deductible expense.

No deductions are allowable in respect of the following:

- Domestic or private expenses (s 39(1)(a)). These would include expenses for the house, family, food, clothing, costs of engaging domestics and generally all expenses which are of a private or personal character and which relate to the maintaining of the taxpayer and his/her family. Travelling expenses incurred by an individual to and from his/her place of employment are also deemed private expenses.

- Expenses not incurred wholly and exclusively for the purpose of acquiring the income (s 39(1)(b)). This appears as a rather superfluous inclusion when juxtaposed with the wording in s 33(1).
- Any capital withdrawn or any sum employed as capital (s 39(1)(c)). "Capital withdrawn" would mean capital withdrawn from a business. The debt would normally be to the individual's personal account rather than a charge to revenue account. Amounts which are expended to acquire items of a capital nature are also excluded. Insofar as capital employed for improvements is concerned one has to distinguish "improvement" from "repair". It is not unusual for a business to charge its revenue account with items which it considers repairs but in strict terms are in the nature of improvements. Here lies an area of constant discourse with the Director General.
- Payments to any pension, provident, savings, widows, widowers and orphans or other similar fund or society which is not an approved scheme (s 39(1)(d)).
- Any expenses in respect of qualifying mining expenditure, qualifying expenditure on plant and machinery, industrial buildings, agriculture, forests and abortive expenditure on prospecting operations for which allowances are given under Sch 2, 3 and 4 of the ITA (s 39(1)(e)).
- Interest on any indebtedness of any kind (debenture, mortgage, royalties, etc), having a Malaysian source, paid to a non-resident person or any person in the case of interest without deduction of withholding tax, except where (from YA 1997) the withholding tax and a 10% penalty on the gross amount has been paid (s 39(1)(f)). Effective from 1 January 2012, the deduction of expenditure will not be disallowed where the income of the person is exempted under the *Promotion of Investments Act 1986* (PIA 1986), or s 127(3)(b) or s 127(3A) of the ITA (s 39(3)).

  In respect of the above, the definition of "person" in s 109C previously included a finance company under the Banking and Financial Institution Act or Islamic Banking Act. This has been amended through Finance Act 2017 with effect from 30 June 2013 to refer to the Financial Services Act and the Islamic Financial Services Act which replaced the earlier two Acts respectively.
- Any sums paid or payable, otherwise than to a State Government or any statutory body or fund approved by the Minister, for the use of a licence or permit to extract timber from a forest in Malaysia (s 39(1)(g)). This includes sums paid to licensees for the informal assignation of their licence to extract timber (*BW Sdn Bhd v DGIR* (1989) 1 MSTC 365).
- Any contract payments from which tax under s 107A has not been deducted except where (from YA 1997) the withholding tax and a 10% penalty on the gross amount has been paid (s 39(1)(i)). Effective from 1 January 2012, the deduction will not be disallowed where the income of the person is exempted under the PIA 1986, or s 127(3)(b) or s 127(3A) of the ITA.
- Any payments in respect of special classes of income from which tax under s 109B or any income from which tax under s 109F has not been deducted except where (from YA 1997) the withholding tax and a 10% penalty on the gross amount has been paid (s 39(1)(j)). Effective from 1 January 2012, the deduction will not be disallowed where s 39(3) is applicable. (See ¶9-550.)

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

- Any sum paid as rental for a motor vehicle in excess of RM50,000 or RM100,000 (s 39(1)(k)). The restriction against deduction does not apply to rental expenses on a motor vehicle licensed or permitted, by the appropriate authority, for commercial transportation of goods or passengers, such as a lorry, truck, bus, minibus, van, station wagon or taxicab. These restrictions will depend on the cash price of the motor vehicle, ie if more than RM150,000, the restriction is RM50,000; if not more than RM150,000, the restriction is RM100,000.
- Any remuneration or any similar payment paid to a partner of a limited liability partnership (LLP) where such remuneration or payment is not specified or provided in the LLP agreement made in accordance with s 9 of the *Limited Liability Partnerships Act 2012* (s 39(1)(n)).
- Any amount paid or to be paid in respect of goods and services tax as input tax by the person if he/she is liable to be registered under the *Goods and Services Tax Act 2014* (GST Act 2014) and has failed to do so, or if he/she is entitled under that Act to credit that amount as input tax (s 39(1)(o)). See Note 1 below.
- Any amount of output tax paid or to be paid under the GST Act 2014 which is borne by the person if he/she is registered or liable to be registered under that Act (s 39(1)(p)). See Note 1 below.
- With effect from 1 January 2016, any remuneration or other payment in respect of services performed or rendered in Malaysia by a public entertainer from which tax under s 109A has not been deducted except where the withholding tax and a 10% penalty on the gross amount has been paid (s 39(1)(q)).

Note 1: The Inland Revenue Board has issued the Public Ruling No 1/2017 on "Income Tax Treatment of Goods and Services Tax Part I" on 8 June 2017. In addition to a general outline of the GST regime, Public Ruling No 1/2017 provides guidance on:

(a) income tax provisions related to GST (such as deductibility of input or output tax);

(b) income tax treatment on the expenditure for GST incurred on the acquisition of goods and services;

(c) GST credits and income tax treatment for GST-registered and non-registered persons; and

(d) other issues such as bad debt relief and documentation requirements.

Law: s 33(1), 39(1), 39(3).

