



INLAND REVENUE BOARD OF MALAYSIA

**PARTNERSHIPS TAXATION
PART I – DETERMINATION OF THE
EXISTENCE OF A PARTNERSHIP**

PUBLIC RULING NO. 7/2021

Translation from the original Bahasa Malaysia text

DATE OF PUBLICATION: 29 DECEMBER 2021



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Published by

Inland Revenue Board of Malaysia

First edition

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DIRECTOR GENERAL'S PUBLIC RULING

Section 138A of the Income Tax Act 1967 (ITA) provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

**Director General of Inland Revenue,
Inland Revenue Board of Malaysia.**

1. Objective

The objective of this Public Ruling (PR) is to provide an explanation on the determination of the existence of a partnership for income tax purposes.

2. Relevant Provisions of the Law

2.1 This PR takes into account laws which are in force as at the date this PR is published.

2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are sections 2 and 20, subsections 19(6), 70(2), 86(1) and 86(3) and paragraphs 4(a) and 4(b).

3. Interpretation

The words used in this PR have the following meaning:

3.1 “Partnership” means an association of any kind (including joint adventures, syndicates and cases where a party to the association is itself a partnership) between parties who have agreed to combine any of their rights, powers, property, labour or skill for the purpose of carrying on a business and sharing the profits therefrom, but excludes a Hindu joint family although such a family may be a partner in a partnership, a limited liability partnership and any associations which is established pursuant to a scheme of financing in accordance with the principles of Syariah.

3.2 “Business” includes profession, vocation and trade and every manufacture, adventure or concern in the nature of trade, but excludes employment.

3.3 “Individual” means a natural person.

3.4 “Person” includes a company, a body of persons, a limited liability partnership and a corporation sole.

3.5 “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.

3.6 “Body of persons” means an unincorporated body of persons (not being a company), including a Hindu joint family but excluding a partnership.

3.7 “Year of assessment” means calendar year.

3.8 “Basis year” means the calendar year coinciding with a year of assessment.

4. Introduction to a Partnership

- 4.1 A partnership is generally is an agreement of two or more persons to carry on business in common with a view of profit. A partnership in Malaysia is required to be registered under Registration of Businesses Act 1956 which is regulated by the Companies Commission of Malaysia (CCM).
- 4.2 Although a partnership is a legal relationship, it is not recognised in law as a separate legal entity as a partnership is not distinct from its partners who constitute it. In Malaysia, the business profits of a partnership are not taxed at the partnership level but is taxed in the hands of each partner based on his share of income from the partnership at the relevant tax rate.

5. Characteristics of a Partnership

Characteristics of a partnership are based on its interpretation in accordance with the Partnership Act 1961 and the ITA as follows:

5.1 Characteristics of a partnership according to Partnership Act 1961 (PA)

- 5.1.1 A partnership is defined as “the relationship which subsists between persons carrying on business in common with a view of profit”. An agreement to a partnership can exist orally, or in writing by way of a formal deed. However, an agreement alone is not sufficient to constitute a partnership as there must be an engagement by the partners in carrying on a business in common with a view to profit.
- 5.1.2 A partnership is an association between a minimum of two (2) but not more than twenty (20) persons as this would contravene section 13 of the Companies Act 2016 (CA). The persons who formed a partnership are individually called partners and collectively called a firm. The name under which the business of the partnership is carried on is called the firm name.
- 5.1.3 Partners in a partnership must be carrying on a business in common. Business includes every trade, occupation, or profession. Business in common is the engagement of partners with the same purpose, sharing rights and responsibilities in the partnership business. If there is only an intention of the partners to start a business or doing preliminary actions without actual engagement of the partners, this does not necessarily constitute a partnership.
- 5.1.4 In the carrying on a business in common, there must be a view of making profits. In order to constitute a partnership, partners must have agreed to carry on a business where there is a sharing of business profits and

losses. With that, a mere sharing of a business' gross income or expenses i.e. not at level of sharing profits or losses, does not constitute a partnership.

