# TECHNICAL DIALOGUE ON 20 APRIL 2001

## REPORT ON PROCEEDINGS OF DIALOGUE WITH TECHNICAL DIVISION OF IRB ON 20 APRIL 2001

The Chairperson of the dialogue, Encik Lim Heng How welcome the representatives from the Malaysian Institute of Taxation (MIT), the Malaysian Institute of Accountants, the Malaysian Association of Certified Public Accountants (MACPA) and other bodies to the dialogue.

The meeting then proceeded to discuss the various issues raised:

### 1. Revised Section 108 Provisions

#### *1.1 Definition of Compared Aggregate*

In accordance with the new subsec. 108(5), "compared aggregate" is defined as the aggregate of the amount:

(i) of the tax paid (if any) and an amount of tax set off under sec. 110 (if any), restricted to the amount of the tax on the chargeable income of the company, less any rebate under sec. 6B (*tax rebate on loan to a small company*) or any relief given for a year of assessment under sec. 132 (*double tax relief*) or 133 (*unilateral relief*), less any tax refunded to the company under sec. 111 (*refund of overpayments*); and
(ii) the balance (if any) carried forward for the credit of the company in accordance with subsec. (8). *[Note : The words in italic are our addition.]*

The effect of the amendment is that the sec. 108 credit for the year is based on the actual tax paid instead of the tax chargeable. This is intended to prevent dividends from being distributed by the company, and the sec. 110 tax credit being claimed by and refunded to the shareholders of the company even if the company has not paid the tax for the relevant year.

However, the formula for calculating the "compared aggregate" appears to be incorrect. As the sec. 110 set off is equivalent to tax already paid, the restriction to the amount of tax charged and deducting the tax refund would amount to a double deduction in arriving at the compared aggregate.

Clarification is sought on the above matter.

**The amount of tax set-off under sec. 110 is restricted to the amount of tax on chargeable income for a year of assessment. The tax refund under sec. 111 is only pertaining to refund as a result of overpayment of instalments and reduced assessments where the discharged amount of tax has been paid by the company.**

**The IRB will be releasing a draft guideline on how to complete the Form R.**

### *1.2 Section 108 Credit Aggregate*

Clarification is sought on the sec. 108 credit position of a holding company which has received dividends from its subsidiary.

Kindly advise on whether the tax set off under sec. 110 is included as part of the company's "compared aggregate" at the time the dividends are received by the company from its subsidiary, or only upon the company submitting its tax return wherein the amount of chargeable income and the tax payable are reported.

**The IRB has confirmed that the tax set off under sec. 110 is included as part of the company's "compared aggregate" at the time the dividends are received by the company from its subsidiary up to the amount of tax on chargeable income. The amount of tax on chargeable income for a year of assessment should be known when the company submits its sec. 108 statement for a year of assessment.**

### *1.3 Verification of section 108 Balance*

(a) The IRB has issued letters to inform the taxpayers of their unabsorbed loss and capital allowance brought forward, exempt income account and sec. 108 credit balance. However, in certain cases, the sec. 108 credit balance in the IRB's record differs from that of the taxpayer and request for reconciliation of the difference has not been attended to by the IRB.

It is suggested that the IRB provide a reconciliation of the difference speedily in view that the *Income Tax (Amendment) Act, 2000* requires the sec. 108 credit balance as at December 31, 2000 to be reported in the tax return for year of assessment 2001.

(b) It is also suggested that the IRB provide a service to enable companies to verify or confirm the amount of their sec. 108 balance at any particular point in time.

This should help to pre-empt the necessity of having to invoke sec. 110(13).

**The IRB has requested that taxpayers seeking a confirmation of the sec. 108 Account and Tax Exempt Account, kindly submit their computation of the sec. 108 Account and Tax Exempt Account balances to the IRB, as to assist the IRB to make a comparison of their own computations and the taxpayers balances.**

### *1.4 Submission of section 108 Statement*

The new subsec. 108(5) requires that a statement, in the prescribed form showing the compared total and compared aggregate of the company, be furnished to the Director General within 6 months following the close of the company's accounting period. This requirement is to take effect from year of assessment 2001.

The revised sec. 108 also provides that in relation to year of assessment 2000 on current year basis, the statement is to be submitted to the Director General within 3 months after the end of year of assessment.

(a) The IRB at the dialogue held in November 2000 has confirmed that the extension of time of 2 months (from 6 months to 8 months from the accounting year end) for filing tax returns for year of assessment 2001 will be accorded to the submission of the sec. 108 statement.

It was also highlighted at the dialogue that companies with accounting period January 1 — December 31, 2000 may encounter problems in submitting the sec. 108 statement within 3 months after the end of the year of assessment. It was suggested that these companies be allowed to submit the sec. 108 statement together with Form C and the IRB agreed to look into the matter.