¶9-170 Specific deductions

The ITA provides for the following specific deductions:

- Interest paid on capital used in acquiring the income (s 33(1)(a)). (See ¶9-305, ¶9-350, ¶9-510.)
- Rent payable in respect of any land or building occupied (s 33(1)(b)).
- Repairs to premises, plant, machinery or fixtures used in the production of income (s 33(1)(c)). (See ¶9-310, ¶9-600.)
- Bad debts (s 34(2)(a)). (See ¶9-400.)

http://www.mbookshop.com

- Employers' contributions to approved funds or schemes, subject to a ceiling of 19% of employees' remuneration (s 34(4)). (See ¶10-700.)
- Mining allowances (Sch 2; s 34(6)). (See ¶11-110.)
- Employers' expenditure on equipment to assist disabled employees (s 34(6)). (See ¶9-702.)
- Deductions for expenditure incurred on translating or publishing books in Bahasa Malaysia (s 34(6)(f)). (See ¶9-708.)
- Contributions to libraries (s 34(6)(g)). (See ¶9-710.)
- Expenditure on providing services, public amenities and contributions to charity or community projects (s 34(6)(h)). (See ¶9-712.)
- Employers' expenditure on the provision and maintenance of childcare centres for the benefit of the employees (s 34(6)(i)). (See ¶9-715.)
- Contributions to establishing and managing a musical or cultural group (s 34(6)(j)). (See ¶9-718.)
- Contributions to sponsoring any approved arts or cultural activity (s 34(6)(k)). (See ¶9-720.)
- Scholarships (s 34(6)(l)). (See ¶9-722.)
- Certification and accreditation expenses) (s 34(6)(m)). (See ¶9-725.)
- Practical training in Malaysia to an individual (s 34(6)(n)). (See ¶9-728.)
- Scientific research expenses (s 34(7), 34A, 34B). (See ¶9-770.)
- Discount or premium incurred on the subscription or issuance of a bond (s 34C). (See ¶9-769.)
- Pre-operational expenses incurred by companies undertaking approved overseas investments (Sch 4B). (See ¶13-700.)

In addition to the above, and in the case of small businesses incorporated in Malaysia with authorised capital not exceeding RM250,000 (incorporated on or after 1 January 1973 but prior to 13 September 2003) or RM2.5 million (incorporated on or after 13 September 2003), certain deductions which would otherwise not fall within the province of s 33 are given. (See ¶9-758.)

Law: s 33(1), 34(2)(a), (4), (6), (7); 34A, 34B, 34C, Sch 4B.

EMPLOYEE'S DEDUCTIONS

¶9-200 General

Deductions under s 33(1) are not confined to any particular class of taxpayer or to any particular source of income. As long as the "deduction formula" and the "criteria" are conformed to, a loss or expense may be considered as one qualifying for deduction.

However, individuals who are employees are entitled to very limited deductions as compared to persons carrying on a trade or profession. The general view the Director General takes is that the employer meets all the necessary expenses that are to be incurred by his/her employee in the course of discharging the duties of his/her office. It follows that if a claim is made by an employee for a deduction, the onus is on him/her to prove to the satisfaction of the Director General that the relevant expenses are incurred in the performance of his/her duties.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

http://www.pbookshop.com

When are expenses deductible?

The general rule to apply would be that all expenses *reasonably incurred* for the *appropriate performance* of the duties of the office of employment would qualify for deduction.

Briefly, therefore, the Director General will require answers to the following three questions before considering the deductibility of expenditure incurred by an employee:

- Was the claimant obliged to incur the expenditure?
- Was it incurred wholly and exclusively for the purpose of the employment?
- Was it incurred in the course of the performance of the duties of the employment?

A reference to ¶9-050 makes it clear that the deductibility or otherwise of an expense can determine whether or not a payment made to, or on behalf of, an employee constitutes an emolument of that employee. There are really several methods of meeting an expense of the employee:

- The employer may pay the employee a salary and leave him/her to bear the expense himself/herself;
- The employer may pay the expense directly;
- The employer may pay the employee an allowance out of which the latter is to pay the expense; or
- The employer may reimburse the employee after the employee first incurs the expense.

Each of these methods can have different tax connotations.

Director General's approach to claims

It is recommended that when claims are made, employees should present a realistic submission and refrain from including non-qualifying deductions. The first reaction of the tax department is to whittle down the claim as much as possible by arbitrarily accepting only 1/3 or 1/2 of the claim. It is advisable therefore for taxpayers to keep a note book and make the necessary entries, from time to time, and, if necessary, to produce these notes as evidence of the claim. Wild inflation of claim figures and unrealistic estimates are not recommended as these merely provide grounds for inflexibility and impatience for the Director General. Despite the arbitrary approach of the Director General in restricting claims by a holder of an office or employment, it is often possible to obtain marginal tax savings and this can only be done by reviewing and recording all qualifying expenditure.

An employee who is guaranteed a minimum earning, including the cost of passage and rent of house which would otherwise be borne by the employer, is not entitled to a deduction for the passages or rent (*CIT (Malaya) v OM* (1950–1985) MSTC 323; *Cordy v Gordon*). Accordingly, employees who are negotiating contracts of service which include travel, accommodation and other facilities ought not to contract an "all inclusive" remuneration. Their salaries or wage figures should be exclusive of these costs as this will reduce their tax bills considerably. Instead, such costs should be paid directly by their employers.

Law: s 33(1).

¶9-210 Travelling expenses

Where an employee travels in the course of his/her duties, the cost of travelling is deductible. Such expenses are normally deducted from the fixed allowance received from the employer. However, reimbursement for actual expenses is not deductible, nor is it taxable on the employee.

Travelling expenses incurred to and from one's home and the place where the employment is exercised, ie an office, site, estate, etc, are not considered as expenses incurred in the performance of one's duties — they are incurred before the duties of the office begin. Consequently an employee who maintains a car to take him/her to and from his/her office is not entitled to a deduction in respect of expenses incurred on petrol, a driver, or the maintenance of his/her car. In England, a doctor who held part-time employment at three hospitals was not entitled to deduct from his income expenses incurred in travelling between his home or surgery and the hospitals because the duties of his employment did not start until he arrived at the hospitals (*Parikh v Sleeman*).