5.1.5 Certain association is excluded within the meaning of a partnership that is if the relation between members of any company or association which is -

- (a) registered as a company under the CA or as a co-operative society under any written law relating to co-operative societies; or
- (b) formed or incorporated by or in pursuance of –
 - (i) any other law having effect in Malaysia or any part thereof; or
 - (ii) any letters patent, Royal Charter or Act of the Parliament of the United Kingdom.

For examples charitable or religious organisations, clubs, societies, co-operatives, shareholders in a limited company or a member of an association if formed under any Act of Parliament as well as mutual benefit organizations and building societies are not considered as a partnership.

5.2 Income Tax Act 1967 (ITA)

Section 2 of the ITA defined partnership as –

- (a) an association of some kind between persons to engage in a business;
- (b) an agreement (expressed or implied) between the persons to combine their rights, powers, property, labour or skill for the purpose of carrying on a business;
- (c) an agreement (expressed or implied) between the persons who have an objective to make and share the profits from the carrying on of a business;
- (d) includes joint adventures, syndicates and cases where a party to the association is itself a partnership;
- (e) excludes the following -
 - (i) a Hindu joint family although such a family may be a partner in a partnership;
 - (ii) a limited liability partnership; and
 - (iii) any association which is established pursuant to a scheme of financing in accordance with the principles of Syariah such as a partnership established under the Musyarakah Mutanaqisah financing scheme.

6. Existence of a Partnership

The determination of the existence of a partnership is a question of law based on the facts of each case.

6.1 Factors to determine the existence of a partnership

To determine whether a partnership exists regards shall be made to the following rules:

- (a) Co-ownership (joint tenancy, tenancy in common, joint property, common property, part ownership) by two or more persons does not of itself create a partnership whether as to anything so held or owned, and whether they do or do not share any profits made by the use thereof;

For example, a husband and wife who jointly own a unit shop does not in itself give rise to a partnership even though the couple conducted their business activities on the property.

Co-ownership consists of joint ownership, ownership in common and part ownership which are defined as follows:

- (i) Joint ownership means each owner obtains an equal share of a right to the same deed, vested at the same time, interests, possession and the right of survivorship in the asset. Upon the death of an owner, the deceased's interest gets transferred to the remaining surviving joint owners.
 - (ii) Ownership in common is whereby two (2) or more persons may own an unequal share, interest and possession or the deed is vested at different times even though each person owns a share of the entire asset. However, there is no right of survivorship in the ownership in common and an owner may transfer his share in the asset to another person that will be the new owner in the ownership in common.
 - (iii) Part ownership refers to owners who divide what is obtained by the use of their shares in the property owned. For example, two (2) owners in common of a house rent it out to a third party and the income received is divided between both of them. They are not considered partners although they may pay for repairs out of the income before dividing it.
- (b) The sharing of gross returns does not of itself create a partnership, whether the persons sharing such returns have or have not any right or interest in any property from which or from the use of which the returns are derived;

For example, Swee Lin who owns a theatre and Xiao Zhang who manages the performances held at the theatre, had agreed to share the proceeds from tickets sold, do not constitute a partnership.

- (c) The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but the mere receipt of such a share, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business; and in particular -

- (i) the receipt by a person of a debt or other liquidated amount, whether by instalments or otherwise, out of the accruing profits of a business does not of itself make him a partner in the business or liable as such;

A partnership does not exist where a person assigns to his creditor his land to run a business and the profits from the business are used to pay the creditor.

- (ii) a contract for the remuneration of a servant or agent of a person engaged in the business by a share of the profits of the business does not of itself make the servant or agent a partner in the business or liable as such;

An employee who receives salary from his employer, the relationship of master and servant subsists, hence no partnership exists.

Observation

The definition of 'business' in the PA includes occupation, that could mean an employment, but the definition of 'business' in the ITA excludes employment.

- (iii) a person being the widow or a child of the deceased partner, and receiving by way of annuity a portion of the profits made in the business in which the deceased person was a partner, is not, by reason only of such receipt, a partner in the business or liable as such;

A widow who received a share of profits of the deceased partner is not considered a partner in a partnership.

