

Chapter 3

Taxation of Companies

Definition

A 'Company' is defined under the Income Tax Act, 1967 as a body corporate and includes any body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia.

Tax Status of Companies

Resident Status

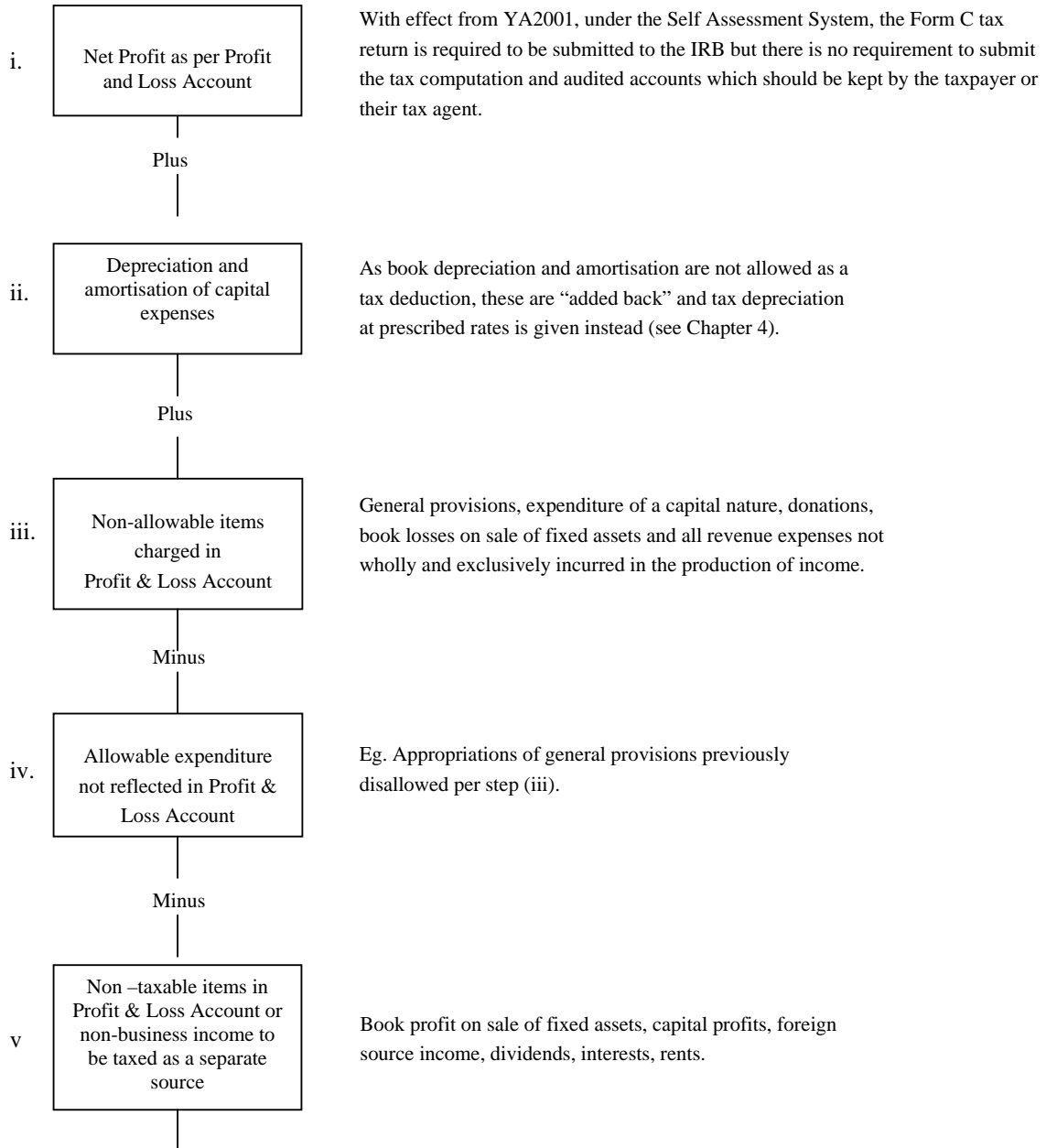
Regardless of where a company is incorporated, it is a resident for a year of assessment if at any time during the calendar year for the year of assessment, it is managed and controlled in Malaysia. Generally, a company is regarded as being managed and controlled in the place where its directors' meetings are held.

