

**MINUTES OF THE DIALOGUE BETWEEN TECHNICAL DEPARTMENT OF THE
INLAND REVENUE BOARD MALAYSIA AND ASSOCIATION OF ACCOUNTANTS
HELD ON 15 MARCH 2006**

**Other Issues Raised By the Association Of Accountants To The Technical
Department Of The Inland Revenue Board Malaysia (IRBM).**

**1. Gazette Orders for Operational Headquarters (OHQ), Regional
Distribution Centres (RDC) and International Procurement Centres (IPC)**

- 1.1 At present, the concept of an OHQ does not exist in the Income Tax Act (ITA), 1967 following the removal of the previous Section 60E. It is important that the new tax provisions (via a gazette order) for OHQs be enacted as soon as possible, as presently OHQs could technically be taxed at 28% based on the existing tax laws. The treatment of brought forward losses of OHQ from qualifying and non-qualifying service is also not provided for in the legislation. Incentives for Regional Distribution Centres and International Procurement Centres as announced in the 2003 Budget have yet to be legislated. The Institutes would like to highlight that the undue delay in the enactment of the above incentives may give a negative impression of the Malaysian legislative system in the eyes of foreign investors.

In this respect, the Institutes would like to urge that the issuance of the gazette orders for the above incentives be expedited. In addition, the Institutes would also like to know the time frame for the issuance of such gazette orders.

Answer:

**Exemption Orders for OHQ, RDC and IPC have been gazetted on
25.08.2005**

OHQ - Income Tax (Exemption) (No. 40) 2005

RDC - Income Tax (Exemption) (No. 41) 2005

IPC - Income Tax (Exemption) (No. 42) 2005

- 1.2 It was mentioned in an earlier Operations Dialogue held on 25 March 2003 that, pending the gazette of the relevant order, IRB will accept a NIL estimate for purposes of the CP204 submission for an OHQ. Subsequent to this, clarification has been sought from the Technical Division on the legal position/status and a member was informed that a NIL estimate is not accepted as the OHQ would be subject to a 28% tax rate since an exemption order has not been gazetted. This has resulted in tax being paid when it should not have been paid.

The Institutes would like to seek the IRB's confirmation on this matter.

Answer:

The issue raised has been overtaken by events.

- 1.3 The Institutes would also like to know the status of the issuance of statutory orders or amendments to the existing legislation (where applicable) for the previous budget proposals as listed in the minutes of the previous technical dialogue on 20 October 2004 as follows:
- The income tax exemption order for the income derived from repair and maintenance activities for luxury boats and yachts in Langkawi.
 - The income tax rules for the accelerated agriculture allowance on qualifying capital expenditure incurred by a non-rubber plantation company in the preparation of land, planting and maintenance of rubber wood cultivation.
 - The income tax rules for a company that invests in a wholly-owned subsidiary company involved in the consolidation of management of smallholdings or idle land.
 - The income tax rules for expenditure incurred by a company for drafting the individual Corporate Knowledge-based Master Plan.
 - The income tax exemption order for group relief under pre-package incentives i.e. forest plantations and selected products such as biotechnology, nanotechnology, optics and photonics.
 - The income tax exemption order for the pre-package incentive scheme for pioneer status with 100% exemption for 10 years or investment tax allowance of 100% for 5 years.
 - The income tax exemption order for the value of increased exports of locally produced products exported by hypermarkets and direct selling companies.

Answer:

The status of issuance of statutory Orders or amendment to the existing legislation is as follows:-

Orders	Status
The Income Tax Exemption Order for the income derived from repair and maintenance activities for luxury boats and yachts in Langkawi .	Under discussion (awaiting information from MOF).
The Income Tax Rules for the accelerated agriculture allowance on qualifying capital expenditure incurred by a non-rubber plantation company in the preparation of land, planting and maintenance of rubberwood cultivation.	Under discussion (awaiting guidelines from the relevant Ministry (Kementerian Perusahaan Perladangan & Komoditi).
The Income Tax Rules for a company that invest in the wholly-owned subsidiary company involved in the consolidation of management of smallholdings or idle land.	Under discussion (awaiting guidelines from the relevant Ministry (Kementerian Perusahaan Perladangan & Komoditi).
The Income Tax Rules for expenditure incurred by a company for drafting the individual Corporate Knowledge-based Master Plan.	Under discussion (awaiting information from MOF)
The Income Tax Exemption Order for group relief under pre-package incentives i.e forest plantations and selected products such as biotechnology, nanotechnology, optics and photoinics.	In the process of drafting.

The Income Tax Exemption Order for the pre-package incentive scheme for pioneer status with 100% exemption for 10 years or investment tax allowance of 100% for 5 years.	The relevant Exemption Orders have been gazetted on 23.03.2006. Pioneer Status - Income Tax (Exemption) (No.11) 2006. Investment Tax Allowance - Income Tax (Exemption) (No.12) 2006.
The Income Tax Exemption Order for the value of increased export of locally produced product exported by the hypermarket and direct selling companies.	Under discussion (awaiting guidelines from relevant Ministry - Kementerian Perdagangan Dalam Negeri & Hal Ehwal Pengguna).

