INLAND REVENUE BOARD OF MALAYSIA

TAX TREATMENT ON INTEREST INCOME RECEIVED BY A PERSON CARRYING ON A BUSINESS

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DIRECTOR GENERAL'S PUBLIC RULING

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

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

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

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

1. Objective

The objective of this Public Ruling (PR) is to explain the tax treatment in respect of interest income received by a person carrying on a business.

2. Relevant Provisions of the Law

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

2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are paragraph 4*(a)*, paragraph 4*(c)*, section 4B and subsection 24(5).

2.3 Savings and Transitional Provisions of the Finance Act 2013 [Sections 39 and 40, Act 755].

3. Interpretation

The words used in this PR have the following meaning:

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

3.2 "Person" includes a company, a body of persons, a limited liability partnership and a corporation sole.

3.3 "Statutory income", in relation to a person, a source and a year of assessment, means statutory income ascertained in accordance with the ITA.

3.4 "Assessment" means any assessment or additional assessment made under the ITA.

3.5 "Basis period" in relation to a person, a source of his and a year of assessment, means such basis period, if any, as is ascertained in accordance with section 21 or section 21A of the ITA.

4. Sources of Interest Income

4.1 Financial Deposit Product

Commercial banks and financial institutions pay interest to depositors through various financial deposit products which among others are as follows:

(a) Fixed Deposit Account

Bank receives a certain sum of money which is deposited for a certain period, either on short term or long term. The interest rate is fixed and normally increases in accordance with a longer period of deposit. Interest will be credited on maturity date. If the deposited money is withdrawn prior to the maturity date, interest may not be paid or may only be paid partly; depending on the terms and conditions of the fixed deposit contract.

Thus, the date of interest accrued for the purpose of income tax is the last day of the period set out in each case. If interest is paid for a deposit which has not reached its maturity date, the accrued interest is for the period for which the interest is paid.

(b) Savings Accounts

Interest on savings accounts are normally computed based on a daily savings balance but only credited at every month-end.

4.2 **Negotiable Instrument of Deposit (NID)**

NID is a form of certificate issued by financial institutions to individuals or corporate clients. It states the total savings amount, the fixed interest rate and the repayment date to the NID holder. This instrument can be traded and may be sold by the original holder to any party in the secondary market before it matures. Nevertheless, the sale prior to maturity is subject to the interest rate at the time when it is sold.

4.3 **Repurchase Agreement (Repo)**

Repo is an agreement of sales of negotiable security by one party (example: financial institution) to another party (example: investor) with an agreement to buy it back at a specified and agreed date and price in the future. The agreed buy back price is higher than the original selling price with the interest amount accrued over the repo period factored therein.

4.4 **Debenture, mortgage and loan**

(a) Interest on debenture normally accrues on a specified date such as interest on government bonds and others.

(b) In general, debentures can be acquired and disposed of in the same manner as stocks and the same consideration applies in respect of the basis of assessment when a disposal or transfer takes place. The interest source income is deemed to commence on the date it first accrued.

(c) Mortgages and loans are normally private contracts between a lender and a borrower, and the lender cannot transfer the debt without the borrower's consent. The payment date of interest on advances is stated in every agreement between the lender and the borrower.

(d) In every case, income will accrue only on the specified date for interest payment, subject to the specific provision in the loan and mortgage agreement.

4.5 **Gains or profits from savings accounts and investments with Islamic banks**

(a) Since the business and financial affairs of Islamic banking are based on the principle of trade in accordance with the Islamic religion rules or Syariah law, the concept of interest does not exist in the dealings of Islamic banking. Any Islamic banking dealings concerning the operation of savings accounts or investments is based on the relationship between the operator (bank) and the capital provider (customer).

(b) Nevertheless, for the purposes of income tax, subsection 2(7) of the ITA provides that any reference in the ITA with regards to interest, shall apply, mutatis mutandis, to gains or profits received and expenses incurred in lieu of interest, in transactions conducted in accordance with the Syariah principle.

(c) Hence, the tax treatment on the gains or profits paid to an investor of a savings account or an investment with an Islamic bank is the same as that of the taxation on interest.