Kindly advise on IRB's decision on this matter.

**It was agreed that sec. 108 Statement for year of assessment 2000 (current year basis) be submitted together with the Form C for companies that had not submitted its Form C. For companies that had submitted its Form C for year of assessment 2000 (current year basis), it has been agreed that sec. 108 statement be submitted by 31 May 2001.**

(b) The IRB has also indicated at the dialogue that it would issue a public ruling on the application of the revised sec. 108. Kindly advise on the status of the proposed public ruling.

**The draft Form R with explanatory notes are in the process of being finalised. A Public ruling on the new sec. 108 provisions will follow suit.**

**2. Recovery of section 110 Relief from Shareholders**

The new subsec. 110(13) empowers the Director General to recoup a company's taxes from its shareholders where the company has insufficient sec. 108 credit.

It is suggested that the IRB issue guidelines or public ruling on the exercise of such power by the Director General, having regard to its potential impact on shareholders.

It is also suggested that the Director General's power to recoup the tax shortfall should only be invoked after exhausting all other possible avenues to recoup the tax due.

**The IRB are aware that the professional bodies are somewhat concern of the above "recoupment" powers under sec. 110(13), but reassure the taxpayers and tax practitioners, that the Director General's power to recoup the tax shortfall from the company's shareholders will be used as a last resort measure.**

## 3. Withholding Tax on Reimbursements

Clarification is sought on whether reimbursements of out-of-pocket expenses (e.g. traveling expenses, meals and accommodation), made to a non-resident are subject to withholding tax.

For example, a non-resident consultant comes to Malaysia to perform work for a short term period of time (no PE arises and therefore sec. 109B applies). The consultant incurs air fare, taxi fare, hotel accommodation and meal expenses, etc. and these expenses are reimbursed by the local entity.

Kindly confirm that withholding tax under sec. 109B would not apply on the out-of-pocket expenses.

**The IRB has taken the stand that the reimbursements of out-of-pocket expenses made to a non-resident would be subject to withholding tax under sec. 109B, as the IRB deems the expenses as being part of the total gross payments made for the services rendered.**

## 4. Proposals in 2001 Budget

### *4.1 Deduction for Donations to Approved Institutions [section 44(6)]*

It was proposed in the 2001 Budget that deduction for gifts of money made by a company to approved institutions is limited to 5% of the company's aggregate income in the relevant year.

The following suggestions have been submitted for IRB's consideration at the dialogue held in November 2000:

(a) Limiting the deduction to 5% may curtail the total amount of contributions that the private sector may wish to make for charitable purposes. In addition, the 5% restriction may give rise to practical problems to certain entities/institutions which are under legal obligation (as prescribed in their memorandum and articles of association, etc.) to donate a minimum percentage of their total income for charitable purposes.

It was suggested that the deductible amount be increased, say to 25% of a company's aggregate income.

(b) It was also suggested that in view of the substantial amendment to sec. 44(6), the IRB issue revised guidelines on application for exempt status under this section.

**The IRB wish to inform that the guidelines are being finalised.**

**Nonetheless, the IRB has also cordially invited the professional bodies to submit their own proposals on the above changes.**

The IRB indicated that it would consult with the Ministry of Finance regarding the 5% restriction. Kindly advise on the status of this matter and also item (b) above.

**The IRB has requested that the professional bodies refer this matter to the Ministry of Finance as it is a policy issue.**

### *4.2 Tax Incentives for Investment in Venture Companies*

It is proposed in the 2001 Budget that investment in approved venture companies at startup, seed capital and early stage financing be given a deduction equivalent to the value of the investment. If the company does not have sufficient statutory income to offset the investment, the deductions will be allowed to be carried forward. This incentive is given provided the investor company does not dispose of its equity in the venture company until such time that the venture company is listed.

The professional bodies at the dialogue with the IRB held in November 2000 have expressed the view that the proviso for the incentive will reduce its effectiveness in encouraging investment in the high-risk sector wherein venture companies operate. Not all venture companies aim for listing. In addition, it does not make business sense to prevent a company from selling out its investment in a venture company to a synergistic buyer who is willing to pay a good price.

It was also suggested that the proviso be relaxed such that an investor company will qualify for the incentive on condition that its equity interest in the venture company is held for a prescribed period, say at least 3 years, rather than subject to listing on KLSE.

The IRB has indicated that the matter would be referred to the Ministry of Finance for consideration.

Kindly advise on the status of this matter.

**The matter has been referred to the Ministry of Finance. Treasury is of the opinion that the condition, as stated, be maintained.**

**The IRB has also confirmed that the VCC Orders and Rules are in the process of being finalised.**

## 5. Basis of Recognition of Profit for Property Developers (Property Development) and Contractors (Construction Contracts)

Property developers are required under approved accounting standards (MAS 7, Accounting for Property Development Activities) to recognise profit from property development activities using the percentage of completion method when the following criteria are met:

(i) the sale of the building unit is transacted;
(ii) building construction activities have commenced;
(iii) the financial outcome of the development activities can be reliably estimated.