- 1.4** The Institutes would also like to know the status of the issuance of public rulings or guidelines which the IRB had indicated would be issued in the previous dialogues such as the Guideline on Tax Treatment for Asset-Backed Securities and the Public Ruling on Section 75A of the ITA .

Answer:

IRBM took note of the outstanding guidelines.

2. Permitted Expenses

Pursuant to Section 60F of the ITA, 1967, permitted expenses refers to expenses incurred by an investment holding company in respect of secretarial, audit and accounting fees, telephone charges, printing and stationery costs and postage.

With reference to the minutes of the Technical Dialogue on 18 July 2003, the IRB confirmed that taxation fees i.e. fees relating to filing and preparing tax computations are allowed to be included as part of the permitted expenses under Section 60F. However, in practice, this treatment is not adopted uniformly. The IRB is not consistent in its treatment of certain expenses for the purposes of determining 'permitted expenses'.

In this regard, the Institutes propose that the legislation be amended to include tax fees as well as bank charges as part of the permitted expenses for investment holding companies, closed-end funds, unit trusts and property trusts under Section 60F, 60H and 63B of the ITA, 1967 as these expenses are essentially a part of the administrative expenses incurred in maintaining an office/carrying on operations.

Answer:

IRBM has no objection to the Institutes' proposal to amend the law. However, it is up to the Ministry of Finance to accept the proposal.

3. Public Ruling 1/2004: Income from Letting of Real Property

3.1 With regard to the Public Ruling 1/2004, it is noted that:

- a. the existing "quantitative" criteria are applicable only to companies and not to individuals; and
- b. the "quantitative" criteria applicable to companies exclude an investment holding company or a company limited by guarantee as provided under Paragraph 5 of the said Public Ruling.

Since the treatment of rent as a business source pursuant to Paragraph 5 of the Ruling only applies to companies, an individual who derives rental income without the provision of any ancillary services will not be entitled to treat the rental income as a business source, notwithstanding the number of units of properties owned.

In this regard, the Institutes would like to urge the IRB to revise the Public Ruling 1/2004 to extend the "quantitative" criteria to individual taxpayers and all non-corporate organisations such as associations. In addition, the professional bodies would like to seek clarification on the reason for an investment holding company that meets the "quantitative" criteria being excluded from applying the Public Ruling.

The Institutes would also like to seek clarification on the tax treatment where an individual has some units for which ancillary services are provided and others for which such services are not provided. Would the total rental income be treated as a business source, or would it be considered as two sources of rental income i.e. one business and one passive? Nevertheless, the Institutes continue to hold the view that the Public Ruling should apply equally to all taxpayers.

Answer:

The "Quantitative" criteria are merely a concession given to companies to avoid the problems the companies have in justifying that they are carrying on a business of letting of properties.

3.2 It is also noted that Paragraph 7.2 of the said Ruling requires that where rental income is treated as passive income (i.e. Section 4(d) income), each property is to be treated as a separate source of income. The properties are to be grouped into categories such as residential properties, shop-houses/commercial properties and vacant land. There is arguably no basis to insist on grouping the properties based on such categories. This is in

contradiction with the judgments given in the *P Securities* and *MP Holdings* cases.

The Institutes are of the view that all the properties should form one source. Accordingly, all expenses relating to the production of rental income would be deductible. We would like to seek confirmation from the IRB on this matter.

Answer:

Where rental income is treated as passive income (i.e. Section 4(d) income), each property is to be treated as a separate source of income. As a concession, properties are to be grouped into categories such as residential properties, shop-houses/commercial properties and vacant land.

4. Public Ruling 2/2004: Benefits-in-Kind (BIK)

As stated in the letter issued by the IRB to the Malaysian International Chamber of Commerce and Industry (MICCI) dated 12 March 1998 in respect of BIK, the Institutes understand that monthly subscription fees paid for a corporate membership (granted by an employer to an employee) is exempt from tax in the hands of the employee. If the employer pays monthly subscription fees for more than one corporate membership, then only the highest monthly subscription fee will be exempted in the hands of the employee. However, such an exemption has been withdrawn as stated in the Addendum to the Public Ruling 2/2004, which was issued on 20 May 2005 (but only came to the knowledge of the Institutes on 30 May 2005). The professional bodies are of the opinion that at least one of the monthly subscription fees (the highest) paid by the employer for senior executives to utilise the corporate membership of clubs in discharging/fulfilling the companies' objectives should continue to be exempted.

In this respect, the Institutes urge that at least one of the monthly subscription fees (the highest) for a corporate membership (granted by an employer to an employee) be stipulated as an exempt item in the Public Ruling 2/2004 as per the previous treatment. It is also noted that the withdrawal of the IRB's letter dated 12 March 1998 to the MICCI had not been highlighted to the Institutes and practitioners until the issuance of the Addendum to the Public Ruling 2/2004. Hence, tax practitioners are not aware of any change and it is inappropriate to force taxpayers/tax agents to comply with the addendum to the said public ruling retrospectively starting from 8 November 2004. In this regard, the Institutes expect, in the interest of professionalism, that any previous decision made by the IRB to grant a concession should continue to apply unless there is a valid rationale for withdrawing the concession. EA forms and Form BEs have been filed this year in compliance with previous practices. Is the IRB expecting that the taxpayers (who are affected by the withdrawal of the concession) revise their self-assessed returns? In the interest of justice and fair play, it would only be logical for the withdrawal of the concession to apply for the tax returns that would be submitted for Year of

Assessment 2005. The Institutes thus seek clarification on this recent development.

