

# INCOME TAX

## 1. Basis of Assessment

Currently, income tax for a year of assessment is levied on income arising in the preceding year. To improve efficiency and responsiveness in tax collections and ensure that the cashflow of the Government reflects the current performance of the economy, the following amendments were proposed in the Budget Speech (absent from the Finance Bill) :

- a. income tax be levied on income of the current year from year 2000;
- b. tax on income received in 1999 be waived; and
- c. losses incurred in 1999 be carried forward to offset against future business income.

It is envisaged that the tax return for year 2000 in respect of income earned in the year 2000 would be submitted in the year 2001. However, the payment of tax for year 2000 income will be on a current year basis.

## 2. Self-Assessment

The current assessment system which requires assessments to be raised after a review of each tax return submitted is labour intensive and costly. In line with recent developments in the Inland Revenue, it is proposed that the self-assessment system be adopted thus placing the onus of filing correct tax returns on the taxpayer.

The change to the self-assessment system is to be implemented in stages as follows :

<b>Taxpayers</b>	<b>Year of Implementation</b>
Companies	2001
Businesses, partnerships and cooperatives	2003
Employees	2004

With self-assessment, greater emphasis will be placed on field audits rather than the current desk audits.

It is envisaged that deterrent penalties would be imposed to discourage evasion and promote correct tax returns.

The Inland Revenue is expected to intensify its tax education programs and issue public rulings and guidelines on a timely basis in view of the change to self-assessment.

### **3. Reinvestment Allowance** *[Schedule 7A]*

Significant changes affecting reinvestment allowance (RA) were introduced through the 1998 Budget. From year of assessment 1998, where a company resident in Malaysia:

- a. has been in operation for not less than 12 months;
- b. has incurred in the basis period for a year of assessment capital expenditure on a factory, plant or machinery used in Malaysia for the purposes of a qualifying project; and
- c. has shown an increase in productivity in the basis period for that year of assessment or in the basis period for the following year of assessment,

the company will be eligible for RA equal to 60% of that expenditure.

It is proposed that paragraph (c) above be deleted with retroactive effect from year of assessment 1998.

By cancelling any need for an increase in productivity measured by the convoluted Process Efficiency Ratio, this incentive would be more readily available once again to resident companies.

### **4. Tax Treatment on Interest-in-Suspense Account**

Currently, interest income in the "interest-in-suspense" account is taxed on the accruals basis subject to a deduction in respect of debts admitted as wholly or partially irrecoverable. To alleviate the cash burden on financial institutions due to increases in non-performing loans, it is proposed that 50% of the interest income in the "interest-in-suspense" account shall not be considered as income for purposes of income tax. Such income will only be taxed once it is received.

This proposed amendment is to be effective for years of assessment 1999 and 2000 only.

## 5. Rental Income from the Use of Malaysian Ships [Section 54A]

Presently, the statutory income of a resident company from the business of transporting passengers or cargo by sea on board Malaysian ships is exempted from tax.

In the case of *Director General of Inland Revenue v. S. Kapal Sdn Bhd (Civil Appeal No. R1-14-1-96)*, the High Court held that income received from the time charter of Malaysian ship is taxable on the grounds that the income does not fall within the definition of “transporting passengers or cargo”.

To encourage the growth and development of the shipping industry, it is proposed that effective year of assessment 1999, the current exemption be explicitly expanded to include the statutory income of a business of letting out on charter a Malaysian ship owned by that Malaysian-resident on a voyage or time charter basis.

## 6. Treatment of Actuarial Surplus [Section 60]

Currently, the income of the life fund and the shareholders' fund of a life insurance business are regarded as separate sources of income and the chargeable income of each is subject to tax at 8% and 28% respectively. One of the components in arriving at the adjusted income of the shareholders' fund is an amount equal to the actuarial surplus for that period arising from the life fund, other than the surplus from the life re-insurance business as is apportioned to the shareholders' fund. The actuarial surplus as aforesaid is subject to any adjustment as the Director General may think fit to make in accordance with the provisions of the *Income Tax Act, 1967 (the Act)*.