It is the practice in Malaysia for employers to grant a travelling allowance or car allowance to certain classes of employees. Where the allowance is used for dual purposes, the Director General accepts an apportionment and that element of the expenditure which relates to travel on business is accepted as a deduction. Notwithstanding the above, pursuant to Income Tax (Exemption) Order 2009, travelling allowance, petrol card, petrol allowance or any of its combinations, for travelling to and from home to the place of work is tax exempt up to RM2,400 per annum for YA 2008 to YA 2010. Besides, tax exemption up to RM6,000 per annum is given for travelling in the performance of employment at a place other than the office with effect from YA 2008.

It must be remembered however, that such exemption is not automatic. The Director General may require the employee concerned to justify the claim for exemption and furnish details of the expenses incurred and how they were related to his duties. This applies to both travelling and entertainment allowances. For example, if an office manager were to receive "travelling allowance" of RM4,800 and it was revealed that he had no official need to travel anywhere "on duty", obviously the entire RM4,800 would be liable to tax. As in the case of allowances exceeding RM6,000, it is always advisable to maintain records and details of the travelling or entertainment carried out on behalf of the employer's business.

¶9-220 Entertainment allowances

Entertainment allowances paid to an employee must be included in the employee's assessable income. The employee may, however, claim a deduction in respect of entertainment expenses incurred by him. With effect from YA 1989, the claim for deduction cannot exceed the amount of the entertainment allowance. Where the employee is reimbursed by his/her employer for actual expenses incurred, the employee cannot make a claim for deduction, nor will the reimbursement be taxable on the employee.

Only so much of the allowance which relates strictly to the employment is deductible. The Director General is particularly concerned with such allowances as the granting of these is often used by employers to provide additional benefits to their employees.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

The claimant has to discharge the onus of proof that part or whole of the allowance is used for business purposes. It is not unusual for the Director General to call for a detailed breakdown of the expenses claimed, indicating persons entertained, the purpose of entertaining, the results, the location of the entertainment, etc.

The general rules applied by the Director General in reviewing entertainment expense claims by employees are:

- that the expense must be entirely and directly connected with specific employment business;
- that only existing clients are entertained; and
- that the circumstances make it necessary to talk business when entertaining.

Where claims are made and the entertaining is of a social or reciprocal nature or where the entertaining is of a very general character, ie where the business element is only incidental, or when the entertainment is of prospective clients, they may be rejected.

See also ¶9-390 and Public Ruling No 4/2015.

Law: s 38A.

http://www.pbookshop.com

¶9-230 Professional subscriptions — books, journals, etc

Employees can claim deductions in respect of subscriptions to professional bodies, professional journals and the costs of replacement of technical books. The Director General needs to be satisfied that the duties of the employment involve the direct application of the professional knowledge of the claimant and there is a close relationship between the subscriptions claimed and the production of the income.

It is accepted in principle that it is necessary for an employee, just as much as it is for a person who is carrying on a profession, to retain his/her professional qualifications by subscribing to his/her professional body. Thus, a doctor needs to keep his/her name on the Medical Register whether or not he/she is an employee. It is also accepted that subscriptions to associations, societies, journals, etc, for purposes of maintaining professional standards of conduct and for keeping abreast with developments in the profession, are necessary liabilities in the exercise of the profession whether as an employee or as an independent person.

Case law

However, in the case of *Ketua Pengarah Hasil Dalam Negeri v Dr Arunjit Dutt* (1995) 2 MSTC 3,454, where a doctor claimed as a deduction the costs of subscriptions, medical journals, magazines and the like, the High Court followed the principle in *Simpson v Tate* 9 TC 73 that such costs were not expenses wholly, exclusively and necessarily incurred in the performance of the taxpayer's duties. The doctor's claims were disallowed.

¶9-235 Fee paid to an agency to obtain employment

Expenditure to secure employment is not deductible under s 33. There are hardly any cases in Malaysia on the subject. However, s 33 does not contemplate sums paid to employment agencies to secure employment as constituting revenue expenditure. Such expenditure secures an asset, ie the source of employment, and is therefore of a capital nature. It would be interesting to see what IRB's stand would be if an

individual, having established an employment source of income, wishes to claim the fees he paid to an agency to help him secure a second employment. The situation would then be similar to one where a house-owner pays an agency fees to get a subsequent tenant for a house being let out; the fee for the first tenant would not be allowable.

¶9-240 Education expenses

It is not uncommon for an employee to incur costs for education or training to enable him/her to perform his/her duties more efficiently and productively. In some cases a bonus is paid to an employee if he/she attains a certain degree of efficiency in languages. Where claims are made for such expenses, it is the practice of the Director General to tax the bonus but admit deductions for expenses incurred such as tutors' fees, costs of books, etc. Travelling costs are not admitted.

Often an employer requires his/her employee to attain a certain degree of academic knowledge. The deductibility test here is not whether the employer imposes the expense but whether the duties of the office or employment do. In other words, if the duties cannot be performed without incurring the particular expense, irrespective of what the employer may prescribe, the outlay will rank for deduction. For example, in the case of *Lupton v Potts*, a solicitor's articled clerk's claim for fees paid by him for sitting for the Law Society's examination was denied because the duties of the taxpayer under the contract of employment were perfectly capable of being performed without incurring the particular outlay.

The New South Wales Supreme Court, however, has held that expenses incurred by a dentist to obtain a higher degree of qualification within his profession ranked for deduction because the specialist knowledge obtained by him in obtaining the degree was so related to the carrying on and advancing of a general practice that the expenses involved were incurred in gaining assessable income (*FC of T v Highfield*).

In another Australian case, a taxpayer who had shown a lifelong dedication to radio and the theatre was entitled to deduct the cost of a trip to Russia and fees incurred in attending a course designed for professionals in radio drama techniques (*Case V32*).

The *Highfield* case indicates a tax advantage in general practitioners becoming specialists. It should be contrasted with the case of *Blackwell v Mills*, where the cost of obtaining a Bachelor of Science degree as an employment prerequisite was disallowed as a deduction.