Answer:

The IRBM is agreeable that the addendum to the said Public Ruling shall be effective in YA 2005.

5. Deductibility of BIK Provided to Employees and Family Member

Where an employer contractually provides an employee with benefits-in-kind as part of the terms of employment of the individual, the cost of providing such benefits should be deductible to the employer, pursuant to Section 33 of the ITA, unless a deduction is specifically prohibited under Section 39. For example, where an employer provides medical insurance coverage for an employee and his family (spouse and children) as per the employment contract, the cost of providing this medical insurance should be deductible pursuant to Section 33. The Institutes have been made aware of instances where the IRB has disallowed such costs on the basis that the expenses are "private".

The Institutes would like to seek confirmation that a deduction should be allowed where the employer and employee are not 'connected persons' and such benefits like medical insurance are provided as part of the employment contract and should be viewed as part of the necessary costs of business incurred to have a stable, productive workforce. To the extent that the parties are connected, then as long as the employment contract is structured on an arm's length basis, such costs should continue to be deductible, unless specifically prohibited as mentioned above. Overzealous interpretation of legal provisions must be curtailed and decisions must be made based on the actual facts of the case.

Answer:

Any expenditure incurred by an employer in providing benefits to its employees qualifies for deduction in ascertaining its adjusted income from business except where the expense is specifically disallowed under section 39.

In the case of a partnership or a sole-proprietorship, any benefits to the partner or the proprietor will not qualify for deduction as it is private in nature.

6. Public Ruling 3/2004: Entertainment Expenses

6.1 Section 39(l)(f) of the ITA, 1967 provides that inter alia:-

*“a sum equal to fifty percent of **any expenses incurred in the provision of entertainment** including any sums paid to an employee of that person for the purpose of defraying expenses incurred by that employee in the provision of entertainment...”*

Based on the provision above, the Institutes are of the opinion that any expenses incurred in the provision of entertainment should be partially allowed as a deduction against the gross income while entertainment expenses which fall under Section 39(1)(i) to (vii) of the ITA, 1967 should be allowed in full as a deduction to arrive at the adjusted income. In this respect, the Institutes would like to seek confirmation of our understanding of the above issue.

However, there are a number of restrictions imposed before an entertainment expense is allowed for deduction as provided in the Public Ruling 3/2004. As defined under Paragraph 3.2 of the ruling, “entertainment related wholly to sales” means the entertainment which is directly related to sales provided to customers, dealers and distributors excluding suppliers. In interpreting Paragraph 3.2 above and Paragraph 6.7 on the provision of entertainment related wholly to sales arising from the business, the Institutes are of the view that entertainment of clients, whether new or existing, should be wholly deductible so long as the expense is incurred in the provision of entertainment and is directly related to sales provided to customers/clients.

Pursuant to Paragraph 7 of the Public Ruling 3/2004, *“Entertainment expenses which are wholly and exclusively incurred in the production of income under subsection 33(1) of the Act and which do not fall into any of the categories of expenses enumerated in the proviso to paragraph 39(1)(i) of the Act would only qualify for 50% deduction. Such expenses would include the following:*

*the expenses incurred in connection with **specific business transactions**; **existing clients** or suppliers are entertained; and allowances paid to employees for the purposes of defraying expenses incurred by the employees in the provision of entertainment.”*

As stated in a response from the IRB dated 28 February 2005, entertainment expenses incurred in connection with specific business transaction should have the following criteria:-

Entertainment expenses incurred must originate from or be followed by a proper business discussion;

Entertainment expenses incurred are for introducing a new product or retaining the existing business relationship; or

Consultation related to the taxpayer's business must exist.

The Institutes are of the opinion that the above criteria for entertainment expenses incurred in connection with specific business transaction are related wholly to sales and hence should qualify for a 100% deduction instead of a 50% deduction.

In addition, the Institutes would also like to highlight that entertainment of existing customers is part of a company's business activity to secure business and sales and a segregation between entertainment of new and existing clients would prove commercially and administratively impractical. The Institutes would also like to enquire about the definition of "specific business transactions".

Answer:

Generally, pursuant to subsection 33(1) ITA, any expenditure incurred wholly and exclusively in the production of income is allowable as a deduction from the gross income. Thus any entertainment, as defined in section 18, must be incurred wholly and exclusively in the production of income, but 50% of such expenditure would not qualify for deduction pursuant to paragraph 39(1)(f) unless such expenditure falls under the exceptions [proviso (i) to (vii)] of that paragraph.

There is no definition of "specific business transaction". However, the IRBM has set out the criteria of entertainment expenses incurred in connection with specific business transaction via letter dated 28 February 2005.

