INLAND REVENUE BOARD MALAYSIA

INTEREST EXPENSE AND INTEREST RESTRICTION

PUBLIC RULING NO. 2/2011

Translation from the original Bahasa Malaysia text

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DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling as provided for under section 138A of the Income Tax Act 1967 is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board Malaysia. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

Director General of Inland Revenue,
Inland Revenue Board Malaysia.

1. This Ruling explains:

   (i) the deductibility of interest expense in computing the adjusted income of a person from a source for the basis period for a year of assessment under paragraph 33(1)*(a)* of the Income Tax Act 1967 (ITA);

   (ii) restriction on the amount of interest expense deductible against gross business income under subsection 33(2) of the ITA; and

   (iii) computation of allowable interest expense according to source of income chargeable under paragraphs 4*(a),* 4*(c),* 4*(d)* or 4*(f)* of the ITA.

2. This Ruling also applies to gains or profits received and expenses incurred in lieu of interest in transactions conducted in accordance with the Syariah principle.

3. The provisions of the ITA related to this Ruling are paragraph 33(1)*(a)*, subsections 33(2) and 39(1).

4. The words used in this Ruling have the following meaning:

   4.1 “Interest” is the return or compensation for the use or retention by a person of a sum of money belonging to or owed to another.

   4.2 “Person" includes a company, a body of persons and a corporation sole.

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

   4.4 “Portfolio” means the various securities or other investments held by a person at any given time.

5. **Tax treatment of interest expense**

   5.1 Deductibility of interest expense under paragraph 33(1)*(a)*

   In ascertaining the adjusted income of a person from a source for the basis period for a year of assessment, interest incurred and payable on money borrowed by that person and -

   (i) employed in that period in the production of gross income from that source; or

   (ii) laid out on assets used or held in that period for the production of gross income from that source

   is an allowable expense.

Example 1:

Abadi Sdn Bhd borrowed RM1 million from CIMB Bank in January 2009 for use as working capital in its manufacturing business. The company incurred interest of RM100,000 in the year 2009. It has no other investments (as reflected in the company's balance sheet).

The interest expense of RM100,000 is allowed as a deduction from the gross business income of the company as it was incurred in the production of that income.

Example 2:

Ahmad bought a machine for use in his printing business by taking a loan of RM50,000 from Bank Industri.

Interest expense which Ahmad has to pay to the bank is allowed as a deduction from his gross business income as the loan was laid out on asset used for the production of income.

Example 3:

Bangi Sdn Bhd which closes its account on 31 December every year borrowed RM10 million from Maybank in March 2008 to build a new factory for its own use in Bandar Baru Bangi. The building is expected to be completed in January 2010.

Although the building has not yet been completed in the years 2008 and 2009, the interest expense incurred by the company in those years are allowed a deduction from its gross business income for the years of assessment 2008 and 2009 respectively since the loan was laid out on asset held for the production of income.

5.2 A person would not be given any deduction on the interest expense which he has incurred on borrowed money to construct a building or plant prior to commencement of his business. The person would not be able to claim industrial building or capital allowance (if applicable) as well on the amount of interest incurred even though such interest expense may have been capitalized as part of the cost of the building or plant. This is so because the interest expense is not part of the cost of construction of building or provision of plant.

Example 4:

IPP Sdn Bhd was incorporated on 8.3.2006. The company was given a concession by the state government to supply electricity to the rural areas in the state. Before commencement of its business of power supply on 1.7.2008, the company has incurred interest expense of RM3 million on a syndicated loan of RM30 million used to build a power plant.

The company would not be able to claim RM3 million in its tax computation for the year ending 30.6.2009 as the amount is a pre-commencement expense nor would it be eligible to claim capital allowance on the RM3 million if the amount has been capitalized as part of the cost of the power plant.

5.3 Borrowed money not wholly and exclusively used in business

5.3.1 Subsection 33(2) of the ITA provides that if a person has borrowed money for purposes of business as well as for non-business purposes, the interest expense charged to the profit and loss account may not be allowed a full deduction. This is so, if in the opinion of the Director General of Inland Revenue (DGIR), a part or whole of the money has either directly or indirectly been used for non-business purposes.