Similarly, in accordance with MASB 7 Construction Contracts, when the outcome of a construction contract can be measured reliably, the contract revenue and contract costs should be recognised using the percentage of completion method.

In both cases, the stage of completion is normally determined by the proportion that costs incurred for work performed to date bear to the estimated total contract costs.

Companies (housing developers/contractors) which adopt the above method of recognition of profits have frequently been asked by the IRB officers to change the basis of recognition to the "Progressive Profit Method" using the following formula:

$$\text{Progressive Profit} = \frac{\text{Total Progress Payment Received}}{\text{Total Estimated Revenue}} \times \text{Estimated Profit}$$

The basis of profit recognition under the "Progressive Profit Method". is not permitted under approved accounting standard. Both MAS 7 and MASB 7 state that progress payments and advances received do not reflect the stage of completion.

In addition, to change the basis of profit recognition from percentage of completion to the "Progressive Profit Method" would require a reconciliation of the tax computations between the two methods, which could cause unnecessary delay in the finalisation of the tax assessment.

It is suggested that the IRB accept the basis of profit recognition prescribed by approved accounting standards for tax purposes. Further, there is no loss of revenue to the IRB as the ultimate profit/loss will be fully recognised on completion of the development project or construction contract and tax duly assessed.

**The IRB has clarified that the guidelines issued, allow taxpayers to present alternative basis of recognising profits for property developers, as long as the methods presented by the taxpayers in the tax computations are fair, consistent and reflective of the profits of the property developer company for the year.**

**The IRB will also disseminate the above issue to its officers via minutes of this dialogue.**

### 6. Initial Allowances for Qualifying Expenditure

Paragraph 12 of sch. 3 to the *Income Tax Act 1967* provides that a business can claim initial allowance in respect of qualifying building expenditure incurred for the construction of a building.

In recent years, it is common for small and medium-size enterprises (SMEs) to purchase completed factory units in an industrial estate rather than construct their own factories/buildings. It is unfair that the SMEs are disallowed from claiming initial allowance on the expenditure incurred for the purchase of such factory units.

It is suggested that the provision in para. 12 of sch. 3 be extended to qualifying building expenditure incurred for the purchase of a completed building.

**The IRB has considered the above proposal as a valid request and will be making necessary proposals to the Ministry.**

## 7. Corporate Debt Restructuring Scheme

### *7.1 Income Tax (Deduction for Corporate Debt Restructuring Expenditure) Rules 2000 — P.U. Order 46(A) 2000*

P.U. Order 46(A) 2000 allows a tax deduction on any expenditure incurred in respect of a corporate debt restructuring scheme completed between October 30, 1999 until December 31, 2000. Hence, (based on the wording of the Order) it would appear that the tax deduction is restricted to companies which completed their debt restructuring schemes on or before December 31, 2000.

However, it is understood that the Corporate Debt Restructuring Committee (CDRC) has taken the view that the tax incentive apply to companies that have signed a Debt Restructuring Agreement (DRA) on or before December 31, 2000, but have yet to complete their debt restructuring schemes. CDRC has also indicated that it has written officially to the IRB on this matter.

Clarification is sought on whether the tax deduction would be extended to the cases described above.

**The IRB has referred the above matter to the Ministry of Finance and are currently awaiting instructions.**

### *7.2 Stamp Duty (Exemption) (No. 7) Order 2000 — P.U. (A) 47*

The above Order grants exemption from stamp duty in respect of all instruments executed pursuant to a corporate debt restructuring scheme completed between October 30, 1999 until December 31, 2000 under the supervision of the CDRC, the Central Bank of Malaysia, or under Pengurusan Danaharta Nasional Berhad.

Clarification is sought on whether the exemption from stamp duty is applicable to companies that have signed a DRA on or before December 31, 2000 but the debt restructuring scheme is not completed yet.

**The IRB has referred the above matter to the Ministry of Finance and are currently awaiting instructions.**

## 8. Definition of Investment Holding Companies under section 60F

In accordance with sec. 60F of the *Income Tax Act*, a company whose activities consist **wholly** in the making of investments and whose income is derived therefrom, is an investment holding company (IHC).

However, recently there have been cases where the IRB treated a company having both management services and investment holding activities as an IHC, under sec. 60F. The IRB has allowed a deduction of the expenses up to the amount of the management fee income earned.

The professional bodies are of the view that a company which is having both management and investment holding activities (i.e. the company is not one whose activities consist **wholly** in the making of investments), is not deemed as an IHC under sec. 60F but is considered to be carrying on a business subject to tax under sec. 4(a) of the *Income Tax Act*.

