

1. **Proposed Amendment to Section 15A of Income Tax Act - Withholding Tax On Services**

The 2003 Budget proposed that an amendment be made to Section 15A of the Income Tax Act, 1967 (ITA) so that payments made in consideration of services rendered under paragraph (a) [in connection with the use of property or rights or installation of plant and machinery] and paragraph (b) [in connection with technical management of administration] are deemed to be derived from Malaysia if the services are performed in Malaysia. The proposed amendment is effective from 21 September 2002.

The professional bodies would like to seek clarification on the following matters :

- i. Whether the effective date, 21 September 2002 refers to:
 - a. the date when the services are performed;
 - b. the date when the invoice for the services rendered is issued, or
 - c. the date of payment for the services rendered.

IRB confirmed that as Section 15A of the ITA is being amended (and not Section 109B), the effective date of 21 September 2002 refers to the date when the services are performed.

- ii. In respect of a contract for services where the services are partly performed in Malaysia and partly outside Malaysia, what would be the method acceptable to the IRB in determining the amount attributable to services performed in Malaysia?

IRB informed that where part of the services are performed in Malaysia and part of it outside Malaysia, the amount attributable to the services performed in Malaysia would be based on the value of services rendered as per the contract.

In this respect, taxpayers are advised to specifically indicate in the contract the :

**value of services rendered in Malaysia; and
value of services rendered outside Malaysia.**

IRB further indicated that if this is not possible, the apportionment of the value should be done on a fair and reasonable basis.

- iii. Pursuant to the amendment to Section 15A of the ITA, payments made to non-residents for the onshore portion of the services rendered under section 4A(i) and (ii) of the ITA are deemed to be derived in Malaysia and payments made to non-resident for the offshore portion of the services rendered will no longer be subject to withholding tax under Section 109B of the Income Tax Act. Consequently, where a non-resident is deemed to have a permanent establishment in Malaysia, payments made to the non-resident for the offshore portion of the services rendered shall not be deemed to be income derived from Malaysia. Accordingly, such payments shall not be subject to withholding tax under Section 109B of the Income Tax Act.

The professional bodies would like to seek the IRB's confirmation that this view is correct.

IRB clarified that the proposed amendment to Section 15A of the ITA shall not affect the determination of the profit attributable to a permanent establishment. The normal approach would apply i.e. all income attributable to a permanent establishment is taxable whether the services are rendered onshore or offshore. The proposed amendment to Section 15A only applies to income chargeable to tax under Section 4A of the Income Tax Act, 1967.

- iv. Since the proposed amendment to Section 15A has not yet been passed by Parliament, should the payer continue to deduct withholding tax until the legislation is gazetted?

The professional bodies suggest that the IRB exercise its administrative powers under the proviso to Section 109B(1) of the ITA to allow the payer to pay or credit the payments due to non-residents without deduction of tax. This is to avoid unnecessary paperwork on the part of the non-residents in submitting claims for refund of the withholding tax when the proposed amendment to Section 15A becomes law.

In view of the need to avoid the situation where withholding tax is deducted and then refunded, IRB agreed that administratively,

- a. **no withholding tax needs to be deducted for payments to non-residents for services rendered abroad which would not be subject to withholding tax under the 2003 Budget Proposals.**
- b. **withholding tax for non-resident contractors shall be deducted based on the new rates as proposed in the 2003 Budget i.e. 10% for the non-resident entity and 3% for its non-resident employees.**

with effect from 21 September 2002

2. Option for Pioneer Status Companies to Qualify for Reinvestment Allowance

The 2003 Budget proposed that a pioneer status company which intends to undertake reinvestment before the expiry of its pioneer status be eligible for reinvestment allowance, on condition that the pioneer status is surrendered for cancellation. The professional bodies would like to seek clarification on whether a company in the following situation is eligible to claim reinvestment allowance:-

The company has claimed reinvestment allowance for 5 years and was granted pioneer status for a new product for year 6 to year 10. Would the company be eligible for reinvestment allowance for year 11 to year 15?