- 6.2 As illustrated in Example 4 of the Public Ruling, the entertainment expenses incurred on the light refreshments by Syarikat Top Auto Service for its customers (who would be existing clients) while waiting for their cars to be serviced, would qualify for a full deduction under proviso (vii) of paragraph 39(1)(f) of the Act, as it is related wholly to sales arising from the business.

In view of the above, the Institutes would also like to seek clarification on the following matters:

- whether the treatment for entertainment expense will be different if the entertainment is provided to a customer after the sale has been concluded, for example, the owner of Syarikat Top Auto Service took the customer out for lunch after the car was serviced as it was almost lunch time; in this case, since a sale had been concluded, the expense should qualify for a full deduction even though the customer is an "existing client".
- whether entertainment of potential customers, such as meals provided by a property sales agent to his potential house buyers, which may not result in a sale transaction, qualifies for a fifty per cent (50%) deduction? What if there is a successful sale concluded?
- whether entertainment expenses incurred on an existing client of a professional accounting services firm (which is providing monthly accounting services for a year) will be considered as entertainment related wholly to sales (as the client has signed a contract or letter of engagement for a year) and thus be allowed a 100% deduction; and

whether general gifts such as hampers and sponsorship of a client's annual dinner either in cash or by way of providing lucky draw gifts (which do not carry any logo of the business) qualify for a 50% deduction.

Answer:

Issues raised	Answer
Whether the treatment for entertainment expense will be different if the entertainment is provided to a customer after the sale has been concluded, for example, the owner of Syarikat Top Auto Service took the customer out for lunch after the car was serviced as it was almost lunch time; in this case, since a sale had been concluded, the expense should qualify for a full deduction even though the customer is an "existing client".	50% deduction: entertainment provided after the sale has been concluded is not entertainment which is related wholly to sales. Therefore it is not entitled for 100% deduction.
Whether entertainment of potential customers, such as meals provided by a property sales agent to his potential house buyers, which may not result in a sale transaction, qualifies for a fifty per cent (50%) deduction? What if there is a successful sale concluded?	No deduction: No deduction is given in respect of entertainment provided to potential customer as it is not in line with the provision of subsection 33(1) of the Act.
Whether entertainment expenses incurred on an existing client of a professional accounting services firm (which is providing monthly accounting services for a year) will be considered as entertainment related wholly to sales (as the client has signed a contract or letter of engagement for a year) and thus be allowed a 100% deduction.	50% deduction: The entertainment provided is to maintain the existing business relationship.

Whether general gifts such as hampers and sponsorship of a client's annual dinner either in cash or by way of providing lucky draw gifts (which do not carry any logo of the business) qualify for a 50% deduction.	No deduction for cash: It does not in line with the definition of entertainment. 50% deduction for gifts: The entertainment provided is to maintain the existing business relationship.
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Note: the answer is subject to the fact that all provisions of the Act are adhered to and the answer may differ where facts surrounding the issue raised differ.

- 6.3 With reference to Example 3 of the Public Ruling 3/2004, cost of travel for a family day trip provided for employees is not deductible as it is treated as leave passage under Section 39(1)(m) of the ITA.

The Institutes are of the opinion that leave passage should only refer to situations where the leave passage is included in the remuneration package provided specifically for senior management of the company as part of the staff benefits. Hence, travelling expenses incurred for a family day trip to the employee and his/her family members should not be treated as leave passage and should be allowed as a deduction.

In relation to the family day expense as discussed above, the Institutes would also like to seek confirmation that the expenses (food and drink, cost of travel and accommodation) incurred for the family of an employee is exempted from tax in the hands of the employee.

Answer:

Where family day expenses include travel expenses, food and accomodation, only expenses relating to provision of food and accomodation is allowable which is not taxable in the hands of the employee. Travel expenses are not an allowable expense as they are specifically prohibited under paragraph 39 (1)(m) ITA.

- 6.4 Due to the confusion and difficulty in interpreting the intention of the Public Ruling, an Appendix is attached where various categories of entertainment expenses are listed together with the view of the Institutes on whether the expense is fully deductible, partially (50%) deductible or not deductible.

The Institutes seek confirmation that the categorisation is acceptable to the IRBM.

Answer:

The Public Ruling is issued to provide principles to the IRBM's interpretation of law whether such expenses are allowable expenses. The answer to the request to ascertain whether specific expenses are fully deductible, partially (50%) deductible or not deductible is indicated in the Appendix C attached (The answer may differ where the facts surrounding the issue raised differ). The IRBM cannot entertain such a request in future. The Institutes have to determine each issue based on the principles given.

7. Income Tax (Deduction for Investment in an Approved Food Production Project) Rules 2001

Pursuant to Rule 4 of the Income Tax (Deduction for Investment in an Approved Food Production Project) Rules 2001, a company incorporated in Malaysia and resident in Malaysia, shall be given a deduction (for the basis period for a year of assessment) in respect of an amount equivalent to the amount of **investments made** in a wholly owned subsidiary, which is undertaking an approved food production project for which the subsidiary has been given the necessary approval.

Issue 1

The term "**investments made**" is not defined in the Rules. In a case where the investment amount for a food production project approved by both the Ministry of Finance and Ministry of Agriculture and Agro-Based Industry is RM20 million and the funding by the holding company to the wholly owned subsidiary is to be provided in the following manner:-

- (a) RM5 million by way of investment in the paid up capital of the subsidiary; and
- (b) RM15 million by way of a loan to the subsidiary,

it is unclear as to the amount for which a deduction would be allowed.

