



PROPOSAL FOR MONTHLY TAX DEDUCTIONS (MTD) TO BE TREATED AS FINAL TAX

15 May 2013

General Comments:

1. Simplification of Tax Administration

CTIM supports the move towards non-filing of tax returns by employees. Treating the Monthly Tax Deductions (MTD) as Final Tax is a right move to improve the efficiency of tax administration. The Final Tax System (FTS) will allow the IRB to deploy the resources released for more productive use. It also saves the taxpayers from the hassle of completing and filing the income tax returns.

As the FTS is a significant change from the current tax practice, in order to facilitate its smooth implementation, it is important that sufficient training and assistance be given to all employers, and proper and detailed guidelines are issued quickly to ensure that employees and employers are clear on their roles and responsibilities.

2. Additional Cost of Doing Business

While the proposed measure improves the efficiency of tax administration, it should not unduly burden the employer with strenuous/tedious administrative duties or potential tax penalties arising from human errors.

CTIM suggests that the IRB consider reviewing the current law to simplify the process to compute the taxable benefit relating to the benefits-in-kind as the existing law makes it burdensome to adopt the Final Tax System. In addition, the IRB could review the existing tax reliefs to streamline/consolidate the tax reliefs as many of the current reliefs are only minimal amounts.

It would be convenient for employees and employers if the information could be keyed in on-line directly to the Forms TP1, TP2 and TP3 which could then be integrated with the employer's payroll system, rather than being filled up manually. This would reduce the administrative burden of the employer and would help the employees and employers to keep the data electronically.

3. Cost Effectiveness

For the Final Tax System to be effective in reducing taxpayers' "burden" with regard to filing of Annual Tax Returns, the IRB needs to assess and quantify the target group qualifying for the Final Tax System, if not already done. If only a small group of taxpayers are able to qualify, then this proposal would only end up creating additional workload for employers.

CTIM would like to request the IRB to share the statistics, if available, on the extent of use of the PCB calculator (i.e. how prevalent is the use compared to the use of the MTD table) and compliance by employers, based on the IRB's experience during MTD audits. This will help to determine the accuracy of data connected with MTD compliance and to assess whether the employers are ready to adopt the proposal of MTD as a Final Tax.

The Inland Revenue Board of Malaysia (IRBM) is proposing that the current Monthly Tax Deduction (MTD) system be enhanced to become a Final Tax System for taxpayers with Single Sourced Employment Income. Below are some of the features of the proposed Final Tax System:

1. Timeline

The proposed implementation date is with effect year 2014

Comments:

Time is needed to disseminate information to the taxpayers and employers on the new arrangement, and the relevant provisions of the Income Tax Act 1967 (ITA) have to be amended. The IRB needs time to enhance the MTD system to achieve a more accurate tax computation. Similarly the software service providers/ big corporations should also be given time to make adjustments to their payroll and accounting systems to cater for the changes.

It is suggested that after enhancing the MTD system, the IRB make a public announcement on the introduction of MTD as final tax in September 2013. The 3 - 4 months that follow could be used to disseminate the information and conduct a test run of the enhanced MTD system by the employers.

CTIM is of the view that the proposed implementation date may be too soon because relevant provisions in ITA may require amendment before the FTS can be implemented. CTIM suggests that 2014 be treated as a transition period for employers and employee to familiarise themselves with the new system. The process can also serve as a test run for the IRB on the enhanced MTD before full implementation of FTS in 2015.

2. The System

Under the proposed system, eligible employees whose MTD have been correctly deducted are exempted from filing tax returns. The IRB has in 2009, introduced the PCB Calculator which enables employers to make exact deduction for the MTD.

Comment:

The exemption from filing individual income tax returns will have an impact on provisions of the ITA. CTIM could assist the IRB in reviewing the necessary changes to the filing, assessment and penalty provisions of the Act that are impacted by this proposal.

3. Eligibility

Comments:

CTIM would like to seek confirmation that the choice for FTS lies with the taxpayers.

The Final Tax System will only apply to:

3.1 Individuals with single sourced employment income. There is no threshold.

- 3.2 Such employment income includes value of benefit-in-kind calculated in accordance with IRBM's guidelines.

Comment:

Currently an irrevocable election to include benefits-in-kind (BIK) [Rule 2A of the Income Tax (Deductions from Remuneration Rules, 1994)] may be made using election form TP2, for the purpose of including BIKs in MTD calculations. The IRB would need to change the MTD rules to make it compulsory to include BIKs and living accommodation in the MTD calculations instead of keeping it as optional. This proposal does not mention the irrevocable election through Form TP2.

The MTD programme will need to be enhanced for it to capture certain prescribed BIK values (e.g. housing accommodation) and track the amounts reported. If the employer cannot incorporate the correct BIK values resulting in incorrect MTD deducted and remitted, the employees can still file an annual tax return. Under such circumstances, would the employee or the employer be penalised?