IRB informed that the reinvestment allowance would be available. However, a company cannot claim two different incentives in a particular year of assessment.

IRB further informed that in line with the 2003 Budget Proposals, the provisions in the Promotion of Investments Act (PIA) will be amended accordingly.

Further, the Malaysian Industrial Development Authority (MIDA) will also issue a guideline pertaining to this matter.

3. Incentive to Acquire a Foreign Company

The 2003 Budget proposed that a locally owned company that acquires a foreign owned company abroad be granted an annual allowance of 20% of the acquisition cost for a period of 5 years for the following purposes:

- a. to acquire high technology for production within the country; or
- b. to gain new export markets for local products.

The Institute would like to seek clarification on the following matters:

- i. The term "high technology" is not defined. It is unclear what types of industries would qualify for the incentive. For example, would utility companies with plants for water treatment or power generation be considered as "high technology industries" since the level of technology employed by these industries can be very high.

- ii. The term "locally owned company" is not defined. It is unclear whether a prescribed quantum of equity interest held by the local shareholders is required.
- iii. What is the minimum quantum of equity interest in a foreign company that must be acquired in order to qualify for the incentive?
- iv. Is the annual allowance granted as a deduction in arriving at adjusted income or in the form of capital allowance?

IRB informed that MIDA will issue guidelines on this new incentive.

IRB indicated a "locally owned company" could be a company which is 60% owned by local. The minimum quantum of equity to be acquired could be more than 50%. (These will be covered in MIDA's guidelines)

IRB further confirmed that the incentive will be granted as a deduction in arriving at adjusted income.

4. Incentive for Operational Headquarters Companies

The 2003 Budget proposed that an approved Operational Headquarters company (OHQ) be exempted from income tax for 10 years and that dividends paid from the exempt income be exempted from tax in the hands of shareholders. The proposal is effective for applications received by the Malaysian Industrial Development Authority (MIDA) from 21 September 2002.

The Institute would like to seek clarification on the following matters:

- i. The Finance (No. 2) Bill 2002 proposed that Section 60E of the ITA be deleted. This means that when the Bill is enacted, there will no longer be any provisions in the ITA to deal with the tax treatment of OHQ companies.

The professional bodies would like to seek confirmation that pursuant to the proposed amendment to the ITA, the existing approved OHQ companies will migrate from the current concessionary tax rate of 10% to full exemption when the Bill is enacted. If the above is affirmative, the professional bodies would also like to seek clarification on whether the existing approved OHQ companies would be granted full tax exemption for the remaining portion of the 10 year period from the date the OHQ status was approved or they would be entitled to full tax exemption for 10 years from YA 2003.

The professional bodies suggest that existing OHQ companies should be entitled to enjoy the full benefit of the new tax incentive, i.e. be granted full tax exemption for 10 years from YA 2003 so as to discourage them from withdrawing their operations from Malaysia.

IRB clarified that an exemption order under Section 127 of the ITA will be issued to stipulate the exemption and the conditions for an OHQ company.

IRB confirmed that full tax exemption is extended to existing OHQ companies. However, the companies may be required to reapply for the additional five years.

IRB informed that application for OHQ status can continue to be submitted to MOF until MIDA takes over eventually.

- ii. The professional bodies would like to further confirm that the above incentive is applicable for both qualifying and non-qualifying services rendered by the OHQ.

IRB confirmed that the above incentive is applicable to qualifying services only.

- iii. The professional bodies also suggest that in respect of new OHQ companies, the proposed incentive should be available for applications for OHQ status which have been recently approved by MIDA, and not applications received by MIDA, from September 21, 2002.

IRB indicated that the above suggestion shall be referred to MIDA or MOF.