Based on the current provisions of the Act, the actuarial surplus to be taxed is calculated on an accruals basis with the result that the shareholders' fund is taxed on an amount that is not actually transferred.

To rectify this anomaly and to encourage shareholders to retain the actuarial surplus in the life fund for the development of the life insurance industry, it is proposed that with effect from year of assessment 1999, the actuarial surplus to be taxed should be the actual amount that is transferred to the shareholders' fund.

Although the proposed amendment does not specifically exclude the actuarial surplus from life re-insurance business (which under the current legislation is regarded as a separate source from the life business and is treated as general business of the insurance company) one should seek to exclude the said surplus when computing the adjusted income of the shareholders' fund.

## 7. Group Relief – Approved Food Production Projects

[Schedule 4C and Section 44]

Against the backdrop of an economic crisis, a back to basic step of encouraging more local food production is wise. Apart from promoting commercial crops such as rubber, oil palm and cocoa, the Government now encourages the corporate sector to undertake large-scale food production through a proposal to grant group relief effective year of assessment 2000.

Group relief is accorded to in respect of an approved food production project (AFPP) which is defined as an agricultural project which is approved by the Minister of Agriculture for the cultivation of maize for animal feed, cattle farming or any other activities as may be prescribed by the Minister of Finance. In relation to an AFPP :

- a. the application for approval must be made on or before December 31, 1999;
- b. the project must commence within one year from the date of approval; and
- c. at least 80% of the sales, if any, of the produce are made within Malaysia.

In accordance with the proposed new *Schedule 4C of the Income Tax Act, 1967 (the Act)*, a Malaysian-resident company may surrender its adjusted loss, in respect of an AFPP fully or partially to one or more related Malaysian-resident claimant companies. Any loss not surrendered in any year of assessment cannot be surrendered in a subsequent year of assessment. The amount surrendered is deductible by any claimant company from its aggregate income. In this connection, the loss claimed is treated on the same footing as the current year business loss of the claimant.

Where the basis period of the surrendering company does not coincide with that of the claimant company, the loss surrendered is prorated by reference to the coincident period on the assumption that the loss accrued evenly over the basis period of the former.

A surrendering company is considered as being related to a claimant company if at the end of the basis period for a year of assessment at least 70% of the issued share capital of :

- a. the surrendering company is directly owned by the claimant company or vice versa; or
- b. the surrendering company and claimant company are directly owned by another company.

Group relief shall not apply to a surrendering company which has been allowed a deduction in respect of qualifying farm expenditure on approved agricultural projects (*Schedule 4A of the Act*) or reinvestment allowance or granted any incentive under the *Promotion of Investments Act, 1986* in respect of the same activity.

A company which has commenced an AFPP is required to maintain a separate account in respect of income derived from that project. Where expenses are incurred which are not directly attributable to that project, the Director General is empowered to allocate as expenses such amount as might reasonably and properly have been incurred in the normal course of business in respect of such project.

Any claim for a deduction by way of group relief shall be made in a written statement and shall be accompanied by a notice of consent from the surrendering company showing the amount of loss being surrendered.

The Director General is authorised to raise assessments or additional assessments on a claimant company to make good any loss of tax where it appears to him that a deduction should not have been granted to that company.

A note in the appendices to the text of the 1999 Budget Speech indicates that in relation to expansion and diversification projects, reinvestment allowance is claimable (by a surrendering company) if group relief is forgone.

The above provision introduces to Malaysia a new form of loss relief, group relief, which is one of the forms of loss relief permitted in some countries, e.g. the United Kingdom. Currently limited to AFPP, there are some benefits if group relief is made more widely available in future.

It is good to note that the Government is promoting the cultivation of maize which is a major cost item in poultry farming. Coupled with the efforts of Malaysian Agricultural Research & Development Institute (MARDI) to produce a suitable strain of maize for Malaysia, it is hoped that the cost of chicken to the consumer will be significantly reduced in the future.