¶9-250 Contributions to Private Retirement Schemes

With effect from YA 2012, contributions to Private Retirement Schemes (PRS) were introduced as an additional option for claiming deductions either as a business expense or as personal relief. This was available to both individuals and employers. For individuals, such contributions are distinct from the existing relief of RM6,000 available for contributions to the Employees' Provident Fund or payment of premiums in respect of life insurance policies. The maximum PRS deduction, available under s 49(1D) is RM3,000. It must be noted that PRS contributions can be claimed by any individual, not just an employee.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

http://www.pbookshop.com

For employers, any deduction in respect of the amount they contributed for the benefit of employees is limited to 19% of employees' remuneration. In other words, the total amount that would be allowable for contributions to the Employees Provident Fund (EPF), other approved retirement funds, and PRS cannot exceed 19%.

When first introduced, this provision did not have any negative consequence of making a withdrawal of contributions to a PRS. However, effective from 1 January 2013, any withdrawal before the age of 55 years or on grounds other than of leaving Malaysia permanently would have a tax of 8% deducted. Such deduction of tax, under s 109G, is to be complied with by the relevant PRS provider who would have to remit the tax to the Director General within 30 days of making the payment to the individual concerned.

From 1 January 2014, the grounds under which a withdrawal could be made without attracting a tax deduction were extended to include permanent disablement, serious disease, or mental disability.

Individuals will also be given a one-off incentive of RM500 if they participate in the PRS effective from year 2014. However, they must meet the following criteria:

(1) has a minimum cumulative investment of RM1,000 within one year, and

(2) must be between 20 to 30 years old.

¶9-260 Accommodation expenses

The provisions of s 38 permit certain expenses, within limitations, to be deducted in cases where fully furnished living accommodation is provided by the employer and the value of this is included in the gross income of the employee. In such cases, the rent paid by the employee, normally expressed in his/her contract as a percentage of his/her income, for the accommodation and furniture, will be allowed against the value of accommodation included in his/her gross income. Deductions are also available in respect of public rates, insurance, repairs and maintenance, if these are borne by the employee.

Example

Henry was provided with a house by his employer. The rent paid by the employer for the house is RM30,000 per annum. Henry is required to reimburse 5% of his annual remuneration of RM120,000 as his share of the rent. During 2016, Henry incurred repairs and maintenance costs of RM1,200 which he had to pay out of his own pocket.

For YA 2016, assuming that the defined value of RM30,000 is less than 30% of Henry's s 13(1)(a) remuneration, the value of accommodation assessable on Henry would be:

			RM
Rent paid by employer (defined value)			30,000
		RM	
Less:	5% rent reimbursement	(6,000)	
	Repairs and maintenance	(1,200)	
			(7,200)
			22,800

Law: s 38.

Chapter 9

¶9-290 Cost of clothing

The cost of clothing is not usually allowable as a deductible expense for s 33 purposes since it is not incurred wholly and exclusively in the performance of an employee's duties [*Hillyer v Leake* (1976) 51 TC 90, approved by the House of Lords in *Mallalieu v Drummond* (1983) BTC 380]. Everyone has to wear clothes. Also, it is not possible to apportion expenditure on ordinary clothing, used exclusively at work, between allowable business purposes and non-allowable personal (warmth and decency) purposes (*Hillyer v Leake*).

Two basic considerations apply where claims against employment income, or in fact any non-business income, are made:

- The expenses must comply with the s 33 principle, ie they must be incurred in the production of income. If not, they will not be allowable. The Director General may want to be satisfied as to the relevance of the expenses to the employee's functions.
- The expenses claimed will not result in a loss, since a loss can arise only where a business is concerned. If an employee receives, say, RM2,500 to carry out entertainment activities in line with his duties and actually spends RM2,900, the excess of RM400 would not be a loss; it would simply be disregarded. This is true of all non-business sources — an excess of expenses over income would not be treated as a loss.

DEDUCTIONS FROM PROPERTY INCOME

¶9-300 General

The deductions and allowances which can be set off against income from property are numerous. Income from property includes rents, premiums, royalties and any other gains arising from property.

The Director General takes the general view, and this is open to argument, that if one of several properties does not produce income for reasons of it being vacant or awaiting to be used at a later stage for purposes of earning income, all expenses relating to such property do not qualify for deduction.

Where, however, a taxpayer carries on a business of letting properties, the Director General may, by concession, allow the standing charges, such as property tax, insurance, etc, on the vacant property or properties as deductions against rental income. Any excess of expenditure over income from property cannot be carried forward for set-off against income of future years unless it can be established that the claimant is carrying on a trade or business of letting property.

¶9-305 Interest

The general rule is that interest paid on moneys borrowed for the purpose of carrying on a trade, business or profession is always allowable expenditure against profits. The rule also extends to the interest paid on borrowings used to generate investment income, ie income from property, dividends, etc. Thus, where money is borrowed for acquiring or developing property, the interest may be claimed as a deduction.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

There are normally three conditions that need to be fulfilled if a claim is to be sustained:

- The borrowed money must be exclusively used for purchasing, developing or improving property.
- The loan must relate to the specific property in the case of individuals (employees and professionals) and to the business in the case of traders (dealers, investment companies and property developers).
- The rate of interest must be commercially viable.

There is no restriction on the type of property that has to be purchased with borrowed money. A taxpayer may purchase a private dwelling house, in which case no interest will be allowed. However, where the taxpayer purchases investment property, the interest will be allowed against the rents received.

¶9-310 Repairs and maintenance

The owner of a property which produces income by way of rents is entitled to claim expenses in respect of any repairs and maintenance to such property. There is no fixed sum which is allowable but a claimant often has to support his/her claim by producing repair bills and contract notes should the Director General require these to enable him/her to distinguish repairs and maintenance from additions, improvements and alterations to the property.