5.3.2 Money used for non-business purposes includes:

(i) investments in landed properties, shares, securities and Islamic securities, placement in fixed deposits; and

(ii) loans (including interest-free loans) given to some other persons.

5.3.3 If a person is able to prove to the satisfaction of the DGIR that investments and loans have not been made directly or indirectly out of the borrowed money, there will be no restriction on the interest expense allowable in calculating the adjusted income from the business source.

5.3.4 On the other hand, if a person fails to prove that the investments and loans have not been financed partly or wholly, directly or indirectly out of the borrowed money, then the amount of interest expense allowable will be restricted.

6. Interest restriction under subsection 33(2) of the ITA

6.1 The deduction of interest expense payable on borrowed money used for purposes of business, investments and loans is determined as follows:

(i) if the total amount of investments and loans is the same with or exceeds the amount of borrowed money, the whole amount of interest expense is disallowed; or

(ii) if the total amount of investments and loans is less than the amount of borrowed money, then only a portion of the interest expense is disallowed.

6.2 The portion of interest expense to be restricted against the gross business income is computed by using the following formula:

$$\frac{\text{Cost of investments and loans financed by interest-bearing borrowed money}}{\text{Outstanding balance of interest-bearing borrowed money at month or year end}} \times \text{Average interest payable, monthly or annually}$$

6.3 Application of the formula

6.3.1 Where the total cost of investments and loans which are financed directly or indirectly from the borrowed money does not exceed RM500,000, subsection 33(2) interest restriction will be computed based on the end-of-year balance.

6.3.2 Where

i. the total cost of investments and loans which are financed directly or indirectly from the borrowed money exceeds RM500,000; or

ii. there are no investments and loans at the end of the financial year because the investments and loans which are financed directly or indirectly by the borrowed money have been sold, transferred or repaid during the year.

subsection 33(2) interest restriction will be applied strictly based on monthly balances and the relevant information should be kept by the taxpayer for tax audit purposes.

6.3.3 The interest expense incurred is deemed to have been accrued evenly every month if monthly balances are used in computing interest restriction under subsection 33(2) of the ITA.

Example 5:

Alamanda Sdn Bhd closes its account on 31 December every year. It had obtained an overdraft facility of RM400,000 from Maybank for use in its business in December 2008. It bought 1,000 units of TNB shares and 5,000 units of Telekom shares on 5 January 2009. It also purchased a terrace house and a shophouse in January 2009. It received income from the investments in 2009 as follows:

Shares	Units	Cost (RM)	Dividend (RM)
TNB	1,000	10,000	2,000
Telekom Bhd	5,000	30,000	Nil
Total	**6,000**	**40,000**	**2,000**

Property	Cost (RM)	Rental received (RM)	Revenue expenses (RM)
Terrace house	100,000	12,000	1,000
Shop house	160,000	24,000	2,500
Total	**260,000**	**36,000**	**3,500**

The company claimed an interest expense of RM40,000 in its profit and loss account for the year of assessment 2009. As the company could not substantiate the purchase of investments were not financed from the overdraft, the amount of interest expense deductible against the gross income from its business has to be restricted.

The interest restriction is computed using the formula in paragraph 6.2 of this Ruling as follows:

$$\text{Interest restricted} = \frac{RM300{,}000}{RM400{,}000} \times RM40{,}000$$

$$= RM30{,}000$$

RM30,000 has to be added back in the company's tax computation (which means only RM10,000 is deductible as a business expense). However, the company can claim interest expense against its investment income since the investments are deemed to have been financed by the overdraft. The computation of interest expense for each investment source is computed as follows:

Dividend income (RM)	***Rental income (RM)***
$\frac{40{,}000}{300{,}000} \times 30{,}000 = 4{,}000$	$\frac{260{,}000}{300{,}000} \times 30{,}000 = 26{,}000$
Gross income 2,000	*Gross income* 36,000
Less: Interest allowable (RM4,000 restricted) 2,000	*Less: Interest allowable* 26,000
	Other expenses 3,500
Statutory income NIL	***Statutory income 6,500***

Example 6:

Same facts as in Example 5 except that the shares were financed by an interest-free loan from one of the directors.