- (iv) an advance of money by way of a loan to a person engaged or about to engage in any business on a contract with that person that the lender shall receive a rate of interest varying with the profits, or shall receive a share of the profits, arising from carrying on the business, does not of itself make the lender a partner with the person or persons carrying on the business or liable as such, provided that the contract is in writing, and signed by or on behalf of all the parties thereto; and

For example, based on a written contract, Yong agrees to provide an advance to Joshua and in return Yong will be paid an interest equivalent to RM10 on every RM1,000 of Joshua's business profits, does not make Yong and Joshua partners.

- (v) a person receiving, by way of annuity or otherwise, a portion of the profits of a business in consideration of the sale of the goodwill of his business, is not, by reason only of such receipt, a partner in the business or liable as such.

Sanusi sold his business Restu Enterprise including the goodwill of the business to Arif. He introduces Arif to the existing customers of Restu Enterprise and received a portion of business profits of Restu Enterprise as a consideration of the sale of the goodwill does not make them partners.

6.2 Consideration of facts in determining the existence of a partnership

The interpretation of a partnership is a question of law. The mutual relation between the parties as evidenced by their methods of carrying on a business is a question of fact. The following questions may help indicate the existence of a partnership:

- (a) whether there is a formal partnership agreement i.e a deed of partnership;
- (b) whether the partnership is registered with any appropriate body such as the CCM, Malaysian Institute of Accountants, Malaysian Institute of Certified Public Accountants, etc.;
- (c) whether the terms of the deed of partnership indeed followed – the mere existence of a deed of partnership is evidence but is not conclusive;
- (d) how are profits shared i.e. the basis of dividing the profit and loss of the partnership, who is entitled to the share, and who is responsible for the losses;
- (e) the bank account of the partnership is in whose name, who are the persons who have the authority to make withdrawals from the bank account, who are the cheque signatories and whether there are any limitations imposed on a particular signatory;
- (f) what are the names shown on the partnership's business letterhead, its trade premises, in the trade directories and in the register of the CCM;
- (g) whether creditors are aware that a partnership exists;

- (h) what arrangements are in force in respect of the partners' remuneration (if any), share of profits and drawings;
- (i) what title does each individual partner have in respect to the assets of the business;
- (j) what is the position on dissolution of the partnership or upon the death of a partner;
- (k) what capital (if any) has each individual partner contributed and what is the interest rate allowable to that partner;
- (l) how is each individual partner's interest dealt with in the books and accounts of the partnership;
- (m) does an individual claiming to be a partner actually exercise the rights and duties of a partner or does he act as a principal (someone with executive authority) or an employee.

6.3 Co-ownership and partnership

A co-owner of property (eg. building or land) may not necessarily be a partner. The main distinction between a co-ownership and a partnership are as follows:

Items	Co-ownership	Partnership
Agreement	An agreement may not necessarily result in co-ownership of a property.	A partnership is bound by the terms of written or oral agreement between partners.
Sharing profit and loss	Terms of co-ownership may not involve profit and loss.	Sharing of profit / loss is a characteristic of a partnership and it involves carrying on of a business.
Transfer of interest	A co-owner can transfer his interest with or without the consent of the other co-owners.	Transfer of interest of a partner depends on the deed of the partnership. A partner cannot transfer his interest without the knowledge or consent of all other partners.
Agent	A co-owner does not have the authority to bind other co-owners.	A partner is an agent, whether express or implied, of the other partners.

Lien (legal right)	A co-owner has no lien on the property co-owned, for expenses, or for what may be due from others as their share of a common debt.	A partner has a lien on anything owned in common, for outlays or expenses, or for what may be due from others as their share of a common debt.
Right to divide property	A co-owner can claim partition of property owned between himself and other co-owners.	A partner has no right to partition in specie and on dissolution of a partnership, he may take legal action for his share in the partnership property.
Purpose of existence	The purpose of co-ownership is not necessarily to generate a profit or gain.	The purpose of forming a partnership is to generate profits or gains to be shared among its partners.