The Institutes are of the view that a deduction for RM20 million should be allowed. The Institutes would like to seek confirmation whether the deduction allowed under Rule 4 is equivalent to RM20 million.

Answer:

New Rules has been issued on 9 February 2006 to replace the Rules 2001. The term "**investment**" is defined in the new Rules.

"Investment " is now defined as "an investment in the form of cash or holding of shares in a related company".

Therefore in the above example, the amount of deduction allowed is RM5million.

Issue 2

If the term “**investments made**” is not necessarily investment in the form of paid up capital of the subsidiary, as far as the deduction from adjusted income in the basis period for a year of assessment is concerned, is the amount to be deducted equivalent to “**the amount of funding actually injected into the subsidiary in that year of assessment**” or “**the entire amount as approved by the Authorities in that year of assessment**”? This distinction is important, particularly when the project funding requirement of the subsidiary may stretch over a few years.

The Institutes would like to seek clarification on the above issue.

Answer:

Refer to the new definition of " Investment" above.

Issue 3

The Rules also make no mention of the possibility of carrying forward the investment made in the basis period for a year of assessment that is in excess of the adjusted income in that year of assessment.

The Institutes would like to seek clarification that if there is insufficient adjusted income, would the excess of investment made be allowed to be carried forward to future years.

Answer:

The expenditure incurred is allowable in ascertaining the adjusted income of a business. If it results in an adjusted loss, the normal provisions relating to adjusted loss is applicable.

8. Income Tax (Exemption) (No 13) Order 2005

8.1 According to the above exemption order, a non-resident company is exempted from payment of income tax in respect of income received from an approved MSC status company for the following:

- (a) payment for technical advice or technical services;
- (b) licensing fees in relation to technology development; and
- (c) interest on loans for technology development.

With reference to the above exemption order, under paragraph 1(2), the order is deemed to have come into operation on 1 October 2002.

The Institutes would like to seek IRB's confirmation whether the effective date of operation of the order refers to the date services were performed or the date payment was made.

Answer:

IRBM confirmed that the effective date of operation of the Order refers to the date services were performed and not the date payment was made.

- 8.2 The Institutes are also of the view that the provision of business process outsourcing services, sales solution services and management services to group companies is within the scope of an "approved MSC status company" in relation to the activities of regional IT solutions hub, regional internet exchange, regional data centre, regional internet data centre and regional call centre.

The Institutes would like to seek IRB's confirmation of the above view.

Answer:

IRBM confirmed that it is within the scope of an "approved MSC status company". However these companies need to adhere to the MSC approved activities as stated in the conditions of grant of MSC status.

9. Industrial Building Allowance

Paragraph 66 of Schedule 3 to the ITA states that, inter alia, where part of a building or of an extension to a building is used as an industrial building and the other part of the building or extension, is not so used, then if the capital expenditure incurred on the construction of the part which is not used as industrial building is not more than one-tenth (10%) of the capital expenditure incurred on the construction of the whole building or extension, the building or extension shall be treated as an industrial building. This means that if the extension to an office building within an industrial building is more than one tenth of the total extension, that portion relating to the office building is not considered as an industrial building.

The Institutes are of the view that the whole building should be regarded as industrial building since the office building or warehouse (for example) or extension thereof, form part and parcel of the operations of the company.

The Institutes would like to seek IRB's view on this and whether Schedule 3 could be amended to allow such part of the building to be claimed as an industrial building.

Answer:

The law in the current provision is clear. Whether the law would be amended is a policy matter.

10. Reinvestment Allowance (RA)

RA is applicable to capital expenditure incurred on a factory, plant or machinery used in Malaysia by a resident manufacturing company for expansion that results in an increase in production capacity.

Lately, members of the Institutes had reported that the IRB has denied the claiming of RA by some companies based on the fact that the actual production output was low although the production capacity has increased.

The Institutes are of the view that the claiming of RA should be allowed so long as the capital expenditure incurred has resulted in an increase in production capacity regardless of whether the production capacity is fully utilised. This is because a company may invest a huge sum of money in capital expenditure to expand its production capacity of the factory, but due to unforeseeable market conditions, the company may not be able to fully utilise its production capacity as the demand for its product may have fallen.

In this regard, the Institutes would like to seek confirmation from the IRB that the claiming of RA for the purpose of expansion is based solely on the fact that the production capacity has increased instead of on the actual production output or sales volume.

Answer:

RA is given for a "qualifying project (as defined in Para 8) ... in expanding & modernising ...It is not simply for any additional capital expenditure incurred on factory, plant & machinery nor for any replacement of existing plant and machinery. Hence, any project for expansion resulting in an increase in production capacity is undertaken with the purpose of increasing production output and sales.

Therefore, a company claiming RA must show an increase in actual production output. If there's no actual increase in output, the company will need to justify why the claim for RA should be considered.

In conclusion, the claiming of RA for the purpose of expansion cannot be based solely on the fact that production capacity has increased. Increased production capacity is just one of the criterias for showing expansion. (Other factors could be cheaper cost per unit, shorter production time, reduced labour).