¶9-315 Land tax or property tax

Taxes or rates paid to the Government in respect of property are deductible from the income derived from such property as these are considered as annual charges. Where a property, eg a piece of land, is lying vacant, awaiting development, any tax or quit rent paid thereon will be allowable but only to the extent of the income produced from that land. If no income is produced no deduction will be made. Property tax is levied on the gross annual value of a property as determined by the Property Tax Department.

¶9-320 Collection, administrative and management expenses

Such expenses are generally incurred by persons other than individuals. It is not unusual, however, for an individual to own a large number of properties and, for the management of these, to incur such expenses. The deduction of expenses under this heading is often at the discretion of the Director General. The expenses must be reasonable and bear relation to the income if a claim is to be accepted. The type of expenses in question are legal expenses to recover rents, normal collection expenses, annual registration fees, bookkeeping and accountancy costs, audit and secretarial costs, costs of directors' meetings, fees for submission of annual returns, directors' fees, the provision of services such as lifts, garden maintenance, security, etc.

http://www.pbookshop.com

¶9-325 Capital allowances

Where the income from property is deemed to be business income, capital allowances are claimable under Sch 3 (s 42). Where property income falls to be assessed under s 4(d), ie rents, premiums, etc, capital allowances cannot be claimed. In such cases, the cost of replacements may be allowed (see further ¶11-050ff and Item 12 of Public Ruling No 2/2011 on "Income from Letting of Real Property").

Law: s 4(d), 42, Sch 3.

¶9-330 Insurance

An insurance that relates to a property which generates income is admissible and the premiums paid will rank as deductions. The insurance may cover furniture and other equipment which are leased out. It may even extend to loss of rental income.

¶9-335 Payments to terminate tenancy

Compensation paid by a taxpayer to a tenant for loss caused by an early termination of tenancy has been held not to be deductible.

Case law

In the case of *CH & Co (Perak) Sdn Bhd v DGIR* (1989) 1 MSTC 396, the taxpayer was the owner of a building which was leased to several tenants. In order to maximise profits, he decided to lease the whole building to a single tenant. The new tenancy agreement required that the taxpayer hand over vacant possession to the new tenant. In the process of evicting the existing tenants, the taxpayer had to pay one of them compensation for trade fixtures and fittings, and the loss of business. The taxpayer claimed that this sum was deductible as an expense wholly and exclusively incurred in the production of income. This was because the payment was made purely to get rid of the existing tenant in order to increase the taxpayer's gross income. The Revenue disallowed the deduction. The Special Commissioners of Income Tax found that the compensation was a once-and-for-all expenditure on an identifiable capital asset. It was an expenditure of a capital nature and therefore not deductible.

INVESTMENT INCOME EXPENSES

¶9-350 Deductibility of investment income expenses

The Director General takes the view that income from dividends and rents received by persons other than investment companies accrues to such persons without any action on their part; that is to say it accrues automatically. Consequently, no deductions are admitted unless it can be established that the expenditure was laid out in generating the income. Where an overdraft is taken by a taxpayer to finance an income-producing investment, such as stocks and shares, the interest thereon is accepted as a deduction by the Director General. Where the interest paid exceeds the investment income, the excess cannot be claimed against the income from other sources.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

Exempt dividend

Under Sch 6 para 12B of the *Income Tax Act 1967* expenses incurred in relation to single-tier dividends are to be disregarded in arriving at **adjusted income**. With effect from YA 2017, an amendment has been made to para 12B to disregard any deductions in relation to single-tier dividend income in arriving at **chargeable income**. This gives rise to the question as to whether adjusted losses, donations, *zakat* payments, etc, need to be attributed to single-tier dividend income and then disregarded in computing chargeable income. Where this is the case, this will impact companies with business as well as passive sources of income.

¶9-355 Investment companies

Investment companies can broadly be of two types. There are the pure investment companies, commonly known as investment holding companies, whose activities are confined to holding investments and deriving income therefrom. The other type is investment dealing companies which buy and sell investments with the object of making a profit.

The deductions provided in s 33(1) apply to investment companies just as much as they do to normal trading companies. The Director General in practice, however, takes a careful look at all the expenditure charged to revenue accounts particularly in the case of private investment companies. For example, it is not unusual to find private investment companies paying out most of their income in the form of directors' remuneration. Some of the directors may be the wives or children of other directors and the Director General, in such cases, investigates the full circumstances of the payments, ie the types of services rendered, the relationship between the directors, the reasonableness of the charge, etc. Where it is found that the remuneration is not commensurate with the services rendered by the directors, the Director General will disallow the expenditure to the company. It is to be noted that the disallowance will not affect the taxability of the amount in the hands of the recipient director.

Where the company receives exempt income, any expense relating to such income would not be allowable.

Certain basic expenses that investment companies have to incur are deductible. Examples are registration fees, accountancy, audit and secretarial fees, interest on money borrowed for investments, rent of business premises, etc. Provided these outlays are reasonable, no difficulties will arise in establishing a claim.

Where investment dealing companies are concerned, deductions are admitted in respect of expenses incurred on adjusting investment portfolios, professional advice on investments, brokerage and stamp fees on purchase and sales of shares. Such expenses will not be allowed to an investment holding company. Investment dealing companies have a further advantage in that they can carry forward and set off their losses against income from non-trading sources as well as against their trading income of future years.

Law: s 33(1).

TRADING EXPENDITURE

¶9-360 General

Any person engaged in a business, profession or vocation is entitled to deduct all revenue expenses incurred in producing income which is assessable provided such expenditure does not fall within the scope of s 39 of the ITA. Expenditure incurred in producing income which is exempt from tax also qualifies for deduction. Where expenditure is incurred partly for the business and partly for private purposes a reasonable apportionment of the deductible element can be negotiated with the Director General.

Law: s 39.

