

INCOME TAX

1. Exemption of Deduction for Corporate Debt Restructuring Expenditure

Previously, under the *Income Tax (Deduction for Corporate Debt Restructuring Expenditure) Rules 2001*, any “corporate debt restructuring expenditure”, incurred in respect of a corporate debt restructuring scheme completed between 1st January, 2001 until 31st December, 2001 under the supervision of the Corporate Debt Restructuring Committee of the Central Bank of Malaysia or under the Pengurusan Danaharta Nasional Berhad is tax deductible.

Pursuant to the *Income Tax (Deduction for Corporate Debt Restructuring Expenditure) Rules 2002*, the incentive is extended to corporate debt restructuring expenditure incurred in respect of a restructuring scheme, completed between 1st January, 2002 until 30th June, 2002.

These Rules as previously, shall not apply to any expenditure allowable under paragraphs 33(1)(a), 33(1)(b) or 33(1)(c) of the Act and shall be deemed to have come into operation on 1st January, 2002.

2. Exemption of Income of Trade Association

Pursuant to the *Income Tax (Exemption)(No.7) Order 2002*, with effect from year of assessment 2002, a trade association resident in Malaysia is exempted in respect of statutory income from member’s subscription fees in accordance with the formula :-

$$A \quad \times \quad \frac{B}{C}$$

- Where
- A is the statutory income from the business of the trade association in the basis period;
 - B is the gross member’s subscription fees in the basis period; and
 - C is the gross income from the business of the trade association in the basis period.

This Order is effective from the year of assessment 2002.

Alternatively, according to the *Income Tax (Exemption)(No.8) Order 2002*, a trade association can be exempted up to an amount of 50% of the statutory income for a maximum period of 5 years of assessment depending on when the trade association was established. If a trade association was established before 1st January, 1996, the trade association is exempted up to an amount of 50% of its statutory income for each year of assessment from the year of assessment 1996 until the year of assessment 2000 (preceding year basis). However, if the trade association was established between 1st January, 1996 and 31st December, 2001, the association can be exempted for a maximum of 5 years of assessment from the year of assessment in the basis period in which the trade association was established.

In this connection, the *Income Tax (Exemption)(No.8) Order 2002* revokes the previous *Income Tax (Exemption)(No. 14) Order 1996*.

For purposes of these two Orders, the definition of “trade association” is as described in Section 53(3) of the Act.

3. Exemption of Income from Export of Qualifying Services

Currently, pursuant to the *Income Tax (Exemption)(No.2) Order 2001*, a person resident in Malaysia is exempted from payment of income tax in respect of 10% of the value of increased exports of qualifying services provided from Malaysia to foreign clients.

The amount of income to be exempted is restricted to 70% of the statutory income for a year of assessment and the balance of statutory income will be taxed at the prevailing rate. Any unutilised amount of exempted income will be carried forward for set-off in future years until it is fully utilized. The exempt account arising is available for two-tier distribution of tax-free dividend.

Qualifying services specified in the schedule to the Order are :-

- | | |
|---------------------------|---|
| • Legal | • Building management |
| • Accounting | • Plantation management |
| • Architecture | • Private healthcare |
| • Marketing | • Private education |
| • Business consultancy | • Publishing services |
| • Office services | • Information technology and communication services (ICT) |
| • Construction management | |

Pursuant to the new *Income Tax (Exemption)(No.9) Order 2002*, the rate of partial exemption of income from qualifying services to foreign clients has been increased from 10% to 50% of the increase in export value of the qualifying services exported.

This new Order 2002 is effective from year of assessment 2002. However, the previous *Income Tax (Exemption)(No.2) Order 2001*, is still in force.

4. Extended Exemption Period for Local and Inbound Tourism

Presently, under the *Income Tax (Exemption)(No.6) Order 2001* and *Income Tax (Exemption)(No.7) Order 2001*, the tax exemption on income derived from domestic and inbound tours expires after the year of assessment 2001.