5. Incentives for Strategic Knowledge-Based Economy

The 2003 Budget proposed that the following tax incentives be given to companies which invest in knowledge intensive activities:

- a. Companies granted "Strategic Knowledge-based Status" be given the following tax incentives:
 - (i) Pioneer status with tax exemption of 100% of statutory income for a period of 5 years; or
 - (ii) Investment tax allowance of 60% on the qualifying capital expenditure incurred within 5 years with the allowance deducted for each year of assessment to be set-off against 100% of statutory income.

- b. Expenditure incurred by a company for drafting the individual Corporate Knowledge-based Master Plan be allowed as a deduction in the computation of income tax. The deduction is to be claimed when the company begins to implement the Corporate Knowledge-based Master Plan.

The professional bodies suggest that :

- i. More detailed guidelines on the criteria for qualifying as a "Strategic Knowledge-based Status Company (SKSC)" be provided.

IRB informed that MIDA will be issuing guidelines on the criteria.

IRB further indicated that the above incentive would most likely apply to IT based entities.

- ii. Pioneer status or investment tax allowance be given to a SKSC which is in the business of preparing Knowledge-based Master Plans for their customers and that tax deduction be given to the companies that implement the Knowledge-based Master Plan (i.e. the customers).

IRB responded that expenses incurred by a company such as engaging a consultant to develop the Knowledge-based Master Plan shall be allowed as a tax deduction. The deduction is to be claimed when the company begins to implement the Corporate Knowledge-based Master Plan.

Incentives such as Pioneer status or Investment Tax Allowance as proposed in the 2003 Budget shall be granted to a 'Strategic Knowledge-based Status Company' (SKSC), which is to approved by MIDA.

6. Reduction in Income Tax Rate for Small and Medium Scale Companies

The 2003 Budget proposed that small and medium scale companies with paid-up capital of RM2.5 million and below be subject to corporate tax at the rate of 20% on chargeable income up to RM100,000. The corporate tax rate on the remaining chargeable income is maintained at 28%. Dividends distributed will be given a tax credit of 20% in the hands of the shareholders.

- i. The proposed amendment to Schedule 1 to the ITA as set out in clause 23 of the Finance (No. 2) Bill 2002 provides that:

"2A. Subject to paragraph 3, income tax shall be charged for a year of assessment on the chargeable income of a company resident in Malaysia which has a paid-up capital in respect of ordinary shares of

less than two million five hundred thousand ringgit at the beginning of the basis period for a year of assessment..."

According to Appendix I to the 2003 Budget Proposals, the qualifying threshold for the new incentive is a paid-up capital of **RM2.5 million and below**.

The professional bodies suggest that the proposed amendment to Schedule 1 be reworded as follows:

"....a paid-up capital in respect of ordinary shares of two million five hundred thousand ringgit and below..."

IRB confirmed that the 20% tax rate applies to a company with paid-up capital of RM 2.5 million and below. Schedule 1 of the ITA, 1967 will be amended to reflect this.

- ii. The professional bodies are of the view that whilst the above incentive is intended to promote investment by small and medium enterprises (SMEs), it would result in additional tax burden being imposed on shareholders of SMEs who are subject to tax at a rate exceeding 20%. As dividends paid by SMEs are given a tax credit of 20%, the holding company of an SME, which is itself not an SME, will have to bear the additional 8% tax on dividends received from its SME subsidiary. Similar tax burden will be imposed on other recipients, including individuals and businesses (which are not SMEs), if their income is subject to tax at a rate above 20%.

The professional bodies would like to submit the following alternative proposals for the IRB's consideration as a measure to avoid the negative tax impact on certain groups:

- a. in the case of investor companies which are not SMEs, dividends received from an SME which are distributed from the first RM100,000 of the SME's income, should be treated as exempt income in the computation of the company's taxable income.

In the case of individuals and other investors (who are not SMEs), dividends received from an SME which are distributed from the first RM100,000 of the SME's income should be given a tax credit at 20% and that such dividend income should not be subject to any additional tax in cases where the recipients' tax bracket exceeds 20%. This would encourage individuals and small businesses to invest in SMEs.