IRBM will issue practice statement to clarify the matter.

11. Seminar/Course/Conference Fees

According to Section 33(1) of the Act, all outgoings and expenses wholly and exclusively incurred in the production of gross income shall be deductible. It is a common practice for companies to send their employees for seminars, courses or briefings that are intended to improve or update their knowledge or skills, which are used in the course of their employment. Such seminar/course fees would be deductible expenses for the company, for example, finance and tax-related courses for employees in the finance department, human resource-related courses for the human resource department, etc. Nevertheless, there are instances where the relationship between the seminar/course and the nature of work may not be clearly defined.

The Institutes are of the view that fire safety and disaster management conference fees incurred by a property developer company or an aquaculture seminar fees incurred by a restaurant operator should be considered as wholly and exclusively incurred in the production of gross income and therefore, tax deductible.

The Institutes would like to seek confirmation on the deductibility of these expenses.

Answer:

IRBM responded that the rule of “wholly and exclusively incurred in the production of gross income” applies. The application of the rule must always relate to the core business of the company and the facts of the case.

12. Decisions in Tax Cases

Over the years, a number of tax cases such as the Seabanc case on guarantee fees, PCEO case on the treatment of interest income, Multi Purpose Holdings Bhd case on interest restriction, etc were brought up to the courts and the decisions had been passed by the courts in respect of the interpretation of the tax legislation. The decisions/principles established from the tax case law and the IRB's treatment of the said issues might not be consistent. This situation creates confusion and difficulties to tax agents and taxpayers in preparing their tax computations especially under the Self Assessment System.

In view of the above, the Institutes would like to urge the IRB to issue a practice note/guideline whenever an important issue/principle is decided upon. Such information should be disseminated to the IRB's officers, tax agents and taxpayers on a timely basis so that the public knows the IRB's stand on the treatment of certain issues. Meanwhile, the Institutes would also like to seek clarification whether the IRB will apply the principles/decisions determined in tax cases in a speedier manner.

Answer:

IRBM took note of the above matter and IRBM would issue a statement on the application of the principles/decisions of important and leading cases.

13. BNM Guidelines on Innovative Tier-1 Capital

Bank Negara Malaysia has issued guidelines on 'Innovative Tier 1 Capital Instruments' which are hybrid capital instruments having the characteristics of both equity and debt. In Malaysia, Innovative Tier 1 Capital is defined to include (as set out in the BNM guidelines):-

"Preference shares that have additional features including moderate step-up rates and limited call provisions; and

Hybrid instruments not classified as hybrid Tier 2 capital instruments, that meet all the minimum requirements for Innovative Tier 1 capital instruments." BNM has indicated that the issuers of such instruments are required to seek clarification from the IRB as to the tax status of such instruments.

The Institutes would like to seek clarification as to whether the IRB will be providing a set of general guidelines on the tax treatment of such instruments and on the deductibility of payments made pursuant to these instruments.

Answer:

The IRBM needs to study the proposal and take note of the need to issue guidelines on the tax treatment of Innovative Tier 1 Capital instruments.

14. Specific Provisions for Non-Performing Loans (NPLs) in Excess of 5 or 7 years.

Bank Negara Malaysia (BNM) has recently given a verbal directive to all banks to write off the NPLs that have been outstanding for more than 5 years and up to 7 years. This directive is also applicable to NPLs that have collateral (due to the long period of time for which the loans have been outstanding).

In view of this, the banks will be writing off these NPLs as specific provisions and will either book the amounts in as a Prior Year Adjustments (with consent from BNM), or as current year provisions or a mixture of both.

This write-off may not necessarily meet the deduction provisions of Section 34 of the Act as the collateral has been ignored and there could still possibly be an amount that is recoverable.

The Institutes would like to seek clarification whether a concession will be granted to the banks for any write-off that is taken under such a BNM directive.

Answer:

Write-off taken under such BNM directive does not qualify as a deduction under subsection 34(2) of the Income Tax Act 1967.

15. Basis period for Non-Corporate Bodies

Pursuant to Section 56 of the Trade Unions Act, 1959, the secretary of the trade union shall submit the audited financial statement of a registered trade union in respect of the period of twelve months ending on the thirty-first day of March in each year before the first day of October in every year. However, as stated in Section 21 of the ITA, the basis year for a year of assessment in relation to a source of a person other than a company, trust body or co-operative society shall constitute the basis period for that year of assessment with effect from Year of Assessment (YA) 2004.

In view of the different requirement of the Acts as stated above, members of the Institutes face practical problems in complying with the requirements of filing the tax return form. As required by the Trade Unions Act, 1959, the audited accounts for a trade union have to be closed on 31 March 2004, but the Return Form T for YA 2004 is for the basis period 1 January 2004 to 31 December 2004. In most of the cases, the audited accounts for 31 March 2004 were only available in August or September 2004. In practice, it is difficult to estimate and apportion the income for the period from 1 April 2004 to 31 December 2004.