## **8. Tax Deduction for Contributions to Approved Charity and Community Projects** [*Section 34(6)(h)*]

Currently, expenditure incurred on the provision of services, public amenities and contributions to a charity or community project pertaining to education, health, housing as well as infrastructure approved by the relevant authority is admissible for income tax purposes.

It is proposed that with effect from year of assessment 1999, the approving authority for deduction be no longer the relevant authority but the Minister of Finance.

## **9. Interest Income of Unit Trust** [*Paragraph 35A, Schedule 6*]

Presently, individuals are entitled to certain tax exemptions in respect of interest income from banks and finance companies.

To promote unit trusts as a collective investment vehicle, it is proposed that from year of assessment 1999, income of a unit trust in respect of interest derived from Malaysia and paid or credited by any bank or financial institution licensed under the *Banking and Financial Institutions Act, 1989* or the *Islamic Banking Act, 1983* be exempt from tax.

Such income may also be distributed to unit holders free of tax.

## **10. Overseas Leave Passage** [*Section 13(1)(b)(ii)*]

Currently, the benefit of leave passage enjoyed by an employee and members of his immediate family not exceeding 3 times within Malaysia or 1 passage overseas in a calendar year is tax exempt to the employee.

As a measure to curb the outflow of funds, it is proposed that the tax exemption in respect of the overseas leave passage be limited to a maximum of RM3,000 with effect from October 24, 1998.

## **11. Pensions Exempted from Tax** [*Paragraph 30, Schedule 6*]

By virtue of *Paragraph 30 of Schedule 6 to the Income Tax Act, 1967*, tax exemption is accorded in respect of pensions derived from Malaysia and paid to a person resident on reaching the age of 55, or on reaching the compulsory age of retirement, or if the Director General is satisfied that the retirement was due to ill health :

- a. in respect of services rendered in exercising a former employment in Malaysia;  
and
- b. where the pension is paid other than under any written law, from a pension or provident fund, scheme or society which is an approved scheme.

It is proposed that effective year of assessment 1999, pensions received in the above circumstances be exempt from tax whether or not the person is resident in Malaysia.

## **12. Employment on Malaysian Ship** *[Paragraph 34, Schedule 6]*

Currently, the income of any person derived from exercising an employment on board a Malaysian ship is exempt from tax.

It is proposed that income of an individual instead of a person would be exempted from tax.

In addition, the definition of "Malaysian ship" for the above exemption purposes has been narrowed in line with *Section 54A(6) of the Income Tax Act, 1967* to exclude a ferry, barge, tug boat, supply vessel, crew boat, lighter, dredger, fishing boat or other similar vessel.

These proposals are to be effective from year of assessment 1999.

## **13. Non-Resident Relief** *[Section 130]*

Currently, individuals who are not resident in Malaysia are generally subject to income tax at a flat rate of 30% without any personal reliefs. Non-resident relief is, however, available in certain circumstances.

Under the Finance (No. 2) Bill 1998, effective year of assessment 1999, it is proposed that non-resident relief shall be restricted to an individual who is a citizen but not resident by reason of his employment which is exercised outside Malaysia in the public services or the service of a statutory authority.

The relief shall be such an amount as will reduce the amount of tax chargeable on him in respect of his chargeable income for that year of assessment to an amount which bears the same proportion to the amount of tax which would be so chargeable if he were resident for that basis year and the tax were charged on his aggregate income as the amount of his total income bears to the amount of his aggregate income.

The calculation of the non-resident relief may be illustrated below :

	<b>RM</b>
Malaysian income taxed at non-resident rate	xxx
Less: $\frac{\text{Malaysian income}}{\text{World income}} \times$ Income tax payable on world income as if the individual were a resident	xx
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Non-resident relief	x ==

Thus, the tax payable by the non-resident individual is RM xx.

An individual claiming non-resident relief shall make his claim in the prescribed form and shall furnish such further particulars as the Director General may require.