Pursuant to the *Income Tax (Exemption)(No.10) Order 2002* and *Income Tax (Exemption)(No.11) Order 2002*, the incentive is extended from the year of assessment 2002 to year of assessment 2006, both years inclusive. The new Orders require the number of tourists on domestic or inbound tours to be certified by the Ministry of Culture, Arts and Tourism. To qualify for exemption in respect of domestic tours, the number of local tourists must be at least 1,200 while for inbound tours the number of tourists from outside Malaysia is not less than 500 in the basis period for a year of assessment to be eligible for the above incentive.

5. Exemption of Income from Export Sales of Malaysian International Trading Company (MITC)

The new *Income Tax (Exemption)(No. 12) Order 2002* provides an exemption of income equivalent to 10% of the value of increased exports but as before, not more than 70% of the statutory income is exempted from tax in a year of assessment. The effect of the new Order is a simplification of the calculation of the incentive which previously was based on a formula.

To further encourage the setting up of MITC to do export sales, several conditions have been relaxed as follows :-

- i) Malaysian shareholding reduced to 60% (previously 70%)
- ii) Annual sales must exceed RM10 million (previously RM25 million)
- iii) Export sales of related companies not restricted (previously not more than 20% of annual sales)

The incentive is given for 5 consecutive years of assessment from the year the company first qualified for the exemption.

6. Additional Double Deduction for Promotion of Malaysian Brand Names

The previous *Income Tax (Deduction for Advertising Expenditure on Malaysian Brand Name Goods) Rules 1999* is revoked by the new *Income Tax (Deduction for Advertising Expenditure on Malaysian Brand Name Goods) Rules 2002*. Under the 2002 Rules, qualifying advertising expenditure for double deduction includes professional fees made to a company resident in Malaysia for advertising or promoting Malaysian brand name goods which was not included in the previous Rules.

Under the new Rules 2002, “qualifying advertising expenditure” means expenditure incurred within Malaysia in respect of :-

- a) the cost of advertising Malaysian brand name goods through :-
 - (i) advertisements on the internet where the host website is located in Malaysia;
 - (ii) advertisements in magazines and newspapers where the magazines and newspapers are printed in Malaysia;
 - (iii) advertisements on local licensed television stations;
 - (iv) advertisements approved by the relevant local authority on advertisement hoardings located in Malaysia;
 - (v) advertisements in trade publications where the trade publications are printed in Malaysia;
 - (vi) advertisements in any form in the course of sponsoring an approved international sporting event held in Malaysia; and
 - (vii) advertisements in any form in the course of sponsoring an approved international trade conference or an approved international trade exhibition held in Malaysia; and

- b) Professional fees made to a company resident in Malaysia for advertising or promoting Malaysian brand name goods on behalf of the company which is the registered proprietor of the Malaysian brand name.

Double deduction for qualifying advertising expenses have effect from year of assessment 1998 whereas for professional fees is effective from year of assessment 2002.

7. Increased Rate of Deduction for Cost of Acquisition of Proprietary Rights

Under the new *Income Tax (Deduction for Cost of Acquisition of Proprietary Rights) Rules 2002*, the rate of deduction is 20% of the cost of acquisition of proprietary rights instead of 10% under the *Income Tax (Deduction Cost of Acquisition of Proprietary Rights) Rules 1999*.

This will accelerate the write off of proprietary rights acquisition cost. Manufacturing companies with at least 70% of its issued share capital owned by Malaysian will qualify for the above incentive. Deductible cost includes consultancy fees and legal fee connected with the acquisition. The faster write-off will further encourage the Malaysian ownership of new technologies.

8. Exemption of Income from Trading on the Kuala Lumpur Options and Financial Futures Exchange

Pursuant to the *Income Tax (Exemption)(No.33) Order 2002*, an individual who is allowed to trade on the Kuala Lumpur Options and Financial Futures Exchange for his own account in any futures market, is exempted from payment of income tax up to an amount equivalent to 70% of the adjusted income from that business for a year of assessment.

The Order is effective from year of assessment 2000 (current year basis) until year of assessment 2004.

