



**SUPPLEMENTARY
TECHNICAL ISSUES
FOR
DIALOGUE WITH THE IRB**
on
17 February 2014

Prepared by:
Chartered Tax Institute of Malaysia (CTIM)

Supplementary Technical Issues for Dialogue with the IRB

Contents

		Page No.
Technical Issues		
1.	Section 140B --- Special Provision Applicable To Loan Or Advances To Director	1
2.	Tax Treatment for Relief on Contribution to Deferred Annuity	3
3.	Amendment to Section 102	3

TECHNICAL ISSUES

1. Section 140B Special Provision Applicable To Loan Or Advances To Director

Section 140B states that:

- (1) *Without prejudice to the generality of section 140A and subject to this section, where in a basis period for a year of assessment, a company makes any loan or advances of any money from the internal funds of the company to a person who is a director of that company, the company shall be deemed to have a gross income consisting of interest from such a loan or advances for that basis period.*
- (2) *For the purposes of subsection (1), the interest for the basis period for that year of assessment shall be the aggregate sum of interest for all calendar months in the basis period and the sum of interest for each calendar month shall be determined in accordance with the following formula: $\frac{1}{12} \times A \times B$*
where A is the total amount of loan or advances outstanding at the end of the calendar month; and
B is the average lending rate of commercial banks published by the Central Bank at the end of the calendar month or where there is no such average lending rate, such other reference lending rate as may be prescribed by the Director General.
- (3) *Where in respect of a loan or advances referred to under subsection (1), interest is charged by the company and the total amount of interest charged and payable by the director to that company for the basis period for a year of assessment ---*
 - (a) *is more than the aggregate sum of interest under subsection (2) for that basis period, this section shall cease to apply; or*
 - (b) *is less than the aggregate sum of interest under subsection (2) for that basis period, this section shall apply and the total amount of interest which is charged and payable to the company for that basis period shall be disregarded.*
- (4) *For the purposes of this Act, "director" has the same meaning assigned to it under subsection 75A(2).*

Comments:

a) Effective Date

The provision is effective from year of assessment 2014 and will have retrospective effect on companies with early financial year-end which are already in their basis period for year of assessment 2014 at the point of tabling of the Finance Bill.

Example

A company, having a 31.1.2014 year-end and which has made a loan or advances to its director, would have been unwittingly caught by the new legislation for at least 8 months from the date of the Budget announcement. This deprives the company of any chance to mitigate the effect of changes in law and giving rise to retrospective effect.

Recommendation:

The Institutes propose that the effective date for the implementation of the amendment be administratively deferred to year of assessment 2015.

Answer: Section 140B is effective from YA2014. For a company with basis period YA 2014 begins in 2013, only the part of basis period from 1/1/2014 will be taken into account for the purposes of this section.

b) Meaning of “internal funds”

Recommendation:

The Institutes propose that the meaning of “internal funds” be included in the law or by Public Ruling for the purposes of clarity.

Answer: Internal fund is the excess funds of the company which may arise from capital injection, retained earnings and reserve.

On the contrary, loans obtained from a third party, for example, bank or holding company is external fund of the company.

The meaning of internal fund will be clarified further in Public Ruling.

c) Interaction with Other Laws

The Institutes would like to raise the question as to whether the provisions of the Moneylenders Act 1951 were taken into consideration in proposing this amendment? It would not be equitable if a company is forbidden by law to charge interest, is nonetheless deemed to earn interest income for tax purposes.

Answer: We will seek legal advice on this issue and would appreciate if you could provide the relevant provisions of the Moneylenders Act 1951 under which a company is forbidden to charges interest.

The Institutes would also like to highlight that the provision does not provide clarity in the context of the following:

d) Mixed funds

Where loans to directors are financed by both internal and external funds, it is not clear how Section 140B would apply.

Answer: Where the loan is financed by both internal and external funds, section 140B is applicable on the internal fund portion only. Company is advised to segregate the two different funds for purposes of tax computation.

Further clarification will be made in Public Ruling.

e) The question of whether Section 140A or Section 140B takes precedence in the case where both provisions potentially apply.

Example

Mr A, a director of XYZ Sdn Bhd, has a loan from the company funded from internal funds. If Mr A is also a 51% shareholder of XYZ Sdn Bhd, should the interest income for XYZ Sdn Bhd be computed based on:-

- (i) the arm's length interest rate as required in section 140A(2), or the average lending rate as provided under the section 140B?

Answer: Section 140A (2) is not applicable in respect of the transaction where section 140B applies.

- (ii) where the proposed section 140B applies, is there still a requirement to prepare contemporaneous transfer pricing documentation?