The interest restriction is computed as follows:

$$\textit{Interest restricted} = \frac{RM260{,}000}{RM400{,}000} \times RM40{,}000$$

$$= RM26{,}000$$

The cost of shares amounting to RM40,000 is not included in the interest restriction computation as the purchase of shares was not financed by the overdraft facility from Maybank.

RM26,000 is added back in the income tax computation. However, the company can claim the interest expense of RM26,000 against gross rental income of RM36,000. There would not be any deduction of interest expense from dividend income as the loan used to finance the purchase of shares is interest-free.

Example 7:

Metro Bhd has obtained a loan facility from RHB Bank Bhd. Particulars of its monthly loan balances and investments financed by the borrowed money from RHB Bank Bhd are as follows:

Month ending	Loan balances (RM)	Investments (RM)	Interest expense (RM)
January	3,000,000	1,500,000	10,000
February	4,000,000	3,000,000	10,000
March	2,500,000	3,000,000	10,000
April	1,500,000	3,000,000	10,000
May	7,000,000	5,000,000	10,000
June	4,000,000	5,000,000	10,000
July	6,000,000	2,000,000	10,000
August	NIL	2,000,000	NIL
September	3,500,000	2,000,000	10,000
October	1,000,000	NIL	10,000
November	7,000,000	3,000,000	10,000
December	4,000,000	3,000,000	10,000

The portion of interest expense that is restricted under subsection 33(2) of the ITA is computed as follows:

Month ending	***Computation***		***Interest restricted (RM)***
January	*RM1,500,000 X RM10,000* *RM3,000,000*	=	*5,000*
February	*RM3,000,000 X RM10,000* *RM4,000,000*	=	*7,500*
March	*The whole interest is disallowed as the invested money exceeds the borrowed money*	=	*10,000*
April	*The whole interest is disallowed as the invested money exceeds the borrowed money*	=	*10,000*
May	*RM5,000,000 X RM10,000* *RM7,000,000*	=	*7,143*
June	*The whole interest is disallowed as the invested money exceeds the borrowed money*	=	*10,000*
July	*RM2,000,000 X RM10,000* *RM6,000,000*	=	*3,333*
August	*No interest expense was incurred for the month*	=	*NIL*
September	*RM2,000,000 X RM10,000* *RM3,500,000*	=	*5,714*
October	*The whole interest is allowable as no investment was made in the month*	=	*NIL*
November	*RM3,000,000 X RM10,000* *RM7,000,000*	=	*4,286*
December	*RM3,000,000 X RM10,000* *RM4,000,000*	=	*7,500*
	Total interest	=	***70,476***

7. Non-application of subsection 33(2) interest restriction

7.1 Subsection 33(2) interest restriction is not applicable where interest on borrowed money charged to the business accounts does not exceed RM10,000 in the case of companies and RM6,000 in the case of individuals and others.

7.2 Where interest on borrowed money charged to the business accounts exceeds RM10,000 in the case of companies and RM6,000 in the case of individuals and others, subsection 33(2) interest restriction should be applied. However, the interest disallowed for business purposes as a result of applying subsection 33(2) can be set-off against income from investments or loans, whichever is applicable.

8. **Interest expense incurred on investments**

8.1 For purposes of deducting interest expense against dividends, interest or rental income, all investments in porfolio shares, loans or properties of the respective sources should be aggregated regardless of whether they are income producing or non-income producing. However, this tax treatment does not apply to investments which produce income that is exempted from tax and interest-free loans to related parties, which are financed by the borrowed money.

Example 8:

Badrul Sdn Bhd obtained a loan facility from Ambank for use in its sundry shop business. The company invested in unit trusts and purchased some shares using part of the proceeds from the loan facility. Interest restriction computed by using the formula in paragraph 6.2 of this Ruling is RM8,000.