Including BIK in the MTD calculation will be an additional payroll administration burden on the employer. Not all employers/payroll vendors are knowledgeable in determining the taxable value of benefits-in-kind (BIK) (e.g. the knowledge on prescribed versus formula valuation basis, accommodation and prescribed BIK items, etc.) and whether the benefits/perquisites are taxable or not taxable (especially off-payroll items). Tracking of BIK claimed would be an issue as well. Training and education for the administrators of payroll/vendor of the software service providers is needed.

- 3.3 The income has been subject to MTD

Comment:

Section 77 (1)(b) of ITA stipulates that *"Every person, other than a company, trust body or co-operative society to which section 77A applies, shall for each year of assessment furnish to the Director General a return in the prescribed form not later than 30 April in the year following that year of assessment:*

Provided that that person has-

- (b) *no chargeable income for that year of assessment, but has chargeable income or has furnished a return or has been required under this Act to furnish a return, for the year of assessment immediately preceding that year of assessment."*

The above implies that the IRB will still receive income tax returns from those who have no chargeable income but have filed income tax returns in the past. This is inconsistent with the objectives of reducing filing of tax returns by making MTD as final tax.

CTIM is of the view that the filing provisions in the ITA have to be re-drafted together with the penalty framework of Sections 112 and 120 of ITA.

4. Individuals Not Eligible

The following employees are excluded from the Final Tax System and therefore will have to file their tax returns in the normal manner:

- 4.1 Individuals working with more than one employer during the year. This includes individuals having more than one employment income source at the same time i.e. those holding more than one job at the same time. As the MTD is deducted separately by different employers, there is a likelihood that the MTD might be under deducted.
- 4.2 The income has not been subjected to MTD or the MTD deducted is incorrect (either over or under deduction).

Comments:

Generally an employee would not know whether the MTD deducted is correct and instead rely on the MTD calculation made by the employer. Where an employee relies on the MTD calculation and treats it as final tax, not knowing that it has been erroneously calculated, it is suggested that the employee should not be penalized provided that full disclosure of the information has been made to the employer.

Since the onus of ensuring accuracy and correctness still lies with the employee, CTIM suggests that the employee be allowed to verify the final tax calculation. It would be useful if the taxpayer could be allowed to login into a system to verify the calculation (in the same layout as the Form BE).

- 4.3 The individual has incomes other than employment income.
- 4.3 The individual opted for joint/combined assessment with his/her spouse because the individual's MTD and the spouse's MTD are not deducted based on the combined income. As such there will be inaccuracies in the MTD.
- 4.4 Employees whose taxes are borne by their employers because the calculation of tax-on-tax is rather complicated.
- 4.5 Employees who derived income from Employee Share Option Schemes (ESOS) during the year. The tax liability on the ESOS might be high and the instalments approved might enter into the next calendar year.

Comments:

The list of individuals not eligible to use the Final Tax System should be clear in order to assist taxpayers. Assuming the exclusion list is exhaustive, the IRB has to consider and include other situations giving rise to incorrect MTD deducted, e.g.

- Non-residents where MTD has been deducted at resident rates.
- Employment income paid offshore by overseas entities.
- Employees receiving lump-sum payments when employment ceases.
- Employees who are eligible for the time apportionment exemption claim under OHQ, RO, TMC, RDC, IPC.
- Employees under the Returning Expert Program (REP)/ employees who qualify for Iskandar Region (knowledge worker) (IRDA) exemptions and are taxed at 15% instead of the usual MTD rates although this is not critical since it should be relatively simple to impose a flat tax rate of 15% like non-residents (26%).
- Employees who have split payroll arrangements where a portion of their payroll is administered in the home country but are fully taxable in Malaysia. It may be difficult for the local employer to administer the MTD as a final tax as the details of

salary and BIK from the home country may not be made known to the local employer.

- Employees who exercise employment outside Malaysia but whose duties are considered incidental to the exercise of employment in Malaysia, and are entitled to claim foreign tax credits for taxes paid overseas on the same income.
- First year inbound assignee. For a first year assignee, the employer is required to deduct the MTD at a non-resident rate of 26% until his tax residence status has been established. This may affect individuals who commenced their employment in Malaysia after July of the year. As such, the MTD as final tax may not be applicable for first year assignees who may be able to qualify as a Malaysian tax resident under Section 7(1)(b) of the Malaysian Income Tax Act, 1967 (ITA).

If the individual qualifies as a Malaysian tax resident, there may be an over deduction of MTD if the employer deducts the MTD at a non-resident rate of 26%.

For an assignee who commenced his employment in Malaysia after July of the year, the MTD would still be deducted at a non-resident rate in the following year as he would not have at least 182 days of physical presence in Malaysia until at least July of the following year.