6.4 Deed of partnership

- (a) Usually a deed of partnership is drawn up, but the deed by itself does not automatically show that a partnership exists. The mere existence of a deed of partnership does not create a relationship between the partners. If the terms of the agreement have not been carried on and put into effect, there is no relationship and a partnership does not exist.
- (b) A deed of partnership is drawn up to define the rights, duties and interests of the partners and includes the following:
- (i) the amount of capital to be contributed by each partner;
 - (ii) the agreed division of profits and losses;
 - (iii) the agreed arrangements as to partner's drawings;
 - (iv) the remuneration (if any) to be paid to the partners;
 - (v) the interest (if any) to be allowed to each partner in respect of his capital, or to be charged on his drawings;
 - (vi) the provisions for preparation of annual audited accounts.
- (c) A deed of partnership has effect only from the date of its execution. It may have a fixed period or indefinite period. A "partnership at will" is where the partners have not agreed to remain partners until the expiration of a definite

term or the completion of a particular undertaking. This means that the partnership can be dissolved by any partner at any time without any liability.

- (d) The absence of a formal deed of partnership or partnership agreement to indicate that two or more persons intend to form a partnership to carry on a business in common, does not mean a partnership does not exist. A partnership may exist if the partners can establish there is a legal relationship to carry on a business for the purpose of making profits even though such partners never intended for such a relationship to exist. In the absence of a deed –
- (i) the partners are usually entitled to equally share in capital, profits and losses;
 - (ii) the partners are not usually entitled to salaries, nor interest on capital;
 - (iii) all the partners may take part in the management of the partnership.

6.5 Joint ventures

Generally, a joint venture is not deemed a partnership. There is a distinction between a joint venture and a partnership. Only when a joint venture has the basis of a partnership, then in such circumstances would a joint venture be considered a partnership. Where a joint venture is formed for a limited term or for a single undertaking and if the parties agree to share gross revenue and expenses rather than sharing profits, the joint venture would likely not constitute a partnership.

6.6 Examples of analysis in determining whether there is the existence of a partnership

Example 1

JJM Developer Sdn. Bhd. (the company) identified a piece of land for the development of shophouses but did not have the necessary funds to purchase the said land. The company made an arrangement with Yazid, where Yazid would purchase the said piece of land for the development and the company would be paid 50% of the net profits after the completion of the project. In addition, the company agreed to assist in the project and share in the losses incurred (if any). Both Yazid and the company agreed that they did not intend to form a partnership and their arrangement is not considered a partnership.

Based on the facts of the case, a partnership is deemed to exist as both the company and Yazid agreed to share the business profits and losses. These would fulfil the characteristics of a partnership even though both parties disclaimed their intention and arrangement to form a partnership.

Example 2

Anthony and Benjamin are jointly engaged in the business of producing and selling beauty products under the firm's name Ant & Ben. Each of them contributed RM50,000 to start up the business. There was no deed of partnership signed and the business was not registered with the CCM. Both of them agreed to equally share the profits and losses of the business and maintain a bank account in their joint names where both are signatories.

Based on the facts of the case, Ant & Ben is deemed to be partners of a partnership as -

- (a) both Anthony and Benjamin agreed to an equal share of the profits and losses even in the absence of a signed partnership agreement or deed of partnership;
- (b) both contributed capital to start off the business; and
- (c) a joint bank account was maintained with both of them as signatories.

Example 3

Xavier and Yvonne commenced a transport business under the name Cergas Transport Services. It was agreed that –

- (a) Xavier would provide the capital needed to set up the business and Yvonne would oversee the operations of the business;
- (b) Yvonne is to be paid a fixed monthly salary and would receive 20% of the net profits (if any) as an incentive or bonus after deducting operating expenses whereas Xavier would receive the balance of the profits. Losses of the business would not be borne by Yvonne.