Badrul Sdn Bhd received the following investment income:

Unit trust	Units	Cost (RM)	Distribution of income (RM)
SBS Growth Fund	20,000	20,000	2,000
Makmur Fund	10,000	10,000	1,000
Total	**30,000**	**30,000**	**3,000**

Portfolio shares	Units	Cost (RM)	Dividend income (RM)
MAS Bhd	2,000	10,000	Nil
XYZ Bhd (pioneer co.)	10,000	50,000	(tax-exempt) 5,000
ABC Ltd (foreign co.)	5,000	20,000	(tax-exempt) 2,000
Malakof Bhd	10,000	40,000	10,000
Total	**27,000**	**120,000**	**17,000**

Tax treatment

(a) *Interest expense applicable to the investments in unit trusts:*

$$\frac{RM30,000}{RM150,000} \times RM8,000 = RM1,600$$

(b) Interest expense applicable to the portfolio shares:

$$\frac{RM50,000}{RM150,000} \times RM8,000 = RM2,667$$

Computation of statutory income

(i) Distribution of income		*RM3,000*
	Less : Interest expense	*RM1,600*
	Statutory income	***RM1,400***
(ii) Gross dividend income		*RM10,000*
	Less : Interest expense	*RM 2,667*
	Statutory income	***RM7,333***

Example 9:

Hanim , the sole proprietor of Hanim Halal Food, had borrowed from Ambank to finance the following investments and loans:

Loans to third parties	Units	Amount (RM)	Interest income (RM)
Loan 1	-	30,000	4,000
Loan 2	-	70,000	8,000
Total		**100,000**	**12,000**

Quoted shares	Units	Cost (RM)	Dividend income (RM)
Amway Bhd	12,000	100,000	10,000
TNB Bhd	15,000	120,000	10,000
Insas Bhd	30,000	80,000	Nil
Maybank Bhd	10,000	110,000	12,000
Takaful Bhd	20,000	90,000	Nil
Total	**87,000**	**500,000**	**32,000**

Shareholdings in Amway Bhd were purchased with a loan taken separately from Affin Bank. Interest claimed in respect of the Amway Bhd shares is RM10,000. The sole proprietor also has 1.2 million unquoted shares (with face value of RM1.00) in two related companies.

Unquoted shares	Units	Cost (RM)	Dividend income (RM)
Haz Sdn Bhd	800,000	800,000	30,000
Ezy Sdn Bhd	400,000	400,000	20,000
Total	**1,200,000**	**1,200,000**	**50,000**

The following properties are registered under Hanim's name:

Properties	Cost (RM)	Rental income (RM)	Revenue expenses (excluding interest) (RM)
House No. 1	250,000	10,000	2,000
House No. 2	300,000	12,000	3,000
House No. 3	150,000	11,000	10,000
Total	**700,000**	**33,000**	**15,000**

House No.1 is an inherited property. House No. 3 was acquired with a separate loan from Public Bank and the interest claimed in respect of this property is RM6,000. Interest disallowed under subsection 33(2) and computed by using the formula in paragraph 6.2 of this Ruling is RM216,000 (RM200,000 from interest restricted on loan from Ambank, RM10,000 from interest on loan from Affin Bank and RM6,000 from interest on loan from Public Bank).

Summary of investments/loans and interest restricted:

Investments	Ambank Bhd (RM)	Affin Bank (RM)	Public Bank (RM)	Others (RM)
Loans to third parties	100,000			
Quoted shares	400,000	100,000		
Unquoted shares	1,200,000			
Properties	300,000		150,000	250,000
Total	**2,000,000**	**100,000**	**150,000**	**250,000**
Interest restricted	200,000	10,000	6,000	Nil

Tax treatment

(a) *RM200,000 is apportioned among the three categories of investments financed by loans taken from Ambank.*