5. Tax Treatment

Interest income is chargeable under paragraph 4*(a)* or 4*(c)* of the ITA. From the year of assessment 2013, section 4B of the ITA provides that interest income cannot be charged to tax as gain or profit from business under paragraph 4*(a)* of the ITA; except for those interest that fall under subsection 24(5) of the ITA.

5.1 Interest income under paragraph 4*(a)* of the ITA

Subsection 24(5) provides that interest is assessed as business income under paragraph 4*(a)* if:

(a) the debebture, mortgage or other source to which the interest relates forms part of the stock in trade of a person; or

(b) the interest is receivable by a person in the course of carrying on a business of lending money and that business is licensed under any written law.

5.2 **Interest income assessed under paragraph 4*(c)* of the ITA**

Interest income received by a person from the carrying on of a business other than those mentioned in paragraph 5.1 is taxed as interest income under paragraph 4*(c)* of the ITA. Such interest income includes:

(a) Interest charged due to delay in payment of trade debt

Example 1

Setia Jaya Sdn. Bhd. (SJSB) operates a business of selling building materials such as sawn timber, cement, bricks and others. SJSB gives a 30-day credit term to its regular customers. An interest of four percent (4%) per annum on the amount due will be imposed if payment is made later than the permissible date.

Interest arising from the late payment is interest income that shall be assessed under paragraph *4(c)* of the ITA on SJSB.

(b) Interest from an easy payment plan

Example 2

Jasmin purchased a sofa set costing RM10,000 from Perabot Mewah Sdn Bhd (PMSB). Jasmin opted to make use of the 24 months instalment plan offered to her by PMSB with the payment amount of RM475 per month commencing from 15 May 2015. PMSB closes its accounts on 31 December each year.

The difference between the price offered through the easy payment plan which is RM11,400 (i.e. RM475 x 24 months) and the cash price which is RM10,000 amounting to RM1,400 is an interest under paragraph 4*(c)* to PMSB.

The income that is to be reported by PMSB with respect to the above transaction is as follows:

Year of Assessment 2015

(i) Business income [paragraph 4*(a)*]

Gross revenue	RM10,000
(-) Cost	xxx
Business profit	RM xxxx

(ii) Interest [paragraph 4*(c)*]

(1,400 x 8/24)	RM 467

Year of Assessment 2016

Interest [paragraph 4*(c)*] (1,400 x 12/24)	RM 700

Year of Assessment 2017

Interest [paragraph 4*(c)*] (1,400 x 4/24)	RM 233

(c) Interest from Housing Development Account

A Housing Development Account (HDA) is a bank account opened and managed by a housing developer. Progressive payments received by the housing developer from the sale of houses in a housing development project and any other related receipts of money shall be deposited into the HDA.

Interest arising from the money placed in the HDA is interest income under paragraph *4(c)* of the ITA.

Note:
The same principle applies to professional services firms such as legal firms or others that use "client accounts" in their affairs of providing services to their customers.

(d) Interest from fixed deposit placed as security

Example 3

Pembinaan Maju Sdn Bhd (PMSB) is a building contractor. For the purpose of obtaining a bank loan to finance the working capital of its business, the bank requires that PMSB maintains a certain amount of money in fixed deposit as security.

The interest received by PMSB from the fixed deposit is interest income under paragraph *4(c)* of the ITA.

(e) Interest arising from the excess of cash from working capital placed in the short term or long term investments

Example 4

Carrowinds Sdn Bhd (CSB) operates a theme park and casino business. CSB had placed part of its excess cash from the working capital into a fixed deposit account in a bank and the remaining part given as a loan to its parent company.

The interests received by CSB from the fixed deposit and that which arises from the loan to the parent company are interest income under paragraph 4*(c)* of the ITA.

Example 5

Quality Tyre Manufacturing Sdn Bhd (QTMSB) operates a business of manufacturing tyres for automotive vehicles. For the purpose of gaining advantage from the raw material price fluctuations from time to time, QTMSB places the excess of cash allocated for any certain period for the raw material purchase (at such time when raw material price is low) into short term and long term deposits. The profit from the investment will be ploughed back into QTMSB's working capital whenever necessary, to be used in the tyre manufacturing business. The investment strategy and the raw material price fluctuations are monitored by an investment officer as well as taking into consideration the views of consultants.