In this regard, the professional bodies are of the view that it is more practical for a trade union and any other non-corporate body to prepare their tax computations based on their financial year as the basis period for a year of assessment rather than on a calendar year basis. This will assist these taxpayers to comply fully with the filing requirements under the Self Assessment System.

Answer:

The IRBM realised the problem faced. However, the prevailing provision does not allow IRBM to provide any concession. The problem faced may be resolved through amendment to the law.

16. Payments for Software

Payments for software may take several different forms such as payments for custom-made software or off-the-shelf software or for partial or full alienation of rights to the software. Some payments for software such as for the

acquisition of shrink-wrap software should be viewed as the payment for the acquisition of a product/asset, rather than as a royalty, as is the case in several other tax jurisdictions. Other payments for software can also be distinguished from royalties. The definition of a royalty is as set out in Section 2 of the Act. Where a payment for the use of software does not allow for the use of the underlying copyright, then the payment should not be viewed as a royalty, as it will not fall within the definition of Section 2.

The Institutes would like to seek the IRB's view on the above and would also like to know whether the IRB will be issuing any guidelines on the treatment of such payments.

Answer:

The IRBM took note of the need to issue guidelines on the treatment of such payments.

17. Dividends Received from Labuan

At present, dividends received from a Labuan offshore company paid out of income derived from an offshore business activity are exempt from tax in the hands of the recipient (Income Tax (Exemption) (No.16) Order 1991). Where the recipient is a domestic company, its shareholders would also be exempt from tax on dividends paid by the company out of dividends received from an offshore company (Income Tax (Exemption) (No.12) Order 2000). However, the 1991 Order referred to above does not entitle the domestic company to create a tax exempt account to 'flow' the dividends out to its shareholders. Therefore, the domestic company is required to comply with Section 108 of the ITA in respect of the payment of such dividends to its shareholders.

The IRB has recently confirmed this requirement and has indicated that the shareholders of the domestic company will be entitled to a refund of the tax deducted on the basis that the dividend is tax exempt in their hands. It has been highlighted to the IRB that this causes unnecessary administrative work for taxpayers as well as the IRB.

The Institutes would suggest that the IRB provide a concession to waive the requirement for the domestic company to deduct tax pursuant to Section 108 in respect of such dividends. In the absence of such a concession, we would recommend that the dividend be allowed to 'flow through', as is the case for foreign source dividend income. Such a concession makes logical sense, as the objective is to prevent unnecessary paperwork for both the taxpayer(s) and the IRB.

Answer:

The IRBM has no power to provide any concession for non application of section 108 ITA 1967.

18. Foreign Income Received in Malaysia

Under paragraph 28 of Schedule 6 of the ITA , income derived from sources outside Malaysia and received in Malaysia by any person (other than a company carrying on business of banking, insurance or sea and air transport) is exempt and the amount received is credited to an exempt account.

The word “received” is not defined in the ITA and thus it could also encompass constructive remittances, which should be credited to the exempt account.

The Institutes would like to seek IRB’s confirmation that crediting constructive remittances to the exempt account is acceptable.

Answer:

The intention to exempt foreign income received in Malaysia is to encourage persons to bring back money into Malaysia. Thus the amount of income received in Malaysia by companies will be credited into the exempt account enabling companies to issue exempt dividend which is paid out of the exempt account. If there is no income actually received in Malaysia, the exempt provision is not applicable.

The amount of income from the foreign source income deemed received in Malaysia is the lower of nett profit or actual amount remitted.

19. Income Derived from A Partnership with Different Year End

A company which is a partner of a partnership with a different accounting year end would face difficulty in declaring its partnership income under the Self Assessment system (current year basis) as illustrated below:-

ABC Sdn Bhd (ABC) and XYZ Sdn Bhd (XYZ) are partners in a partnership. ABC's financial year end falls on 31 December while XYZ's financial year end is 31 March. The partnership closed its accounts in line with the dominant partner's (ABC) year end. XYZ when submitting its tax return for the year of assessment (YA) 2005 (in October 2005) and subsequent YA would not be in a position to disclose the correct amount of its share of its partnership as the partnership accounts have not been closed and the partnership return will only be submitted in June 2006.

Based on the minutes of the Operations Dialogue held on 21 November 2001, the IRB had clarified that an estimate of the share of the partnership's income will be accepted. Upon the finalization and submission of the partnership return, an additional or reduced assessment will be issued by the IRB.

The Institutes would like to propose that in such a situation, XYZ's balance of the finalised partnership income for the year ended 31 December 2005

(which may either be an excess or deficit) be assessed in YA 2006 so as to avert any revision to its tax return for YA 2005. The above circumstance will not be restricted to that of March and December year ends, but will occur when a partnership return is submitted after the corporate partner's return is submitted. Therefore, we would like to propose that should such circumstances arise, the balance of the share of the partnership income be allowed to be assessed in the following YA. The Institutes also urge the IRB to consider the introduction of self-amending provisions in the ITA to allow revisions of tax returns in such situations.

Answer:

The basis period for a partnership is 31 December. Section 21(1). Whatever the basis period for a year of assessment of the partners, the share of partnership profit for the year of assessment will be income from partnership of the partners for that YA.