- b. SMEs be given the option to claim the concessionary tax rate of 20% on the first RM100,000 of its income or be subject to the normal tax rate of 28% on its entire income.

- c. The Finance (No. 2) Bill 2002 (clause 19) proposes that when SMEs declare a dividend, the tax deducted or deemed to be deducted under Section 108 of the ITA is at 20%. This would result in a "dividend trap" as highlighted above.

The professional bodies suggests that to overcome the problem, SMEs be allowed to deduct tax or deemed to have deducted tax on dividends declared at 28%.

- d. To allow two pools of dividend franking credits i.e. at 20% and 28%.

IRB responded that the above are policy matters. The concerns raised by the professional bodies are noted and recommendations proposed by the professional bodies shall be referred to the MOF.

- iii. The professional bodies would like to seek further clarification as to whether the 20% tax rate would apply to the first RM100,000 of a SME company enjoying an existing tax incentive (eg. Pioneer Status.)

IRB confirmed that if a SME enjoys pioneer status on 70% of its statutory income, it will be eligible for the 20% tax rate on the first RM100,000 of the taxable chargeable income.

- iv. In the event where a company has a paid-up capital of RM2.5 million or less (i.e. SME) in year 1 but subsequently its paid-up capital increased to more than RM2.5 million (i.e. it ceases to be a SME) in year 2, the professional bodies would like to seek confirmation as to whether the company's chargeable income shall be subject to tax at the corporate tax rate of 28% from year 2 onwards.

Further, the professional bodies would like to seek clarification as to whether the company shall continue to frank dividends at 20% from year 2 onwards.

IRB responded that the tax rates to be applied (i.e. whether at 20% or 28%) shall depend on whether the company is a SME in a particular year of assessment, as illustrated below :-

	<u>Tax Rate</u>	<u>Dividend</u>
Year 1 (SME company)	20% on first RM100,000 28% on remaining income	20%
Year 2 onwards (Non-SME company)	28%	28%

- v. The professional bodies would like to seek clarification as to whether a SME company shall continue to frank the Section 108 balance brought forward (which existed prior to the 2003 Budget Proposals) at 28%.

IRB clarified that any dividend declared in the year of assessment out of the Section 108 Account (including the brought forward Section 108 credit from YA 2002 and earlier) when the SMI is subject to the 20% tax rate, must be franked at 20%.

- vi. When completing Form CP 204 for a year of assessment, pursuant to Section 107C(3) of the ITA, a company is required to furnish the estimated tax payable which must not be less than the previous year of assessment's revised estimate or if none is furnished, the previous year of assessment's estimate of tax payable.

The professional bodies would like to seek clarification that when completing Form CP 204 for year of assessment 2003 (and subsequent years), would a SME be allowed to furnish an estimated tax payable less than the previous year of assessment's revised estimate in view of the new tax rate as proposed in 2003 Budget.

IRB informed that a SME can only lower its estimate (to reflect the lower tax liability at 20%) when revising its estimated tax payable and not when submitting the original estimate.

7. Special Incentives to Increase Exports

The 2003 Budget proposed that a locally owned manufacturing company be given additional tax incentives as follows :

- a. Tax exemption of statutory income equivalent to 30% of increased export value provided the company achieves a significant increase in exports;
- b. Tax exemption of statutory income equivalent to 50% of increased export value provided the company succeeds in penetrating new markets; and
- c. Full tax exemption on increased export value provided that the company achieves the highest increase in exports.

The professional bodies would like to seek clarification on the following:

- i. What is deemed as "significant increase" in exports?
- ii. What is the definition of new markets? Does it refer to new markets to the company or to the country?
- iii. How is the "highest increase in exports" determined?

At the time a company files its tax return, it may not be aware whether it qualifies as the "best national exporter" to be entitled to the full exemption of its statutory income. The professional bodies suggest that guidelines be issued to provide more specific criteria on entitlement to the incentives.