The interest from the short-term and long-term investment received by QTMSB is interest income under paragraph *4(c)* of the ITA.

(f) Interest received by a person from loan given to employees

Example 6

Kedai Emas Sarah is a sole-proprietorship business of Puan Sarah. As a measure to enhance employee loyalty towards continuously working for Kedai Emas Sarah and not opting to switch to other employers, Puan Sarah gives short term personal loan facilities to her employees. Interest at the rate of three percent (3%) per annum is charged on the loan balance.

The interest arising from the loan to the employees is interest income under paragraph 4*(c)* of the ITA to Puan Sarah.

(g) Interest received by an estate administrator after the death of a money lender

Although the interest received by a money lender is considered as business income under paragraph 4*(a)* during his lifetime, interest arising after his death when the business has stopped and then received by the estate administrator becomes interest income under normal circumstances which is to be assessed as income under paragraph 4*(c)* of the ITA.

5.3 **Savings and transitional provisions**

In the event that interest income received is not from the carrying on of a money lending business but has been assessed under paragraph 4*(a)*, then, with effect from the year of assessment 2013 the interest income shall be assessed under paragraph 4*(c)*. The tax treatment for any unabsorbed losses and capital allowances with respect to the interest income is as follows:

(a) Losses that could not be absorbed in the year of assessment 2012 with regards to interest assessed as business source shall be carried forward and be deductible against the aggregate of statutory income of any other business sources in the year of assessment 2013 and the subsequent years of assessment until fully absorbed.

Example 7

Syarikat A Sdn Bhd has two sources as follows:

(i) Source 1 – Building Contractor Business
(ii) Source 2 – Interest

The statutory income and the adjusted loss from the two sources for the year of assessment 2012 and year of assessment 2013 are as follows:

Sources of Income	Statutory income/(Adjusted loss) (RM)	
	Year of Assessment 2012	Year of Assessment 2013
Source 1: Business – Building Contractor	10,000	15,000
Source 2: Interest	(20,000) **[assessed under paragraph 4*(a)*]**	5,000 **[assessed under paragraph 4*(c)*]**

Year of Assessment 2012	RM	RM
Source 1: Business statutory income		10,000
Source 2: Business statutory income [Interest under paragraph 4*(a)*] (Adjusted loss: 20,000)		Nil
Aggregate income		10,000

Less :		
Basis period loss from interest [subsection 44(2)]	(20,000)	
Restricted to	10,000	(10,000)
Loss from interest c/f	(10,000)	
Chargeable income		Nil

Year of Assessment 2013	RM
Source 1:	
Business statutory income	15,000
Less:	
Loss from interest b/f [subsection 43(2)]	(10,000)
	5,000
Source 2:	
Other statutory income [Interest under paragraph 4*(c)*]	5,000
Aggregate income	10,000

(b) In cases where there is no aggregate statutory income from a business source for the year of assessment 2013 and the subsequent years of assessment, the loss can be allowed against the adjusted income of non-business sources until the loss is fully absorbed.

Example 8

Same facts as in **Example 7**. The statutory income and adjusted loss from the two sources for the year of assessment 2012 and the year of assessment 2013 are as follows:

Sources of Income	Statutory income/(Adjusted loss) (RM)	
	Year of Assessment 2012	Year of Assessment 2013
Source 1: Business – Building Contractor	10,000	(15,000)
Source 2: Interest	(20,000) **[assessed under paragraph 4*(a)*]**	5,000 **[assessed under paragraph 4*(c)*]**

Year of Assessment 2012	RM	RM
Source 1:		
Business statutory income		10,000
Source 2:		
Business statutory income		Nil
[Interest under paragraph 4*(a)*]		
(Adjusted loss: 20,000)		
Aggregate income		10,000
Less:		
Basis period loss from interest	(20,000)	
[subsection 44(2)]		
Restricted to	10,000	(10,000)
Loss from interest c/f	(10,000)	
Chargeable income		Nil

Year of Assessment 2013	RM	RM	RM
Source 1:			
Business statutory income			Nil
(Adjusted loss: 15,000)			
Business loss c/f	(15,000)		
Source 2:			
Other statutory income		5,000	
[Interest under paragraph 4*(c)*]			
Less:			
Loss from interest b/f	(10,000)		
[subsection 43(2)]			
Restricted to	5,000	(5,000)	Nil
Loss from interest c/f	(5,000)		
Aggregate income			Nil