(i) Interest expense applicable to loans given to third parties:

$$RM200{,}000 \times \frac{RM100{,}000}{RM2{,}000{,}000} = RM10{,}000$$

(ii) Interest expense applicable to quoted and unquoted shares:

$$RM200{,}000 \times \frac{RM1{,}600{,}000}{RM2{,}000{,}000} = RM160{,}000$$

(iii) Interest expense applicable to landed properties:

$$RM200{,}000 \times \frac{RM300{,}000}{RM2{,}000{,}000} = RM30{,}000$$

(b) The interest expense of RM10,000 claimed in respect of the investment in Amway Bhd should be aggregated with the portion of interest RM160,000 applicable to investments in shares financed by loans from Ambank. The total amount of RM170,000 will be allowed as a deduction against gross dividend income from quoted and unquoted shares.

(c) The interest expense of RM6,000 claimed in respect of House No. 3 should similarly be aggregated with the interest expense of RM30,000 that is applicable to the landed properties financed by loan from Ambank. The total amount of RM36,000 will be allowed as a deduction against gross rental income from the 3 properties which is assessed as a single source of income under paragraph 4(d) of the ITA.

Computation of statutory income

(i) Interest income:

Gross interest income	*RM12,000*
Less: Interest expense	*RM10,000*
Statutory income	***RM 2,000***

(ii) Dividend income:

Gross dividend income	*RM82,000*
Less : Interest expense RM170,000 (restricted to)	*RM82,000*
Statutory income	***Nil***

(iii) Rental income:

Gross rental income		*RM33,000*
Less : Expenses	*RM15,000*	
Interest	*RM36,000*	
	RM51,000 (restricted to)	*RM33,000*
Statutory income		***Nil***

The excess of interest expense over income from dividend or rental is not to be deducted against other sources of income or be carried forward to subsequent years of assessment.

Example 10:

Same facts as in Example 9 except that there is nil income from investment in Amway Bhd. In this case, the gross dividend income from quoted and unquoted shares would be RM72,000.

Computation of statutory income

(ii) Dividend income:

Gross dividend income	*RM72,000*
Less : Interest expense RM170,000 (restricted to)	*RM72,000*
Statutory income	***Nil***

The excess of interest expense over income from dividend or rental is not to be deducted against other sources of income or be carried forward to subsequent years of assessment.

Example 11:

Same facts as in Example 9 except that there is nil income from investment in quoted and unquoted shares. In this case, the gross dividend income is nil.

Computation of statutory income

(ii) Dividend income:

Gross dividend income	*NIL*
Less : Interest expense RM170,000	*-*
Statutory income	***Nil***

The interest expense of RM170,000 that cannot be deducted against dividend income is not to be deducted against other sources of income or be carried forward to subsequent years of assessment.

8.2 Interest expenses incurred on money borrowed which is given as interest-free loans to related parties are not allowable under paragraph 33(1)*(a)* of the ITA.

Example 12:

Kim Seng obtained a loan facility of RM400,000 from BDB Bank for use in his business. Kim Seng gave loans to related persons by using part of the proceeds from the loan facility. The first loan was given interest-free. The second loan that was given was charged at market rate. Kim Seng claimed an interest expense of RM40,000 in his profit and loss account.

Loans given to related persons and interest income received are as follows:

Loans to related persons	Amount (RM)	Interest income (RM)
Loan 1	20,000	Nil
Loan 2	60,000	7,000
Total	**80,000**	**7,000**

The interest restriction is computed using the formula in paragraph 6.2 of this Ruling as follows:

$$\text{Interest restricted} = \frac{RM80,000}{RM400,000} \times RM40,000$$

$$= RM8,000$$

RM8,000 is to be added back in Kim Seng's tax computation (which means only RM32,000 is deductible from his business income).

The computation of interest expense allowable from interest income and the computation of statutory income from interest are as follows:

(i) *Interest expense in respect of loans given:*

$$RM8,000 \times \frac{{}^{1}RM60,000}{RM80,000} = RM6,000$$

[1]*Interest expense in respect of Loan 1 (which was given interest-free) is not allowed a deduction under paragraph 33(1)(a) of the ITA.*

(ii) *Computation of statutory income from interest:*

Gross interest income	*RM7,000*
Less: interest expense	*RM6,000*
Statutory income	***RM1,000***

Example 13:

Same facts as in Example 12 except that the first loan given was not financed by the loan facility from BDB Bank but from Kim Seng's own savings.