Kindly confirm whether the above view is correct.

**The IRB is very concern that certain taxpayers have undertaken both investment holding and management activities solely to avoid falling under the limiting provisions of sec. 60F of the Act.**

**However, the IRB acknowledges that there are "genuine cases" where companies are truly undertaking both investment holding and management services as a commercial activity and will consider theses companies, on a case to case basis.**

## 9. Tax Treatment of Interest-in-Suspense

Loans outstanding for a period of 6 months or more are classified as non-performing loans and the interest accrued will be credited into the interest-in-suspense account. For years of assessment 1999 and 2000 (preceding year basis), a deduction of 50% of the amount in the interest-in-suspense account was allowed for income tax purposes. For year of assessment 2000 (current year basis), 100% of the interest-in-suspense was allowed as a deduction. The interest-in-suspense deducted will be taxed when realised.

Clarification is sought on whether the above tax concession will be extended to year of assessment 2001.

**The IRB has confirm that the above tax concession has NOT been extended.**

## 10. Double Deduction Guidelines for Research and Development

The professional bodies wish to highlight that there appears to be some inconsistency between the wording of the Bahasa Malaysia guidelines issued and the English version issued. In particular the question of “research”, where the Bahasa version limited the double deduction claim for traveling expenses to employees whereas, the English version did not.

The professional bodies request the IRB undertake the synchronizing of both guidelines as well as, to take the broader view and allow the claim for traveling expenses for individuals (i.e. research scientist, etc.) visiting research facilities in Malaysia for an exchange of ideas.

**The issue was noted and the IRB has released a revised Double Deduction guideline for Research and Development.**

**The revised guidelines has taken the Bahasa version of terminology.**

## 11. Tax on Tax issue for employees

Due to the change towards a current year tax system, employers are encountering difficulties in stating in the EA form, the total “benefit-in-kind (BIK)” received by employees whose taxes are paid by the company.

This is because, an individual (whose taxes are paid by the employer) would declare the amount of BIK received from the employer for the year and would include the taxes paid by the Company, i.e. a “tax on tax” payment. This “tax on tax” payment will indirectly give rise to a discrepancy in the BIK declared, as the amount of BIK would directly be increased by the “tax on tax” payment by the company in the year.

Hence as we are under a current tax system, the issue is whether the “tax on tax” is to be included as a Benefit-in-kind in the EA Form of the year.

**As time is of the essence the IRB has agreed that in the interim, the employee should declare the actual tax paid (i.e. PCB payments made) in the year as the amount of BIK received from the employer.**

**Nonetheless, the IRB will review the above issue and revert their findings soon.**

## 12. Guidelines on sec. 44 (6) applications

Due to the recent changes of sec. 44 of the ITA, the professional bodies have requested that the IRB issue some guidelines on the procedural/documentation requirements for a sec. 44 (6) application.

**The IRB are currently in the process of finalising the above mentioned guidelines.**

## 13. Confirmation of positions taken in dialogues

The professional bodies raised the issue that sometimes, the decisions taken in the annual dialogues are not disseminated to the relevant individuals and this has resulted in much confusion and uncertainty between IRB and tax practitioner.

**The IRB has reassured the professional bodies that the minutes/issues of the dialogues held are always disseminated to relevant parties, yet there will always be isolated cases where an individual is not aware of a particular decision taken in a dialogue.**

**Nonetheless if there is confusion or uncertainty, the tax practitioner will always have the option of referring the issue to HQ for confirmation.**

## 14. Co-operation between IRB and the Professional Bodies

(a) The professional bodies would like to commend the IRB on its current policy of greater flexibility and transparency in the implementation of the tax law and regulations, especially relating to the new tax system. IRB's willingness to consult with the professional bodies in the development of new regulations and guidelines proved to be highly beneficial to both the tax practitioners and the revenue authority. The professional bodies believe that this is a step in the right direction for the successful implementation of the self assessment tax regime.

However, it is noted that certain official publications (i.e. guidelines, orders) are being issued by the IRB without any prior consultation with the professional bodies. It is felt that the consultation process is useful in minimising potential confusion or practical difficulty in compliance with the new requirements.

(b) The professional bodies would also like to seek the IRB's co-operation to inform the professional bodies promptly of any changes to its policies, guidelines or procedures so that the information can be disseminated to the members and their clients. Taxpayers generally do not object to any change in policy by the IRB but they are often unaware of such changes.

(c) It is understood that the IRB is currently looking into the legislative changes necessary for the implementation the next phase of self assessment for sole-proprietors, co-operatives and partnerships in year 2003.

The professional bodies would like to offer their assistance in the implementation process.

**The issue was noted.**