Where the basis period of a partner ends on a day other than 31 December, its estimated share of partnership income must be declared in its tax returns and an amendment of the amount of the actual amount of its share of profits must be made when the accounts of the partnership is finalised and the partnership files its return for the YA. The revision may be made by way of a letter.

20. Tax Treatment for Contractors and Property Developers

In line with the requirement of paragraph 29 of Financial Reporting Standard (FRS) 111 on Construction Contracts and paragraph 35 of FRS 201 on Property Development Activities, profit from construction and property development activities are to be recognised by using the percentage of completion method.

The Institutes understand that the IRB applies the percentage of completion method based on the progress payments receivable in assessing property developers. Where the duration of a project does not exceed two years, the completion of project method is allowed (this was previously agreed by the IRB in the Technical Dialogue held on 16 February 1994).

Based on the minutes of the technical dialogue held on 20 April 2001, the IRB allows taxpayers to present alternative basis of recognising profits for property developers so long as the methods presented in the tax computations are fair, consistent and reflective of the profits of the property developer company for the year, other than the "Progressive Profit Method" that may be required by the IRB.

The Institutes would like to seek confirmation whether the percentage of completion method (used in preparing the audited accounts) is still acceptable in computing the adjusted income of the taxpayer, or whether there is any change to the above treatment and whether this basis has been

extended to include contractors, whose nature of work is similar to that of a developer.

Answer:

A reference can be made to a Public Ruling On Property Development and Construction Contracts which has been issued on 13 March 2006. The IRBM will also issue a Regulations on this issue.

21. Determination of Residence Status of Individuals

The determination of the residence status of individuals is essentially governed by the physical presence of an individual in Malaysia, as provided for by Section 7 of the ITA. In this respect, the passports of individuals have been used in determining the physical presence in Malaysia. Expatriates are issued with Gold Cards that are used instead of their passports. With the use of the Gold Cards, the passports are no longer stamped at the point of entry/exit and therefore, cannot be used to indicate one's physical presence in Malaysia. Travel printouts are then issued by the Immigration Department upon request by the taxpayer or their agents.

The Institutes have received feedback from members that the Immigration Department has ceased printing such travel printouts of expatriates who use the Gold Cards to travel. In the absence of such printouts, the determination of the residence status has been difficult and onerous.

The Institutes would like to seek the IRB's view on other alternative means to be used in determining the residence status of such individuals when they are leaving Malaysia permanently. Does this mean that expatriates should insist that the Immigration Department stamp their passports at the point of entry/exit and forget about the Gold Cards? Is it sufficient to rely on the terms and conditions stated in the contract of employment? Where a logbook (which has details of the period of stay/travel) is kept and endorsed annually by the employer, would the IRB consider that this is acceptable for purpose of determining residence?

Answer:

Administratively the IRBM has considered the employment pass as a means to determine the physical presence in Malaysia, so a logbook (which has details of the period of stay/travel) provided that it is endorsed by the employer or such similar document that can indicate one's physical presence in Malaysia is acceptable.

22. Islamic Banking Products

There are more and more Islamic banking products being created for Malaysian taxpayers but there is a lack of clarity on how each of these new

products should be dealt with in the tax computation for both the bankers and the enterprise utilising the product.

For example, it is not clear as to how a taxpayer should claim qualifying cost for capital allowances purposes or how profit should be recognised by the financier if an asset is acquired under (i) Deferred-installment Sale [Al-Bai Bithaman Ajil] contract; and (ii) Advance Purchase [Bai'Salam] contract.

The Institutes are of the view that the IRB should take positive steps to participate in the development of the Islamic banking products jointly with Bank Negara Malaysia so as to ensure that once a new Islamic product is available, a Public Ruling is also issued to clarify the tax implications.

Answer:

The IRBM took note of the concern and the need to issue guidelines to clarify tax implications on Islamic financial instruments.

23. RPGT returns – Conditional Contracts

Pursuant to Section 13 of the RPGT Act, 1976, every chargeable person who disposes of a chargeable asset and every person who acquires the asset so disposed of shall make a return to the Director General within one month (or such further period as the Director General may allow on a written request being made to him) of the date of disposal of that asset.

In practice, the disposer is required to submit CKHT 1 return and the acquirer is required to submit CKHT 2 return to the tax authorities within one month from the date of disposal of the chargeable asset. Under normal circumstances, disposal of real property is deemed to have taken place on the date of a written agreement. However, conditional contracts, (for example, where approval from specific authorities is required, etc) may defer the date of disposal to a later date. In some cases of conditional contracts, problems arise where the disposer and the acquirer had submitted a return to the Director General within one month from the date of the contract and the assessment had been raised based on the return submitted, but the contract was aborted subsequently due to non-fulfillment of the conditions as stated in the contract. Under such circumstances, the disposer may face difficulties in recovering the tax he/she had paid to the authority.

In view of the above, the Institutes propose that Section 13 of the RPGT Act, 1976 be amended to allow the filing of RPGT returns (CKHT 1 and CKHT 2) upon the fulfilment of all conditions as stated in the contract. This will cut down taxpayers' compliance costs as well as the administrative costs of the IRB.

Answer:

Administratively, extension of time can be given for such cases and the application for that extension of time must be made to the respective IRBM branches.