9. Expansion of Projects for Approved Agricultural Projects

Under the *Income Tax (Approved Agriculture Projects) Order 2002*, the scope of food products eligible for 100% allowance on capital expenditure incurred for purposes of Schedule 4A of the Act has been expanded to include:

| No. | Project | Period (year) | Minimum area (hectare) |
|------------|--|----------------------|-------------------------------|
| i. | Cultivation of crops | 1 to 7 | 8 – 40 |
| ii. | Floriculture | 2 | 8 |
| iii. | Forest Plantation Project | 6 to 50 | 50.0 |
| iv. | Cultivation of vegetables, tubers, roots, herbs, spices, crops for animal feed and hydroponic based products | 3 | 40.0 |
| v. | Ornamental fish culture - open system (land/concrete pond) | 2 | 5.0 |
| vi. | Ornamental fish culture - enclosure system | 2 | 0.25 |
| vii. | Pond culture - fish and prawns (brackish water/fresh water) | 2 | 20.0 |
| viii. | Tank culture - fish (brackish water/fresh water) | 2 | 1.0 |
| ix. | Off-shore marine cage culture - fish | 2 | 0.5 |
| x. | Marine cage culture - fish (brackish water/fresh water) | 2 | 0.5 |
| xi. | Cockle culture | 1 | 10.0 |
| xii. | Mussel and oyster culture | 2 | 0.5 |
| xiii. | Seaweed culture | 1 | 5.0 |
| xiv. | Shrimp hatchery | 2 | 0.25 |
| xv. | Prawn hatchery | 2 | 0.25 |
| xvi. | Fish hatchery (seawater/brackish water/fresh water) | 2 | 0.5 |

For agricultural projects in items (i) and (ii), the new Order shall be deemed to have effect from year of assessment 1989. However, for agricultural project in item (iii), the Order shall be deemed to have effect from year of assessment 1999. For the remaining agricultural projects in items (iv) to (xvi), the Order shall have effect from year of assessment 2002.

10. Approved Food Production Projects

The new *Income Tax (Approved Food Production Projects) Order 2002* revokes the *Income Tax (Approved Food Production Projects) Order 2001*. Under the new Order 2002, the approved food projects for the purposes of Schedule 4C of the Act are :-

- a) Planting of kenaf, vegetables, fruits, herbs and spices
- b) Aquaculture
- c) Rearing of cattle, goats and sheep

The Order is effective from the year of assessment 2001.

11. Tax Exemption of Political Association

Pursuant to the *Income Tax (Exemption)(No.22) Order 2002*, a political association is exempted from the payment of income tax in respect of all income.

This Order is effective from the year of assessment 2001.

12. Tax Exemption of Chartering Services of a Luxury Yacht

Under the *Income Tax (Exemption)(No.23) Order 2002*, subject to the approval of the Minister of Finance, a company resident in Malaysia is exempted from the payment of income tax in respect of its statutory income derived from the provisions of chartering services of a luxury yacht departing from and ending at any port in Malaysia.

“luxury yacht” means a light sailing vessel propelled by sails, steam, electricity or motive power other than oars equipped with :-

- a) bathrooms, galleys, saloons, cabins and staterooms, which has exotic and expensive furnishings and finishing; and
- b) recreational facilities.

The luxury yacht so equipped must be verified by the Ministry of Transport Malaysia.

The tax exemption is for 5 consecutive years of assessment commencing from the year of assessment in the basis period in which the approval is in effect. The income exempted is available for a two-tier distribution of tax-free dividend.

This Order takes effect from 20th October, 2001.

13. Tax Exemption on Rental of ISO Containers

The previous *Income Tax (Exemption)(No.17) Order 2002* is revoked by the new *Income Tax (Exemption) (No. 24) Order 2002*.

Pursuant to the new Order 2002, tax exemption (including withholding tax) is granted on income derived by non-resident persons from the rental of International Standard Organisation containers to a Malaysian resident shipping company who carries on a business of :-

- a) transporting passengers and cargo by sea on a ship; or
- b) letting out a ship on a voyage or time charter basis.

This new Order is effective from 20th October, 2001.

14. Tax Exemption on Statutory Income of International Trade Exhibition Promoter

Pursuant to the *Income Tax (Exemption)(No.15) Order 2002*, the statutory income derived by an international trade exhibition promoter from organizing an international trade exhibition which is approved by the Malaysia External Trade Development Corporation (MATRADE) is exempted from tax. The international trade exhibition promoter may be a company, an association or an organisation and the total number of foreign trade visitors brought in by the promoter must not be less than 500 for a year of assessment.