Based on the facts of the case, a partnership does not exist as –

- (a) there is no sharing of profits and losses of the business between Xavier and Yvonne;
- (b) the 20% of net profits (after deducting operating expenses, if any) given to Yvonne is not within the meaning of sharing profits (or losses) but an incentive scheme;
- (c) Yvonne is paid a fixed salary, the relationship of master and servant subsists; and
- (d) Xavier is the sole proprietor of the business and Yvonne is an employee.

Example 4

Axcell Sdn Bhd, a steel company and Berimbun Sdn Bhd, a timber company entered into an agreement with Comforture Sdn Bhd, a furniture manufacturer to produce and sell furniture. Axcell Sdn Bhd and Berimbun Sdn Bhd would supply steel and sawn timber respectively to Comforture Sdn Bhd for the furniture manufacturing business. It was formally agreed that the profits and losses from the sale of the furnitures would be shared equally among the three companies.

Based on the facts of the case, a partnership exists as –

- (a) there is an association of the three companies;
- (b) all the three companies combined their rights, power, property, labour and skill for the purpose of carrying on a business; and
- (c) there is an equal sharing of profits and losses among the three companies.

Example 5

A consortium is formed between Zoux Pte Ltd, a foreign company and Yusheng Sdn Bhd to undertake a construction project in Malaysia. Each party would be required to perform certain functions as stipulated in their contract with the State Government. All income and expenses are reflected in the consortium's accounts. At the end of the contract, the profit of the consortium will be allocated based on the agreed ratio i.e 49% for Zoux Pte Ltd and 51% for Yusheng Sdn Bhd.

Based on the facts of the case, a partnership exists as –

- (a) both companies have agreed on their share of profits at a ratio of 49% and 51% when they signed the contract with the State Government; and
- (b) all income and expenses from the project are accounted for in the consortium's account.

Example 6

A property developer entered into an agreement with Khairil, a land owner to develop 60 units of low rise luxury apartments on the land. Based on the agreement –

- (a) Khairil is the registered owner of the land and would grant a power of attorney to the developer to develop the land;
- (b) In return, Khairil would receive 25 units of the completed apartments; and
- (c) all development expenditures are to be borne by the developer who will receive the balance 35 units of the completed apartments.

Based on the facts of the case, a partnership does not exist as –

- (a) there is no sharing of business profits and losses between the developer and Khairil;
- (b) allocation of income is at the gross income and not at profits as Khairil receives 25 units of the apartments by merely exchanging of his land and the developer receives 35 units for developing a total of 60 unit apartments; and
- (c) there are no partnership accounts but the accounts are maintained by the developer who bears all development expenditures.

Example 7

Destar Sdn Bhd and Fukurama Sdn Bhd entered into an agreement to jointly submit a tender for a construction project and were successful in obtaining the contract. The terms of the agreement are -

- (a) the contract sum is to be divided equally between the two parties;
- (b) each party would carry out their responsibilities based on the scope of work that has been clearly stipulated in the agreement i.e. Destar Sdn Bhd is to supply all the raw materials and assets whereas Fukurama Sdn Bhd would supply professional and skilled manpowers; and
- (c) the expenditures incurred by each party in accordance to the agreement would be borne by each of them respectively.

Based on the facts of the case, a partnership does not exist as –

- (a) there is no sharing of business profits and losses between the parties;
- (b) the sharing of contract sum is at the gross income level; and
- (c) there is no business in common as each party bears its own cost of supplying the raw materials and provides manpowers respectively.

Note: Partnership does not exist even if the tenderers may be held jointly and severally liable for any defects.

7. Types of Partners

According to subsection 19(6) of the ITA, a person is not a partner in a partnership if he does not personally engage in carrying on the partnership business. Generally, partnerships would have different types of partners but for partner taxation purposes, it is important to differentiate these types of partners in a partnership.

7.1 Active partner

Is also known as a working partner or full partner, who is actively involved in the business and management of the partnership. The income of an active partner

from the partnership is to be taxed under paragraph 4(a) of the ITA as an income from a business source.