IRB indicated that MIDA will be discussing with MATRADE to issue guidelines on the definition of the various terms.

8. Export Incentives for Professional Services

The 2003 Budget proposed that double deduction on expenses incurred for the promotion of export be extended to professional services including legal, accounting, taxation, management consultancy, architectural, engineering, medical and dental services provided by entities/businesses registered with the Registrar of Businesses.

The professional bodies suggest that similar guidelines as that for promotion of export of services by companies be issued to avoid ambiguity.

IRB informed that the guideline to be issued will be similar to the exemption order issued earlier on the promotion of exports by companies.

9. Incentives for Modernising Chicken and Ducks Rearing System

The 2003 Budget proposed that chicken and duck rearers who reinvest for the purpose of shifting from open house system to closed house system be given reinvestment allowance (RA) for a period of 15 consecutive years commencing from the first year the reinvestment is made. RA is claimed as follows:

- a. For projects located in promoted areas, that is the Eastern Corridor of Peninsular Malaysia, Sabah and Sarawak, RA of 60% on qualifying capital expenditure incurred with the allowance deducted against 100% of statutory income of each year of assessment; and
- b. For projects located outside the promoted areas, RA of 60% on qualifying capital expenditure incurred with the allowance deducted against 70% of statutory income of each year of assessment.

This incentive is given to chicken and duck rearers who are approved by the Ministry of Agriculture and on condition that the minimum rearing capacity of the closed house system is as follows:

- i. 20,000 broiler chicken/broiler ducks per cycle; or
- ii. 50,000 layer chicken/layer ducks per cycle.

The professional bodies are of the view that the conditions imposed for entitlement to the proposed incentive appears rather restrictive. The professional bodies also hold the view that shifting from an open house to a closed house system of chicken and duck rearing falls within the meaning of modernisation in Schedule 7A to the ITA. Therefore, the provisions in Schedule 7A should be applicable to such capital expenditure.

IRB is of the opinion that the current provision in paragraph 9, Schedule 7A does not cover the activity of rearing chicken and ducks. Therefore the proposed amendment to Schedule 7A is made to cover this activity.

10. Proposed Section 75A: Director's Liability for Payment of Company's Tax.

The finance (No. 2) Bill 2002 (clause 15) introduces a new Section 75A to the ITA in order to make any director and any other person who is concerned in the management of the company's business and who, either on his own or with one or more associates, is the owner of, or is able directly or indirectly to control more than 50% of the ordinary share capital of the company, jointly and severally liable for the tax due and payable by the company.

The professional bodies are of the view that although the proposed Section 75A has limited the liability for payment of a company's tax to its directors, the provision may still have negative impact on Government's efforts to promote investment.

The professional bodies feel that it is inequitable to make a director liable for the payment of the company's tax when the company genuinely has no financial resources to meet its tax liability. For example, the company made profit in year 1 and was therefore liable to income tax. However, in year 2, one of its major debtors encountered severe financial problem and was unable to pay the debts owed to the company, which grossly affected the company's financial position. In such situations, it is unjustifiable to require the directors to bear the tax liability of the company.

The professional bodies trust that the IRB will apply the provisions of the proposed Section 75A with due consideration to the circumstances. The Institute would like to reiterate its view that the directors should be held personally liable for the company's tax only if they have knowingly and improperly appropriated the company's funds for their personal gain thereby resulting in the company's inability to meet its tax payments.

The professional bodies also suggest that the IRB issue guidelines on the application of the proposed Section 75A to alleviate any anxiety on the part of company directors.

IRB informed that directors would be liable only after all means of recovery from the taxpayer company have been exhausted.

11. Incentives to Consolidate the Management of Smallholdings and Idle Land

The 2003 Budget proposed the following incentives to promote the consolidation of management of smallholdings and idle land:

- a. A company that invests in a wholly-owned subsidiary company involved in the consolidation of management of smallholdings or idle land be allowed a deduction equivalent to the amount of investment; and
- b. A wholly-owned subsidiary company involved in the consolidation of management of smallholdings or idle land be exempted from service tax.