“Aggregate income” in relation to an individual claiming the non-resident relief for a year of assessment means his total income, accruing in or derived from Malaysia or elsewhere, computed in accordance with the provisions of the *Income Tax Act, 1967 (the Act)*.

Where an individual and his wife elect for combined assessment under *Section 45(2) of the Act*, in arriving at the aggregate income, the reference to total income shall include the total income of the wife of the individual.

The above amendment is effected through a new *Section 130*. In view of the amendment to *Section 130, Paragraph 8 to Schedule 7* (bilateral credit) in which certain subsections of the existing *Section 130* have relevance, is consequently proposed to be deleted.

## Tax Incentives

### 14. Incentive for Trading Companies

To encourage Malaysian trading companies to be actively involved in international trade, it is proposed that any company approved as an International Trading Company be given a 5 year income tax exemption of 70% of its statutory income arising from increased export sales. For the purpose of this incentive, export sales do not include trading commissions and profits derived from trading at the commodity exchange.

To qualify as an International Trading Company, a company must satisfy the following criteria :

- a. be incorporated in Malaysia;
- b. achieve an annual sales turnover of more than RM 25 million;
- c. have an equity holding of at least 70% by Malaysian;
- d. market manufactured goods, especially those from the small and medium scale industry; and
- e. be registered with MATRADE.

In addition, the company must satisfy the following conditions to enjoy the tax incentive :

- i. not more than 20% of annual sales is derived from trading of commodities;
- ii. not more than 20% of annual sales is derived from the sales of the goods of related companies; and
- iii. use local services such as banking, finance, insurance, shipping, ports, airports, haulage and warehousing.

The computation of the amount exempted is illustrated below :

Preceding year export sales	RM40million
Current year export sales	50 million
Increase in export sales	----- RM10million =====
Increased export sales over current year export sales	<u>RM10million</u> RM50million
	= 20%
Current year statutory income in relation to export sales	RM8million
Statutory income for increased export sales	RM 8 million x 20% = RM 1.6 million
Exempt income	RM 1.6 million x 70% = RM 1.12 million

This proposal will be effective from year of assessment 1999.

## **15. Incentive for the Development of Domestic Tourism**

As a measure to further develop domestic tourism, it is proposed that income derived by companies from organising domestic tour packages involving at least 1,200 local tourists annually be exempted from income tax.

For this exemption, a domestic tour package means any tour package within Malaysia participated by local tourists whether transportation is by air, land or sea and providing accommodation for at least one night. Local tourists are those other than inbound tourists.

This proposal will be effective for years of assessment 1999 and 2000.

## **16. Incentives for the Use of Sports, Culture and Arts Complexes**

To promote optimum use of the National Sports Complex, National Theatre, National Arts Gallery and Petronas Philharmonic Hall, it is proposed that cultural and arts shows, exhibitions, festivals and sports activities of international standard held at these places be given the following tax exemptions :

- a. income tax exemption up to year of assessment 2001 on income earned by non-residents from performing in cultural and arts shows and participating in exhibitions, games and sports;
- b. income tax exemption of 50% up to year of assessment 2001 be given on income earned by the organizers from organizing sports, cultural and arts shows, exhibitions and festivals involving foreign participation.

It is also proposed that admission tickets to cultural and arts shows, exhibitions, festivals and sports competitions be exempt from the entertainment duty.

The above proposals are to be effective from October 23, 1998.

## **17. Incentive for the Repair and Maintenance of Luxury Boat and Yacht in Langkawi**

To make Langkawi a leading centre in the region for the repair and maintenance of luxury boats and yachts, it is proposed that such activities undertaken in Langkawi be granted income tax exemption for a period of 5 years.

The proposal is to be effective after October 23, 1998.

## **18. Incentives for Car and Motorcycle Racing**

To encourage the hosting of car and motorcycle racing events of international standard in Malaysia, it is proposed that the drivers and the organizers of such racing be given the following incentives :

- a. income earned by the drivers be exempted from tax;
- b. income earned by the organizers be given tax exemption of 50%.

The proposal is to be effective from year of assessment 1999.