- Leaver Cases

Where the tax residence status has not been verified, FTS may result in underpayment of tax liability if the individual does not qualify as a Malaysian tax resident.

Individuals who cease their Malaysian employment during the year should file their tax return and confirm their tax residence status in order to obtain their tax clearance letter and close their file accordingly.

How will employees who are eligible to claim DTA exemption or foreign tax credit in the home countries provide a copy of the Malaysian tax return if they are not required to file a tax return?

5. Filing of Returns

In general, individuals who qualify for the Final Tax System need not file tax returns. However, those who have additional income to declare, claims ~~to made~~ or amendments to be made can file a tax return before the normal due date of 30th April. Filing after 30th April will be treated as late filing and subject to the normal late filing penalties.

Comment:

Please refer to our comments on Paragraph 3.3.

6. Employer's Role

The success of the system is dependent on employers making the correct deductions. Efforts will be made to ensure the employers are not burdened under the system. In fact, most of the requirements under the Final Tax System are the same as the current requirements to deduct MTD, file Form E and issue statement of income (Form CP8A/CP8C). Under the proposed system, the employer will issue a statement of income and tax deduction (Form PCBII) to his employees and the IRBM after 10th January but not

later than the last day of February (similar to the due date for Form CP8A/CP8C). This statement will be similar to the Form CP8A/CP8D with some enhancement.

Comments:

The FTS is likely to work smoothly for employees with a relatively simple remuneration structure (i.e. basic salary, bonus and allowances). However, generally at a higher remuneration scale, the more complex remuneration package with performance-related incentives, share plans, deferred income plans, BIKs etc., will render the FTS inapplicable or difficult to apply.

There are perquisites, such as long service awards, which may not be captured through the payroll system as it is processed through the Finance Department. This may lead to the MTD not being deducted on a timely basis. Significant administrative burden will also be placed on employers for benefits-in-kind that are not provided on a regular basis (e.g. leave passage, utilities).

Some benefits can only be ascertained at the year end, for instance, the value of living accommodation provided is a function of Section 13(1)(a) income which is only ascertained at year end.

Currently, Forms TP1 and TP2 are submitted to the Employer as and when there is a change in the relief claimed or benefit-in-kind received. If every employee is to provide the Form TP1 to the employer for final tax purposes on a monthly basis, the volume of employees with different relief claims would create an administrative burden on the employer and the accuracy and correctness of the data entry into the payroll system could be compromised. Even if there is a robust system to cater for this, it would also be a burden for the employee to keep track on a monthly basis of the reliefs that he wishes to claim. Can an employer prepare its own Form TP1 which is integrated into its computerized payroll system?

If the completion of the Form TP1 is not made compulsory or submitted by the employee on a timely basis, the Final Tax System will be redundant as the employees would still need to file an annual tax return to claim the deductions / reliefs.

7. Employee's Role

To ensure the correct deductions are made by the employers, the employees must ensure Form TP1 submitted to the employers are true and correct. Any under-payment of tax arising from insufficient or wrong information provided to the employer will be the responsibility of the employee.

Comments:

Form TP1 indicates that the employer does not need to check the relief deducted by employee. However, where an employee has made accurate disclosure but the employer has made a mistake, under the existing rules, the employer has committed an offence. This has placed an undue burden on the employers as the payroll clerk would have to be knowledgeable in individual taxation law, and may probably need to be a tax professional.

Form TP1 does not cover all the deductions, for example donation, membership subscription to professional bodies and other deductions wholly incurred in the course of employment duties, such as travelling expenses/relocation expenses.

Where an employee has submitted TP1 to claim additional relief and subsequently found it was an error, how should he notify his employer? If he notified his employer before the due date for submission of his tax return, will he be penalised?

The proposals did not mention about the Forms TP2 & TP3.

8. Monthly Tax Deduction (MTD)

The MTD programme will be further enhanced in term of accuracy in calculating the amounts to be deducted. IRBM will endeavour to provide support to employers, both using computerised system as well as those using the manual system.

Comment:

Receipts for approved donations which are made on a monthly basis indicating the total donations during the year may only be issued in the following year. It may not be possible to include such deductions in the MTD calculation on a monthly basis.

The task of verifying claims made, such as whether the child relief is only claimed by the employee or his spouse and not both, may pose a burden.

The relief for net deposits into the Skim Simpanan Pendidikan Nasional (SSPN) can only be determined at the end of the year as the relief granted is based on the net deposits made during the year.

Based on the proposal, it appears that it may be compulsory for the employer to take into account the deductions and rebates in the MTD. However, some deductions or reliefs may only be ascertained after the year end. This will increase the administrative burden for the employers to keep track of the deductions and rebates.