For the purposes of the Order :

“foreign trade visitors” means individuals who are non-Malaysian citizens visiting the international trade exhibition, but does not include individuals who are non-Malaysian citizens who reside in Malaysia;

“statutory income derived from organizing an international trade exhibition” means fees and other payments received by a company, an association or an organisation in performing its duties as an international trade exhibition promoter less allowable expenses for tax purposes and capital allowances, if any.

The amount of statutory income exempted is available for the two-tier distribution of tax free dividend.

This Order is effective from the year of assessment 2002.

15. Tax Exemption on Royalty Received by a Non-Resident Franchisor from a Registered Institution in Relation to an Approved Programme

Pursuant to the *Income Tax (Exemption)(No.16) Order 2002*, royalty received by a non-resident franchisor from a registered institution in relation to an approved programme is exempted from tax (including withholding tax). The terms “registered institution”, “franchisor” and “approved programme” used in the Order are as defined under the Private Higher Educational Institutions Act, 1996.

This Order is effective from 20th October, 2001.

16. Double Deduction for the Promotion of Export of Services

The *Income Tax (Deduction for Promotion of Export of Services) Rules 2002* provides for a double deduction of outgoings and expenses incurred by a company for the promotion of export of services.

The qualifying outgoings and expenses are those incurred for :-

- a) feasibility studies for overseas projects identified for the purpose of tender;
- b) participation in a trade or industrial exhibitions in Malaysia or overseas;
- c) participation in exhibitions held in a Malaysian Permanent Trade and Exhibition Centre overseas;
- d) overseas travel by a representative of the company for the promotion of export of services; and
- e) accommodation and sustenance subject to a maximum of RM300 and RM150 per day respectively.

This said Order is effective from the year of assessment 2002.

17. Double Deduction for the Promotion of Exports of Local Products

The *Income Tax (Deduction for Promotion of Exports) Rules 2002* provides for a double deduction of outgoings and expenses incurred by a resident company for the promotion of local products. Outgoings and expenses which qualify for double deduction are those incurred in respect of participation in an international virtual trade show and trade portal for the promotion of local products as verified by MATRADE, and the cost of maintaining warehouse overseas.

The Rules have effect from the year of assessment 2002.

18. Deduction of Expenses in Respect of Patents, Trademarks and Product Licensing Overseas

Under the *Income Tax (Deduction for Promotion of Exports)(No.2) Rules 2002*, a deduction of outgoings and expenses incurred by a resident company in respect of registration of patents, trademarks and product licensing overseas for the purpose of

promoting exports is allowed. The Rules will avoid such expenses being treated as capital or initial expenditure.

The Rules have effect from the year of assessment 2002.

19. Deduction of Expenses in Respect of Hotel Accommodation and Sustenance Provided to Potential Importers for Promotion of Exports

The *Income Tax (Deduction for Promotion of Exports)(No.3) Rules 2002* provides for deduction of outgoings and expenses incurred by a company in respect of accommodation (maximum RM300 per day) and sustenance (maximum RM150 per day) provided to potential importers for 3 nights stay in Malaysia.

The visit by the potential importers to Malaysia shall be as a follow-up to the trade and investment mission organized by Government agencies, industrial or trade associations that the company has participated in the 12 months preceding the visit to Malaysia of the potential importer. The company's participation must be verified by MATRADE.

The Rules have effect from the year of assessment 2002.

20. Deduction for Implementation of RosettaNet

Pursuant to the *Income Tax (Deduction for Implementation of RosettaNet) Rules 2002*, certain expenses incurred by a qualifying company resident in Malaysia in assisting local small and medium scale manufacturer to adopt and implement RosettaNet would qualify for deduction. The qualifying expenses for purposes of implementing RosettaNet are as follows :-

- Cost of new computer hardware, software and networking device provided by a qualifying company to RosettaNet Malaysia Berhad.
- Cost of new office equipment provided by a qualifying company to RosettaNet Malaysia Berhad.
- Basic salary of employees on secondment from a qualifying company to RosettaNet Malaysia Berhad for a period of not more than 3 years.
- Basic salary of employees on secondment from a qualifying company to a local manufacturer for a period of 2 to 6 months.
- Cost relating to fees, traveling expenses, accommodation of trainers and rental of facilities provided by a qualifying company for the provision of training to the employees of a local manufacturer of not more than RM100,000.