The professional bodies suggest that guidelines be provided on the definition of "small holdings" and "idle land".

IRB informed that the Ministry of Primary Industries will be issuing guidelines which will elaborate on acreage, etc.

12. Incentives to Increase the Planting of Rubberwood Trees

The 2003 Budget proposed that a non-rubber plantation company that plants at least 10 per cent of its plantation with rubberwood trees be given accelerated agriculture allowance whereby the write-off period on capital expenditure incurred for land preparation, planting and maintenance of rubberwood cultivation be accelerated from two years to one year.

The incentive is effective for applications received by the Ministry of Primary Industries from 21 September 2003.

The professional bodies would like to seek confirmation that the effective date is from 21 September 2002 and not 21 September 2003.

IRB confirmed that the incentive is effective from 21 September 2002.

13. Review of Income Tax Exemption on Interest Earned from Private Debt Securities (PDS)

The professional bodies are of the opinion that some from of guidelines or public rulings should be drafted by the IRB on the following items:-

- i. Tax treatment of financial instruments i.e. debentures, bonds, etc.
- ii. Eligibility of the expenses incurred in relation to the issuance of Islamic PDS i.e. the type of expenses that are deductible.

IRB took note of the above.

14. Income Tax Treatment for Expatriates in OHQ's and Regional Offices

In order to attract regional offices to be located in Malaysia, the 2003 Budget proposed that expatriates working in a OHQ or a RO be taxed only on the portion of chargeable income attributable to the number of days they are in the country.

The professional bodies would like to seek further clarification as to the methodology to be used to compute the time frame or "days" an expatriate is located in the country as an employee of the OHQ or RO for the purposes of ascertaining the chargeable income of the expatriate.

The professional bodies would like to propose that the apportionment be based on "Gross Income" instead of "Chargeable Income".

IRB informed that the apportionment will be based on chargeable income from employment and number of days in Malaysia. An expatriate is deemed to be in Malaysia for a day if he is in Malaysia for part or the whole of that day.

The rationale for adopting "Chargeable Income" instead of "Gross Income" is because the relief claimed by the expatriate is accounted for before the apportionment.

15. Review of Residence Requirement for Individual Income Tax

The 2003 Budget proposed that in order to relax the condition for resident status, it is proposed that the requirement for an individual to be in Malaysia on 31 December of the current year and 1 January of the following or preceding year be removed. The absence is to be deemed as a temporary absence. The proposal is effective from year of assessment 2003.

The professional bodies would like to seek confirmation whether the amendment takes effect from the year of assessment 2002 or year of assessment 2003.

IRB confirmed that the Section 7(1)(b) amendment will be effective from year of assessment 2002.

16. Amendment of Section 108(16)

With reference to Clause 19 of the Finance Bill (No. 2), Section 108 of the principal Act is amended by inserting the following subsections:

(16) Notwithstanding the foregoing subsections, where

- (a) the excess is increased by an amount under subsection (7) or (9); or the amount due is increased by an amount under subsection (10),
- (b) the Director General may in his discretion, for any good cause shown, remit the whole or part of that amount and, where the amount remitted has been paid, the Director General shall repay the same.

The professional bodies would like to seek confirmation as to whether the Director General will exercise such power to waive only for any "good cause shown" and not in the event of a discovery during a field audit.

IRB informed that the proposed provision will apply to all cases so long as "good cause" is shown.

17. Retrenchment Benefit

The 2003 Budget proposed that the amount of compensation for loss of employment exempted from tax will be increased from RM4,000 to RM6,000 for each completed year of service.

The professional bodies would like to seek confirmation that STD is not applicable to the amount of RM6,000 so exempted.

IRB responded that the Operations Division of the IRB will look into this matter.