Note:
The loss brought forward from the year of assessment 2012 amounting to RM10,000 shall first be deducted from business income (if any). When there is no business statutory income for the year of assessment 2013, the loss brought forward shall be deducted from the adjusted income of

the other source, which is the interest income amounting to RM5,000 that is assessed under paragraph 4*(c)* in the year of assessment 2013. The priority is to deduct first the loss brought forward from the interest income assessed under section 4*(a)* amounting to RM10,000 and not the basis period loss. Therefore, the basis period loss amounting to RM15,000 shall be carried forward to be absorbed by business sources from the year of assessment 2014 onwards.

(c) In cases where there are more than one source of business, a taxpayer is allowed to choose either to deduct losses or capital allowances that were unabsorbed in the year of assessment 2012. This will bring the best efficiency on taxpayer's tax liability for the year assessment 2013 and the subsequent years.

Similarly, in cases where there is a mixture of business and non-business sources, allowances under Schedule 3 of the ITA that was unabsorbed in the year of assessment 2012 with regards to interest income assessed as business source shall be allowed to reduce the statutory income of any of the business sources for the year of assessment 2013 and the subsequent years of assessment. If there is no business source, the capital allowances can be deducted against the adjusted income from other sources until the allowances are fully absorbed.

Example 9

Syarikat B Sdn Bhd has 2 sources of income as follows:

Sources of Income	Year of Assessment 2012 (RM)	Year of Assessment 2013 (RM)
Source 1: Beauty centre business - Adjusted income - Capital allowance	 18,000 8,000	 30,000 5,000
Source 2: Interest (*) - Adjusted loss - Capital allowance	 (40,000) 15,000	 15,000

(*) Interest income was assessed under paragraph 4*(a)* of the ITA in the year of assessment 2012.

Year of Assessment 2012	RM	RM
Source 1:		
Beauty centre business		
Adjusted income		18,000
Less:		
Capital allowance		(8,000)
Business statutory income		10,000
Source 2:		
Business statutory income		
[Interest under paragraph 4*(a)*]		Nil
(Adjusted loss: 40,000)		
Less:		
Capital allowance	15,000	
Absorbed	Nil	
Capital allowance c/f	15,000	
Aggregate income		10,000
Less:		
Basis period loss from interest	(40,000)	
[subsection 44(2)]		
Restricted to	10,000	(10,000)
Loss from interest c/f	(30,000)	
Chargeable income		Nil

Year of Assessment 2013	RM	RM	RM
Source 1:			
Beauty centre business			
Adjusted income		30,000	
Less:			
Capital allowance	5,000		
Capital allowance b/f	15,000	(20,000)	
Business statutory income		10,000	
Less:			
Loss from interest b/f	(30,000)		
Restricted to	10,000	(10,000)	Nil
Unabsorbed loss from business c/f	(20,000)		

Source 2:			
Other statutory income			
[Interest under paragraph 4*(c)*]		15,000	
Less:			
Unabsorbed loss from interest b/f	(20,000)		
Restricted to	15,000	(15,000)	Nil
Unabsorbed loss from interest c/f	(5,000)		
Aggregate income			Nil

Note:
Business losses and capital allowances that had not been fully absorbed in the year of assessment 2012 shall be carried forward to the year of assessment 2013. The business loss from interest under paragraph 4*(a)* amounting to RM30,000 in the year of assessment 2012 shall first be deducted from income of business sources.

In cases where the loss is yet to be fully absorbed, the balance of the unabsorbed losses shall be deducted against other sources. The priority is to deduct the loss from interest brought forward amounting to RM20,000 against the interest income of RM15,000; and not the basis period loss (if any). The remaining unabsorbed loss of RM5,000 shall be carried forward to the year of assessment 2014.

(d) The above savings and transitional provisions are to ensure that losses and capital allowances arising from interest income which had been previously assessed as business source are fully absorbed within a short period. Therefore, taxpayers are advised to record separately the carried forward losses and capital allowances with regard to interest assessed as income under paragraph 4*(a)* prior to the year of assessment 2013 for ease of tracing back the amounts involved.

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