The interest restriction is computed using the formula in paragraph 6.2 of this Ruling as follows:

$$\text{Interest restricted} = \frac{{}^{2}\text{RM60,000}}{\text{RM400,000}} \times \text{RM40,000}$$

$$= \text{RM6,000}$$

[2]Loan 1 amounting to RM20,000 is not included in the interest restriction computation as that loan was not financed by the loan facility from BDB Bank.

RM6,000 is to be added back in Kim Seng's tax computation (which means only RM34,000 is deductible from his business income).

The computation of interest expense allowable from interest income and the computation of statutory income from interest are as follows:

(i) Interest expense in respect of loans given:

$$\text{RM6,000} \times \frac{{}^{3}\text{RM60,000}}{{}^{3}\text{RM60,000}} = \text{RM6,000}$$

[3]There was no interest expense payable in respect of Loan 1.

(ii) Computation of statutory income from interest:

Gross interest income	*RM7,000*
Less: interest expense	*RM6,000*
Statutory income	***RM1,000***

8.3 Rental income from letting of real property received by a person may be assessed as a business source under paragraph 4*(a)* of the ITA or as a non-business source under paragraph 4*(d)* of the ITA. A person who receives rental income is carrying on a business if he provides maintenance services or support services in relation to the real property.

Example 14:

Sedap Restaurant Sdn Bhd with year ending 31 December has three properties - a bungalow costing RM2 million, a shophouse costing RM500,000 and a terrace house costing RM300,000. The bungalow is situated in an exclusive area in town and is rented out to an expatriate family. In the rental agreement, the company is to provide cleaning and maintenance services to the swimming pool and the landscaped garden. The bungalow is fully furnished with air-conditioners, water heaters and furniture. The shophouse is for own use and the terrace house is rented out without any services provided. In its accounts for the year ending 31.12.2009, the company has an overdraft facility of RM3 million. The company has no other investments besides the three properties. The company has provided information that the bungalow and the shophouse were purchased by using part of the overdraft obtained from Scotia Bank. The terrace house was purchased by a term loan from Maybank. The terrace house was temporarily vacant from January to August 2009.

The company's profit and loss account for the year is as follows:

Gross income - Business			RM800,000
Rental income - Bungalow	180,000		
- Terrace house	6,000		186,000
			986,000
Less : Expenditure			
Depreciation		100,000	
Quit rent & assessment			
- Shophouse	10,000		
- Bungalow	14,000		
- Terrace house	7,200	31,200	
Fire insurance			
- Shophouse	5,000		
- Bungalow	1,000		
- Terrace house	300	6,300	
Overdraft interest		300,000	
Term loan interest		5,000	
Cleaning & maintenance			
- Shophouse	15,000		
- Bungalow	6,000	21,000	
Other revenue expenses		463,500	927,000
Net profit			**59,000**

Capital allowances (CA) for the restaurant business assets are RM110,000 and bungalow assets are RM5,000.

Interest restriction computed by using the formula in paragraph 6.2 of this Ruling is RM155,000 (RM150,000 from interest restricted on overdraft from Scotia Bank and RM5,000 from interest on loan from Maybank).

Rental income from letting of the bungalow will be assessed under paragraph 4*(a)* of the ITA whereas that of the terrace house will be assessed under paragraph 4*(d)* of the ITA.