For the purposes of the above Rules;

“qualifying company” means

- a) a company which is a member of RosettaNet Malaysia Berhad and which is assisting a local manufacturer to adopt and implement RosettaNet; or

- b) a company, association or statutory body which is a member of RosettaNet Malaysia Berhad and which is assisting RosettaNet Malaysia Berhad.

“local manufacturer” means a company which is

- a) incorporated in Malaysia and at least 70 per cent of the issued share capital of the company is owned by Malaysian nationals;
- b) carrying on manufacturing activities; and
- c) adopting and implementing RosettaNet.

The Rules is effective from year of assessment 2002.

21. Public Ruling (PR)

During the year 2002, the following new rulings have been issued by the Inland Revenue Board.

a. **PR 1/2002 – Deduction for Bad and Doubtful Debts and Treatment Of Recoveries**

The Public Ruling No. 1/2002 considers the deduction for bad and doubtful debts as provided under Section 34 of the Act and the treatment of recoveries under Section 30 of the Act.

(i) **Debt must be “bad”**

Trade debts written off as bad are generally deductible against gross income in computing the adjusted business income of a business. A debt is “bad” when all circumstances of recovery of the debt as to the likelihood and cost of its recovery have been considered.

All reasonable steps to recover the debt should be based on commercial considerations and supported by evidence such as :-

- issuing reminder notices;
- debt restructuring scheme;
- rescheduling of debt settlement;
- negotiation or arbitration of a disputed debt; and
- legal action (filing of civil suit, obtaining of judgement from court and execution of the judgement).

The fact that the anticipated cost of any legal action is prohibitive in relation to the amount of debt can be considered a reasonable basis for treating a debt as “bad”. Any reasons for not taking further action to recover debts should be documented.

For deductibility purposes, there must be evidence that each debt is evaluated separately, when and by whom the evaluation was done and the specific information drawn in arriving at the evaluation.

In evaluating a debt as “bad”, the following factors should be considered:-

- the debtor has died without leaving any assets from which the debt can be recovered;
- the debtor is a bankrupt or in liquidation and there are no assets from which the debt can be recovered;
- the debt is statute-barred;
- the debtor cannot be traced despite various attempts and there is no known assets from which the debt can be recovered;
- attempts at negotiation or arbitration of a disputed debt have failed and the anticipated cost of litigation is prohibitive; and
- any other circumstances where there is no likelihood of cost effective recovery.

The debts should have been included in the gross income of the person for the basis period for the current or prior year of assessment to be eligible for tax deduction.

In the case of a business of money lending, both the interest (gross income) and the loan (business loan) are considered for write-off as bad debt after taking into account all circumstances.

(ii) Deductibility of provision for doubtful debts

A trade debt considered to be doubtful of recovery should be based on sound commercial considerations and not on personal, private or other reasons.

For deductibility of specific provision for doubtful debts, the following evidence is required :-

- that each debt has been evaluated separately;
- how the extent of its doubtfulness was evaluated;
- when and by whom this was done; and
- what specific information was used in arriving at that evaluation.

and also consider the factors relating to :-

- the period that the debt has been outstanding;
- the current financial status of the debtor;
- the credit record of the debtor;
- the person's history of bad debts;
- the experience for the particular trade/industry; and
- the age-analysis of the debts.

(iv) Deductibility of general provision

Provision for doubtful debts based on a percentage of sales / trade debts is not allowable for tax purposes, even if there is a legal requirement or an accounting convention to do so in that particular industry.

(v) Forgiveness of debts

A decision to forgive or to waive payment of a trade debt by the creditor is not regarded as a valid commercial reason for tax deduction of the debt waived.

(vi) Non-trade debts

Non-trade debts that are written off as bad or provisions made (both specific and general) are not deductible for tax purposes. Subsequently, any recoveries of non-trade debts are not taxable.

(vii) Debt due from related or connected person

Any decision to write-off (or to extinguish by other means) or to make a specific provision for a trade debt due from a related or connected person is subject to stringent examination before it can be considered for tax deduction purposes.