¶9-365 Remuneration and other rewards for services

Payments to employees are among the prime costs of carrying on a business, profession or vocation and any person engaged in such activity is allowed deductions in this respect. All such payments which relate directly to services rendered by the employee and which are in accord with the service agreement are deductible. The quantum of the payments must be realistic and reasonable. Rewards of service to relatives of the employer can often be far in excess of the type and degree of services rendered and the Director General has the power to disregard such payments or to bring them in line with commercial standards.

Examples of expenses under this heading are salaries, wages, bonuses, gratuities, allowances, payments in lieu of leave or notice, travelling expenses (but not the provision of leave passage), removal expenses, employee's life insurance premiums, cost of food (where it is provided in the course of duty and is not incidental to the entertainment of clients), compensation for loss of office, pensions on retirement from service, damages paid by employer under a contract of employment if such damages are to relieve him/her from making onerous salary payments in future, accident and injury premiums, provident fund contributions, commissions, payments made to secure the retirement of an unsuitable employee and commutation of pensions already granted. It is considered that so long as the reward, by whatever name it is called, is made to an employee for the purpose of producing the income of the employer it would rank for deduction.

¶9-370 Rewards for services not deductible

The following are some of the types of payments made to or on behalf of an employee which are not deductible or can become a subject of serious dispute with the Director General:

- *Ex-gratia* payments or voluntary rewards are non-contractual and unless the Director General is satisfied that it is the claimant's general policy to make such awards and the amounts in question are reasonable, the Director General will resist the claim. The circumstance of each claim are fully considered. The position is the same where ex-gratia payments are made to the dependants of a deceased employee or a retired employee.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

- Payments made to an employee in consideration of an undertaking by him/her not to exercise a similar employment on the termination of his/her service are not deductible. Such payments restrain the employee from performing the same or certain activities for an agreed period of time and/or in a specified location. The view taken is that such outlays are not in the production of the income of the claimant. In substance, such payments are considered to be in the nature of goodwill. The employee, on the other hand, is taxable on such receipts. However, subject to para 15 of Sch 36, he/she may be granted exemption on such amounts. (See ¶7-260.)
- Payments made to employees on the closing down of a business are not regarded as deductible. Such payments are considered as necessary for facilitating the winding up of the business operation rather than as being incurred in the production of the income of the business.
- Where a re-organisation takes place and the activities of one associated company are taken over by another, payments made by the successor company in respect of services rendered by an employee to the previous company are not deductible against the income of the successor company. Examples of such payments are pension payments, contractual payments taken over such as leave pay, leave passages, gratuities, bonuses, etc, and any other compensation payments arising on the takeover.
- Premiums or contributions made for the benefit of an employee to an unapproved provident fund or scheme are not deductible.
- Reimbursement of entertainment expenses and the payment of entertainment allowances are not deductible by the employer (s 39(1)(l)). (See further ¶9-390.)
- Leave passages are not deductible by the employer (s 39(1)(m)).

Law: s 39(1).

¶9-375 Bonuses

Bonus payments whether contractual or voluntary are fully deductible in computing the assessable income of an employer.

The word "bonus" is not defined in the ITA. The courts have held that a bonus is a gratuitous payment over and above the remuneration agreed on. It does not include payments which are contractual and not gratuitous (*DGIR v H&C (M) Sdn Bhd* (1988) 1 MSTC 3,055; *HMP Ltd v DGIR* (1988) 1 MSTC 3,019; *RPM (M) Bhd v DGIR* (1988) 1 MSTC 101).

Payments that are ostensibly contractual, or are described as such, can in fact be bonus payments. For example, additional payments made by a taxpayer to its senior executives and managerial staff under its additional remuneration scheme were held to be bonus payments. The character of the remuneration, which had been payable contingent on the taxpayer making a profit, made it separate and distinct from fixed salary and clearly a bonus (*DGIR v H&C (M) Sdn Bhd*).

Additional payments to a "consultant" based on net profits also constituted bonus (*S Sdn Bhd v DGIR* (1998) MSTC 2,955). Payments to executive staff based on varying percentages of annual net profits have been held to be bonus payments and not commissions (*KH (M) Sdn Bhd v DGIR* (1995) 2 MSTC 3,444). Payments described

http://www.pbookshop.com

CHAPTER 14

THE ADMINISTRATIVE PROVISIONS

Table of Contents

Administration of income tax .... ¶14-050
Administration .... ¶14-100
Self-assessment for companies .... ¶14-123
Self-assessment for other taxpayers .... ¶14-138
Returns .... ¶14-200
The machinery of assessment, tax payment and repayment .... ¶14-300
Offences and penalties .... ¶14-500
Appeals .... ¶14-600
Finality of an assessment .... ¶14-700
Tax agents of a taxpayer .... ¶14-750
Review panel .... ¶14-800
Fund for tax refund .... ¶14-850
Rulings .... ¶14-860
Tax audit .... ¶14-880
Tax investigation .... ¶14-920

http://www.pbookshop.com

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);

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

- 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.

http://www.pbookshop.com

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

The above practice ceased from YA 2014 when all companies are required to submit their return forms by electronic means.

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.

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.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

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*.

The following amendments were also introduced in respect of electronic filing by a company, limited liability partnership (LLP), trust body, or co-operative society:

(a) With effect from YA 2014, s 77A(1A) provides that it is mandatory for a company to submit its tax return form by means of an electronic medium.

(b) Similarly effective from YA 2016, an estimate or revised estimate of tax was to be submitted by electronic means.

(c) Where an employer is company, the employers' return (Form E) also has to be lodged through an electronic medium, with effect from YA 2016.

Law: s 77A.

¶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 2016. The company submitted its tax return for YA 2016 on 31 July 2017.

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 2017.

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.

With effect from YA 2016, it is compulsory for company to furnish CP 204 through e-Filing.