7.2 Salaried partner

- (a) A salaried partner is a partner in a partnership who would receive a fixed salary with or without a commission or share of profit but does not share in the losses of the partnership. Normally a salaried partner does not have any right in the partnership's goodwill or to direct the partnership.
- (b) Whether a salaried partner is actually a partner in a partnership is a question of fact i.e. it depends on the facts of each individual case. If in the partnership itself he is merely an employee, his income from the partnership is to be taxed under paragraph 4(b) of the ITA.
- (c) Hence, for taxation purposes, a salaried partner is not regarded as a full partner and his admission to or retirement from the partnership does not result in a change of the partnership.

7.3 Inactive partner

Also known as a sleeping or dormant partner, does not participate in the conduct of a partnership business. He merely receives a share of the partnership profit through his capital contribution. The income of an inactive partner from the partnership is to be taxed under paragraph 4(a) of the ITA.

7.4 Limited partner

A limited partner merely subscribes a fixed amount of capital for the partnership. He does not take part in the management of the partnership business and has no power to bind the partnership. For purposes of determining the share of profit or loss of a limited partner, he is treated in the same manner as an active or full partner. Thus, the income of a limited partner from the partnership to be taxed under paragraph 4(a) of the ITA.

7.5 Corporate partner

Corporate partner refers to a company who could be an active or a limited partner in a partnership. Partners of a partnership may consist purely of companies. The income of a corporate partner from the partnership is to be taxed under paragraph 4(a) of the ITA.

7.6 Precedent partner

A precedent partner under paragraph 86(1)(a) of the ITA is the partner who, being an acting partner present in Malaysia:

- (a) is the first named in a partnership agreement; or

- (b) if there is no partnership agreement, is specified by name or initial singly or with precedence to the other partners in the usual name of the firm.

8. Partnership Accounts

The accounts of a partnership business are normally kept along the same lines as the accounts of a sole proprietorship except for the following:

- (a) Separate capital and drawing accounts are kept for each partner. Where a partner's capital or drawings account is overdrawn, instead of being credited with interest, he is debited with interest, any corresponding credit to profit and loss account must be deducted in the income tax computation;
- (b) At the end of each accounting period, the net profit or loss is apportioned in accordance with the profit sharing ratio as per the deed of partnership. The share of each partner is transferred to the partner's capital or drawing account;
- (c) If a partner is entitled to remuneration, profit and loss account is debited and the partner's drawing account is credited;
- (d) When interest is allowed on partners' capital, profit and loss account is debited and the relevant capital account (or drawings account) credited;
- (e) Conversely, when interest is charged on overdrawn capital, profit and loss account is credited and the relevant capital account (or drawings account) debited.

It is to be noted that partners' remuneration and interest on capital are appropriations of the partnership profits, and not expenses of the business. Such items that are debited into the profit and loss account is to be disallowed in computing the provisional adjusted income of the partnership.

9. Filing of Income Tax Return Form

The profits of a partnership business are not taxed at the partnership level. Although a partnership is not a taxable person, all partnerships are required to file an Income Tax Return Form (Form P) annually. By virtue of subsection 86(1) of the ITA, Form P for each year of assessment is to be submitted to the Director General of Inland Revenue not later than 30 June in the year following a year of assessment.

9.1 The responsibility to file in the Form P lies with -

- (a) the precedent partner of the partnership; or

(The precedent partner is also responsible for issuing the Apportionment of Partnership Income in Form CP30 to each and every partner. The Form

CP30 has to be provided to each partner to enable them to declare their partnership income within the stipulated period.)

- (b) any attorney, agent, manager or factor of the partnership in Malaysia if there is no acting partner present in Malaysia.

9.2 Partnership dissolved

According to subsection 86(3) of the ITA, if a partnership has been dissolved as to all its partners, the persons who were partners of the partnership immediately before the dissolution would be deemed to continue to be partners for the purpose of filing the Form P in relation to the dissolved partnership.

10. Disclaimer

The examples in this PR are for illustration purposes only and are not exhaustive.

This PR should be read together with PR No. 8/2021 titled Partnerships Taxation Part II – Computation And Allocation Of Income.

**Director General of Inland Revenue,
Inland Revenue Board of Malaysia.**