Tax Treatment

Business I *- Restaurant*		*RM*
Net profit as per P&L account		*59,000*
Less: Rental income		*186,000*
		-127,000
Add: Depreciation	*100,000*	
Quit rent & assessment	*21,200*	
Fire insurance	*1,300*	
Cleaning & maintenance	*6,000*	
Interest restriction	*155,000*	*283,500*
Adjusted income		*156,500*
Less: Capital allowances		*110,000*
Statutory income		***46,500***

Business II *- Letting of bungalow*		*RM*
Gross income		*180,000*
Less: Quit rent & assessment	*14,000*	
Fire insurance	*1,000*	
Cleaning & maintenance	*6,000*	
Interest expense	*150,000*	*171,000*
Adjusted income		*9,000*
Less: Capital allowances		*5,000*
Statutory income		***4,000***

Rental income *- Terrace house*		*RM*
Gross income		*6,000*
Less: Quit rent & assessment	*7,200*	
Fire insurance	*300*	
Interest expense	*5,000*	*12,500*
Adjusted loss		***-6,500***

<u>Tax Computation</u>

Statutory income - Business I	*46,500*
- Business II	*4,000*
Statutory income from terrace house	*NIL*
Chargeable income	***50,500***

Rental income from the letting of terrace house is assessed under paragraph 4(d) of the ITA and is of non-business source. Therefore, the loss of RM6,500 cannot be deducted against any other sources of income or be carried forward to subsequent years of assessment.

9. **Refinancing loan**

Any interest incurred on a second loan taken to refinance an existing loan would be deductible for tax purposes if the earlier loan was taken for the purpose of producing the business income. However, if the second loan is taken to finance the earlier loan which was used for business as well as non-business purposes, then interest restriction under subsection 33(2) of the ITA applies.

Example 15:

Company A was involved in timber-logging activity. In early 2005, the company obtained a loan of RM100 million (first loan) from Maybank to pay outstanding timber royalty payments. The company was allowed a deduction of interest payment on the first loan. In the year 2009, the company took another loan of RM70 million (second loan) from Public Bank to refinance the outstanding first loan because of lower interest rates offered by the bank. The company claimed interest expense incurred in respect of the second loan as an allowable deduction.

In order to qualify as an allowable deduction under subparagraph 33(1)(a)(i) of the ITA, the purpose of the borrowing needs to be ascertained, that is whether it was incurred in the production of income. The purpose of the second loan is to refinance the first loan so that the company can enjoy savings provided by the second loan. Since the interest expense from the first loan had been allowed, the interest expense arising from the second loan qualifies as an allowable deduction under subparagraph 33(1)(a)(i) of the ITA because it is a mere replacement of the first loan.

Example 16:

Madam Leong purchased a luxury condominium by taking a loan of RM1.3 million in the year 2005 from Maybank Bhd. The condominium is rented out since the purchase. In the year 2009, Madam Leong transferred the financing of the property to Nova Scotia Bank because of lower interest rates that the bank could offer. The balance of the loan at the end of the year 2008 was RM1 million. Nova Scotia Bank approved a non-revolving loan of RM1.35 million for the refinancing of the property (RM1 million) and the balance of the loan was used for her personal requirements. Interest paid on the loan of RM1.35 million is RM42,000.

The interest expense deductible against rental income is as follows:

Month	*Balance of previous loan (RM)*	*Refinancing loan (RM)*	*Interest Claimed (RM)*	*Interest Allowed (RM)*
January	*1,000,000*	*1,350,000*	*3,500*	*2,593*
February	*1,000,000*	*1,350,000*	*3,500*	*2,593*
March	*1,000,000*	*1,350,000*	*3,500*	*2,593*
April	*1,000,000*	*1,350,000*	*3,500*	*2,593*
May	*1,000,000*	*1,350,000*	*3,500*	*2,593*
June	*1,000,000*	*1,350,000*	*3,500*	*2,593*
July	*1,000,000*	*1,350,000*	*3,500*	*2,593*
August	*1,000,000*	*1,350,000*	*3,500*	*2,593*
September	*1,000,000*	*1,350,000*	*3,500*	*2,593*
October	*1,000,000*	*1,350,000*	*3,500*	*2,593*
November	*1,000,000*	*1,350,000*	*3,500*	*2,593*
December	*1,000,000*	*1,350,000*	*3,500*	*2,593*
Total			***42,000***	***31,116***

Note: Computation of allowable interest expense:

$$\frac{RM1{,}000{,}000}{RM1{,}350{,}000} \times RM3{,}500 = RM2{,}593$$

10. Deferred payment credit

An asset may be purchased and full payment is made after a period of long term credit, either by instalments or in one lump sum payment. If the credit facility is used, the price to be paid (deferred payment) is higher than the cash price. The difference between the deferred payment and the cash price is deferred interest that is deductible under paragraph 33(1)*(a)* of the ITA.