With effect from YA 2019, an LLP, trust body or co-operative society shall furnish the estimate or revised estimate of tax payable via e-Filing.

http://www.mbookshop.com

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 2018. Its basis period for YA 2018 would be from 1 July 2017 to 30 June 2018 (12 months). It would be required to submit an estimate of its tax payable for YA 2018 by 1 June 2017 (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.

Example 3

Company B had a financial year ending 31 December 2017. It commenced operations on 1 February 2017. Its basis period would be from 1 February 2017 to 31 December 2017 (11 months). It would be required to submit an estimate of its tax payable for YA 2017 by 30 April 2017 (ie within three months from the date of commencement of operations).

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.

The IRB has released the "Guidelines on Estimate of Tax Payable under s 107C of the *Income Tax Act 1967*" (No 1/2017) dated 23 February 2017. The guidelines clarify the submission procedures of the Form CP 204 by:

- companies, limited liability partnerships, trust bodies and cooperative societies; and
- companies with paid-up share capital of RM2.5m and below.

The guidelines clarify, among others, the submission procedures, deadlines, payment schedules, appeals and change of accounting period.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

Form CP 204 for small and medium enterprises (SMEs)

In line with the Government's initiative to spearhead economic growth through 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.

http://www.mybookshop.com

Example 4

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.

Quantum of estimated tax payable

From YA 2002 to YA 2005, 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;

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

- 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.

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 on "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 15th day of each month beginning from the second month of the basis period for the year of assessment.

Prior to 1 January 2015, the due date for making payment of monthly instalments was the 10th day of the month.

Example 5

Company C's financial year end was 30 June 2016. Its basis period for YA 2016 was from 1 July 2015 to 30 June 2016.

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 2015.

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 15th day of each month beginning from the sixth month of the basis period for the year of assessment.

Example 6

Company D commenced operations on 1 February 2016 with 31 December 2016 as the financial year end. Its basis period would be from 1 February 2016 to 31 December 2016 (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 2016.

http://www.pbookshop.com

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 7

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. 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 8

	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.

http://www.pbookshop.com

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.

¶14-127 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.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

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).

http://www.pbookshop.com

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.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

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 RM141,144. 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.

However, 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 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.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

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/her 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 s 113(2);
- any increase in tax under s 103, 107B or s 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 or s 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*.]

http://www.pbookshop.com

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/her 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/she 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).

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

¶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.

¶14-135 Section 108 credit as at 31 December 2000

The balance in the s 108 credit as at 31 December 2000 remains as a credit and will be carried forward to YA 2001 and subsequent years of assessment. This implies that there will be two separate s 108 credit accounts maintained to distinguish the new provisions which takes into account dividends distributed based on a basis period instead of a calendar year basis.

The old/existing s 108 credit account may be increased or reduced by an assessment or a revision to any assessment up to YA 2000 (CYB).

If there is a shortfall in the existing s 108 credit account due to tax discharged or repayable up to YA 2000 (CYB), the shortfall will be a debt due to the Government.

The s 108 credit balance will be reduced by the tax deducted from future dividends until the balance is nil.

¶14-136 Single-tier tax system

To simplify and enhance the efficiency of the tax administration system, with effect from YA 2008, the single-tier system was implemented. Under this system, the tax on profits of companies is a final tax and the dividends distributed to the shareholders will be tax exempted in their hands. To cater to companies that had a s 108 balance as at 31 December 2007 and wished to utilise it, a transitional period was provided to operate from 1 January 2008 to 31 December 2013 during which the transitional provisions would apply. With effect from 1 January 2014, all companies are under the single-tier tax system, and any s 108 balance they still might have on that date would be "lost".

However, transitional provisions for resident companies are in place to take into account the following:

- Companies with no s 108 credit balances as at 31 December 2007.

  On 1 January 2008, companies with no s 108 credit balances will automatically move to the single-tier system.

http://www.mbookshop.com

- Companies with s 108 credit balances as at 31 December 2007:
  - Companies with s 108 credit balances as at 31 December 2007 will be given a six-year transitional period from 1 January 2008 to 31 December 2013 to fully utilise the credit balances.
  - These companies will automatically move to the single-tier system on 1 January 2014 although they may still have unutilised credit balances.
  - These companies will be given an option to make an irrevocable election to move to the single-tier system. A company which makes such an election is required to complete a Form R50 and submit it to the IRB's Processing Centre.
  - These companies which have fully utilised the credit balances at any time during the transitional period will automatically move to the single-tier system.
  - These companies will only be allowed to adjust their s 108 credit balances downwards for any tax discharged, remitted or refunded in respect of taxes which have earlier been accounted for.
  - The tax on dividends paid to shareholders by small and medium companies is to be deducted from the s 108 credit balance based on the highest current tax rate.

The following conditions also apply with regard to the claim of tax credit by shareholders:

- Only cash dividends paid on ordinary shares are eligible for tax credit.
- Only direct expenses related to dividend income are allowed for deduction in arriving at adjusted dividend income.
- The statutory dividend income of a company is deemed to be the total income or part of the total income of the company.
- With the exception of dividends received from public listed companies, shareholders who receive franked dividends during the transitional period will only be allowed to claim a tax credit if the shares have been held continuously for 90 days or more from the date of purchase.

Section 45 of the saving and transitional provisions of the *Finance Act 2007* provides that a company is required to furnish a statement of the s 108 account in the prescribed form (Form R31) within 30 days from the date the dividend is paid. However, the following concessions have been given by the IRB:

- companies with a 31 December year end will be exempted from filing the statement in respect of dividends paid during the period between 1 January 2008 to 31 December 2013; and
- companies with a non-31 December year end on or before September 2007 are given an extension of time until 30 April 2008 to file the statement in respect of dividends paid during the period from the first day of the basis period for YA 2008 to 31 December 2007. Companies with October and November 2007 year ends are given seven months from the date of the close of their accounts.