In addition to the conditions in (i) and (ii) above, there should also be evidence to prove that the decision is made on an arm's length basis and for valid business and commercial reasons, rather than private, personal or non-commercial reasons.

(viii) Recoveries

Tax adjustment is required for the amount of trade debts recovered if a tax deduction for bad debts was obtained previously and the recovery is not credited into the income statement.

(ix) Settlement of trade debt with assets

Where a debt is settled by the foreclosure of an asset held as security for the debt or by an asset given in exchange for the debt, the net proceeds from the sale of the asset or the market value of the assets given in exchange is taken as the value for settlement of the debt.

b. PR 2/2002 - Pre-Operational and Pre-Commencement of Business Expenses for Companies

This ruling is applicable only to companies. In other cases, generally, expenses incurred prior to the commencement of a business would not be allowable as a deduction.

The surrounding facts and circumstances have to be considered to determine whether a business has commenced. Activities which are preparatory in nature should be distinguished from those which are integral to the income producing process normally undertaken in the course of a particular business. The PR provides the following instances as indicative of the commencement of business :-

- manufacturing – purchase of raw materials
- retailing – purchase of goods for resale
- agriculture – when planting first began
- construction – levelling of land
- property development – purchase of land

Special Deduction for Pre-Commencement Expenses

There are provisions both in the Act and Rules which allows for the following deductions for companies :

- *Income tax (Deduction of Incorporation Expenses) Rules, 1974;*
- Pre-operational business expenditure (Schedule 4B of the Act);
- Pre-commencement of business expenditure on approved training [*Income Tax (Deduction of Approved Training) Rules 1992*];
- Pre-commencement of business training expenses [*Income Tax (Deduction of Pre-Commencement of Business Training Expenses) Rules 1996*]

(i) Income Tax (Deduction of Incorporation Expenses) Rules 1974

Companies incorporated in Malaysia on or after 1st January 1973 with an authorised capital not exceeding RM250,000 would qualify for

deduction of the following expenses against gross income from its business source for the basis period in which it commenced business :

- Cost of preparing and printing the Memorandum, the Articles of Association and the Prospectus, and of circulating and advertising the Prospectus;
- Cost of registering the company and the statutory documents, together with fees and stamp duties payable;
- Cost of drawing up the preliminary contracts and stamp duty thereon;
- Cost of printing and stamping debentures (if any) and of share certificates and letters of allotment;
- Cost of the seal of the company; and
- Underwriting commission.

A claim must be made in the tax computation even though the expenses may have been capitalised.

(ii) Pre-Operational Business Expenditure Incurred Outside Malaysia (Schedule 4B of the Act)

Certain pre-operational business expenditure in relation to a proposal to undertake investment outside Malaysia in respect of an approved business venture by a resident company can be claimed as deduction for tax purposes.

The qualifying expenses are :

- expenses directly relating to the conduct of feasibility studies;
- expenses directly relating to the carrying out of market research or survey or the obtaining of marketing information;
- expenses incurred on overseas travel in conducting feasibility study or market survey purposes; and
- actual expenses on accommodation and sustenance not exceeding RM400 per day.

(iii) Pre-Commencement of Business Expenditure on Approved Training

A manufacturing company is allowed a double deduction for pre-commencement of business expenditure on approved training in arriving at the adjusted income if it satisfies the following :

- it has incurred the said expenditure during the period of pre-commencement of its business;
- the expenditure is in respect of training its employees for the acquisitions of craft, supervisory or technical skills which will contribute directly to the future production of its products;

- the training is provided under a training programme approved by the Malaysian Industrial Development Authority (MIDA) or a training programme conducted by a training institution approved by the Minister of Finance; and
- the said employees are Malaysian citizens.

(iv) Pre-Commencement of Business Training Expenses

A company providing training to its employees prior to the commencement of business can claim a single deduction on the training expenses in arriving at the adjusted income provided all the following conditions are met :-

- the training is to impart basic skills to enable the company to commence its business;
- the training expenses are incurred within 1 year prior to the commencement of its business; and
- the training expenses are the kind allowable under Section 33 of the Act.