Answer: Where section 140B applies, transfer pricing documentation is not required.

f) The question of whether dormant companies are subject to Section 140B

Example:

A dormant company has paid up capital of RM50,000. The company does not intend to commence business for a few years and hence a loan is made to the directors/shareholders of RM50,000. The company has not registered a tax file as it has not commenced business. Would section 140B apply in this situation?

Answer: Although the company has not commenced business activities, it has commenced operation by way of depositing the RM50,000 in the bank account by virtue of section 21A(8). Hence, section 140B applies.

g) Meaning of loans and advances

Clarity is required as to what this means. Would this also cover the provision of other types of financial assistance? For example, if a company provides financial assistance to its directors, (e.g. a company purchases a car by hire-purchase for its director and deducts the monthly hire-purchase instalments, inclusive the hire-purchase interest, from the director's remuneration), would S.140B apply?

Answer: The meaning of loans and advances to director will be clarified in a Public Ruling. As different arrangements may be made on repayment of capital and payment of interest pertaining to financial assistance schemes, examples would be better illustrated in Public Ruling.

Would it make any difference if the benefit is applicable to all employees of the company?

Answer: This issue will be discussed in Public Ruling.

(2) Tax Treatment for Relief on Contribution to Deferred Annuity

Section 2(1) of the ITA 1967 define "deferred annuity" as "*deferred annuity contracted on or after 1st January 2014 issued by insurers licensed under the Financial Services Act 2014 [Act 758] or takaful operators registered under the Islamic Financial Services Act 2013 [Act 759], and contains the Retirement Saving Standards ["RSS"] approved by Central Bank.*"

Section 49(1D) of ITA [**Deduction allowed for deferred annuity and contribution to private retirement scheme**] is also amended (*in italic*) as follows:

“49(1D) In the case of an individual resident for the basis year for a year of assessment who has –

- (a) paid ~~any~~ *premium for* deferred annuity; or
- (b) made or suffered the making of a contribution to a private retirement scheme,

there shall be allowed for that year of assessment a deduction of the aggregate amount of the payments or contribution or both or a deduction of three thousand ringgit whichever is the less.”

Section 49(3) [**Meaning of “insurance” and “deferred annuity”**] is consequentially amended (*in italic*) as follows:

“In relation to an individual claiming a deduction under subsection(1) *and (1D)*, “insurance” and “deferred annuity mean an insurance or deferred annuity contracted for by the individual –
.....”

Comments:

- a) The Institute would like to bring to your attention the tax relief of RM3,000 granted under Section 49(1)(D). Previously, tax relief of RM3,000 is given to a resident individual who has paid deferred annuity during the basis year for a year of assessment.

With the new definition of “deferred annuity” which specifically makes reference to those **contracted on or after 1st January 2014**, it would appear that the relief previously available to taxpayers whose deferred annuities were contracted prior to 1st January 2014 would not be eligible for the tax relief of RM3,000 effective YA 2014.

We would like to seek clarification as to whether this impact is intentional.

Answer: The relief previously available with regards to deferred annuity is still applicable.

- b) We are of the view that the amendment to S.49(3) should read “in subsection (3), by inserting after the words “subsection (1) the words “and (1D(a))”

Answer: We appreciate the comment.

(3) Amendment to Section 102

T new Section 102(1A) provides that:

“Where a person has made an application to invoke a mutual agreement procedure (MAP).....under this Act --

- (a) *no appeal shall be sent forward to the Special Commissioners until the determination of the Mutual Agreement Procedure.*
- (b)
- (c)”

Comments:

It is understood that where a taxpayer wishes to use the MAP as recourse, the taxpayer would be precluded from availing itself of the appeal mechanism under Form Q until the conclusion of the MAP.

Clarification sought:

- (a) At present, the DG has a 12 month period to forward a taxpayers appeal to the Special Commissioners. On the other hand, the taxpayer has a 3 year time-frame to seek recourse via the MAP. If DG has already forwarded the taxpayer's appeal to the Special Commissioners (outcome pending), the question arises as to whether the taxpayer is now precluded from applying for a MAP i.e., will the right of a taxpayer to avail itself of a MAP be invalidated within the 3 year time frame as a result of this amendment?

Answer: No. The current law with regards to MAP still applies. This new amendment is to provide deferment of submission of Form Q to Special Commissioners where MAP is invoked within 12 months or before Form Q is forwarded to Special Commissioners. This provision does not affect taxpayer's rights on MAP.

- (b) Assuming a taxpayer files a Form Q and the outcome of the appeal is known within the 3 year time-frame, can the taxpayer still opt for a MAP if he is dissatisfied with the court's decision? [It would no longer be a concurrent procedure as the appeal process would be completed].

Answer: Yes.