Example 17:

Sunshine Sdn Bhd (SSB) purchased office furnitures from Kedai Perabot Aman on 1.5.2008 to be used in its business. SSB used the 24-month credit facility offered by the furniture shop and paid RM30,000 (deferred payment) on 1.5.2010. The cash price of the furniture was RM24,000. SSB closes its account on 31 December every year.

The deferred interest amounting to RM6,000 is deductible under paragraph 33(1)(a) of the ITA in the year of assessment 2010.

Example 18:

Same facts as in Example 17 except that the deferred payment was paid in 24 equal monthly instalments commencing from 1.5.2008.

The deferred interest amounting to RM250 monthly (RM6,000 ÷ 24) is deductible under paragraph 33(1)(a) of the ITA in the year of assessment in which the expense is incurred. As such the deferred interest claimed for the following years of assessment are:

Year of assessment	*Deferred interest (RM)*
2008	*2,000*
2009	*3,000*
2010	*1,000*

NOTE: *If the instalment is paid according to some other basis (for example on a decreasing amount basis), the company has to compute accordingly to ascertain the amount that can be claimed as a deduction under paragraph 33(1)(a) of the ITA.*

11. Treatment of interest expense attributable to dividend income received by a company

The single-tier tax system has been implemented with effect from the year of assessment 2008. Under this system, tax paid by a company is a final tax. The company may declare single-tier exempt dividends to its shareholders who will not be taxed on the dividend income. However, a company with balance in its section 108 account is allowed to continue to frank dividends from that account during the transitional period from 1.1.2008 until 31.12.2013 or until such time when the 108 balance is reduced to nil, whichever is earlier. The statutory income from dividend (assessed under paragraph 4*(c)* of the ITA) received by a company is deemed to be total income or part of total income of the company with effect from the year of assessment 2008.

Example 19:

Mutiara Sdn Bhd has the following income for the year ending 30.9.2009. Mutiara Sdn Bhd makes a contribution of RM4,000 to an approved institution in that year.

	Business I (RM)	**Business II (RM)**
Adjusted profit / loss	90,000	-40,000
Capital allowance (CA)	35,000	33,000
Statutory income	55,000	Nil

Non-business income	**Gross income (RM)**	**Interest expense (RM)**	**Statutory income (RM)**
Rental	50,000	15,000	35,000
Dividends:			*5,000
Single-tier	14,000	6,000	
Franked	6,000	1,000	
Tax-exempt	10,000	3,000	

**Under paragraph 12B, Schedule 6 of the ITA, single-tier dividend income is exempted from tax and any expenses related to the derivation of the dividends are to be disregarded. Tax-exempt dividend income of RM10,000 cannot be aggregated with franked dividend income as one source of income. Therefore the computation of statutory income from franked dividend is as follows:*

Gross income	*RM6,000*
Less: Interest expense	*RM1,000*
Statutory income	*RM5,000*

Tax Computation

Statutory income - Business I	*55,000*
- Business II (CA c/f RM33,000)	*Nil*
- Rental	*35,000*
Aggregate income	***90,000***
Less: current year loss	*40,000*
	50,000
Less: approved donation	*4,000*
	46,000
Add: Statutory income - Dividend (deemed as part of the total income)	*5,000*
Total income/Chargeable income	***51,000***
Income tax @ 25%	*12,750*
Less: section 110 set-off	*1,500*
Tax payable	***11,250***

12. **Effective date**

This Ruling is effective for the year of assessment 2011 and subsequent years of assessment.

Director General of Inland Revenue,
Inland Revenue Board Malaysia.