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

Transitional provisions for dividend payment under the single-tier system

For ordinary shareholders, a company is allowed to declare "single-tier" dividends without having to inform the IRB, provided that the s 108 balance has been fully utilised or the company has opted to forgo s 108 balances. The same dividend voucher may be used as long as the dates of payment for the various categories of dividend payment are similar.

If the dividends paid are other than to ordinary shareholders, eg preference shareholders, it will be treated as single-tier dividends and can be declared even though the company still has unutilised balances in its s 108 account or has not set aside the s 108 balances.

SELF-ASSESSMENT FOR OTHER TAXPAYERS

¶14-138 Overview

The *Income Tax (Amendment) Act 2002* was legislated to facilitate the implementation of self-assessment from YA 2004 for:

- individuals;
- partnerships;
- sole corporations;
- trust bodies;
- co-operative societies; and
- executors and administrators of deceased estates.

The key changes made to the ITA are in relation to basis periods, filing of returns and some transitional matters.

(1) Basis period

The basis period for individuals (sole proprietors) and partnerships for a year of assessment will remain as the calendar year. This means that individuals and partners which have business income as a source of income with an accounting period ending on a date other than 31 December would have to amend the basis period in which they make their accounts to the calendar year basis.

Where a person becomes a partner in an existing partnership or partner of a sole proprietor — on a day in the basis year 2002 and 2003, and that day falls in an accounting period ending in the basis year 2003 — then, the day the person becomes a partner to 31 December 2003 will be the basis period for YA 2003.

The basis period for trust bodies and co-operative societies is the accounting period applicable to such bodies.

(2) Filing of tax returns

The due date for the filing of tax returns for individuals and partnerships for a particular year of assessment is 30 April of the following year as opposed to 30 days from the date of issuance of the Return Form. With effect from YA 2004, the tax filing deadline was extended to 30 June for those carrying on businesses such as sole proprietorships, partnerships, clubs, associations and Hindu joint families.

http://www.pbookshop.com

In addition, where an individual does not have chargeable income for the year but has submitted a tax return in the previous year, he/she is still required to file a tax return unless specifically exempted by the IRB. New arrivals are required to submit a notice of chargeability within two months of arrival.

From YA 2014, an employee from whose remuneration monthly tax deductions had been made and who fulfils certain other conditions may elect not to submit his/her return form.

See ¶1-500 and ¶1-900.

Trust bodies and co-operatives must submit their tax returns within seven months from the closing date of accounts.

An estimate of tax payable is not required to be furnished if the basis period in which the company (non-SME), trust body or co-operative commences operations is less than six months.

(3) Notice of assessment

In line with the self-assessment system, the taxpayer will be deemed to have been served a notice of assessment on the day he/she submits his/her tax return to the IRB.

(4) Tax payments

Any tax payable/balance of tax payable not covered by an instalment scheme or schedular tax deductions will be payable by 30 April of the following year for individuals.

With effect from YA 2004, the due date for sole proprietorships, partnerships, clubs, associations and Hindu joint families will be 30 June in the year following the year of assessment. The due date for trust bodies and co-operative societies will be the last day of the sixth month (seventh month with effect from YA 2004).

(5) Estimate of tax payable

The LLPs, trust bodies and co-operative societies are required to furnish an estimate of tax payable. With effect from YA 2019 pursuant to s 107C(7A), an LLP, trust body or co-operative society also are required to furnish the estimate or revised estimate of tax payable via electronic filing.

For the quantum of estimate tax payable, see ¶14-124.

An estimate of tax payable is not required to be furnished if the basis period in which the company (non-SME), trust body or co-operative commences operations is less than six months.

Law: s 107C(3); *Income Tax (Amendment) (No 2) Act 1999*; *Income Tax (Amendment) Act 2000*; *Income Tax (Amendment) Act 2002*; *Finance (No 2) Act 2002*.

¶14-140 The Special Commissioners and their powers

The appointment of the Special Commissioners is made by the Yang di-Pertuan Agong (the King). There are at least three such Commissioners and to them is attached a Clerk who holds a federal public office. It is necessary that the Special Commissioners include persons with judicial experience. An appeal must be heard by at least three Special Commissioners. The Yang di-Pertuan Agong may appoint from

© 2018 Commerce Clearing House (Malaysia) Sdn Bhd

among those persons a Chairman or Deputy Chairman to preside at the hearing of an appeal. If the Chairman or Deputy Chairman has not been appointed or is not present at the hearing of the appeals, the Special Commissioners present at the hearing of the appeals may choose one of their number who shall be a person with legal experience to preside at the hearing.

The Special Commissioners have the following powers:

- the power to summon any person to attend the hearing of an appeal and to give evidence;
- the power to examine the person summoned as a witness on oath or otherwise;
- the power to require such a person to produce any books or documents which may be in his/her custody;
- the power to allow such a person any reasonable expenses incurred by him/her in attending the appeal;
- generally, all the powers of a subordinate court with regard to the enforcement of attendance of witnesses, hearing evidence on oath and punishment for contempt;
- the power to admit or reject any evidence, whether oral or documentary;
- the power to postpone or adjourn the hearing of an appeal.

Schedule 5 of the ITA deals with appeals and covers the following:

- hearing of appeals;
- place of sitting;
- place and date of hearing;
- scope of argument;
- onus of proof;
- representation and attendance;
- powers of Special Commissioners;
- procedures;
- deciding orders;
- vexatious and frivolous appeals;
- costs and fees; and
- further appeals.

To encourage judicial flexibility, Sch 5 para 1(3) has been amended and para 1A, which provides for concurrent hearing of appeals before the Special Commissioners, has been included. The following procedures will be taken into consideration:

- Two or more hearing of appeals before the Special Commissioners may be held concurrently at any one time.
- If the Chairman of the Special Commissioners is presiding at the hearing of one of the appeals or has not been appointed or is not present, the Special Commissioners present at the hearing of the appeals may choose any one of themselves to preside at the hearing of the appeals.