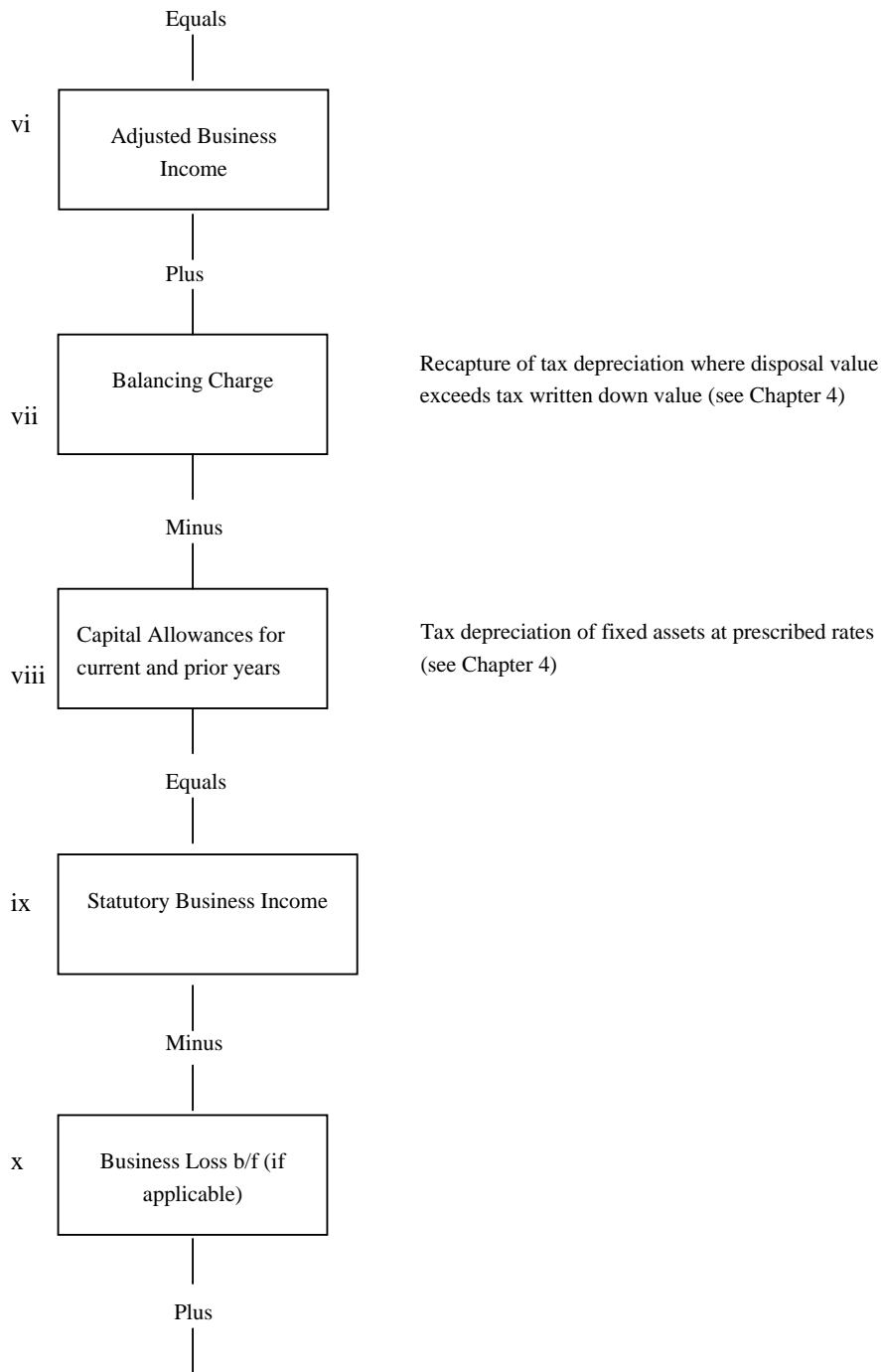
Rate of Tax

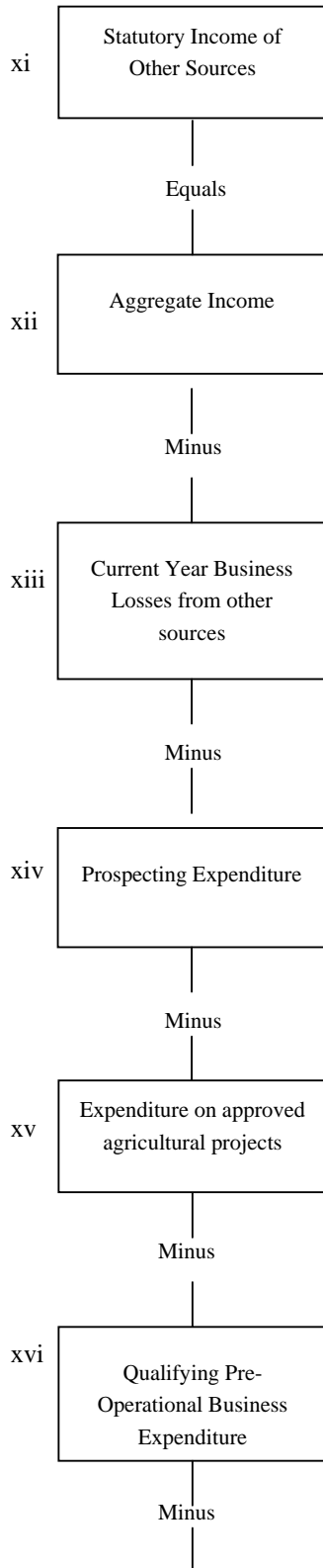
The type and rates of tax assessable on companies are dealt with in Chapter 1.

Taxable Income

Computation of Chargeable Income-General Guidelines

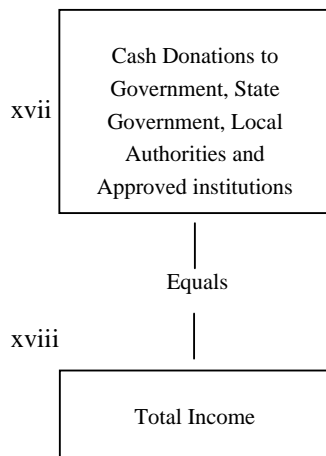






Taxpayer is given a deduction for qualifying prospecting expenditure incurred in the basis year if election is made

Taxpayer is given a deduction for qualifying farm expenditure incurred in the basis period for an approved agricultural project if election is made



With effect Year of Assessment 2001, the allowable deduction for any gift of money made to any institution or organization approved by the Director General of Inland Revenue shall not exceed 5% of the aggregate income of the taxpayer.

Adjustment of Profits or Losses for Income Tax Purposes

As illustrated by the diagram above, the profit or loss of a business is adjusted to take account of or exclude those expenses that are allowable or prohibited in ascertaining the assessable income for any given period. Please refer below for further details.

Foreign Source Income

With effect from Year of Assessment 1995, foreign source income when received in Malaysia by a resident company (other than a company carrying on the business of banking, insurance, shipping and air transport) is exempt from tax. With effect from Year of Assessment 1998, a unit trust is also exempted from income tax on income received in Malaysia from sources outside Malaysia.

Capital Gains

There is currently no capital gains tax in Malaysia, except for that imposed on gains on the disposal of real property. Please refer to Chapter 8 of this book.

Treatment of Previous Years' Losses and Capital Allowances

Capital Allowances

Capital allowances can only be set-off against income of the business to which the capital expenditure is related. It follows that where capital allowances cannot be fully absorbed because of an insufficiency of adjusted income, the unabsorbed capital allowances can be carried forward indefinitely to offset future income from that same business until they have been fully claimed. This set-off takes priority before setting-off any unabsorbed business losses brought forward from previous years.

Losses

Losses suffered in a business, profession or vocation may be set-off against income from other sources for that assessment year. Where there is insufficient income to absorb the losses, the unabsorbed losses can be carried forward indefinitely for set-off against future business income, not necessarily from the same business, until the entire loss has been utilised. The set-off for business losses brought forward should be made after the unabsorbed capital allowances have been utilised.

General Deduction Rules

In general, the Income Tax Act 1967 permits deduction only in respect of all out-goings and expenses of a revenue nature wholly and exclusively incurred in the production of income.

Based on this rule, an expense will only be deductible if:-

- It is incurred, laid out or expended during the basis period. It follows that provisions or reserves for anticipated losses or for contingent liabilities, which may be fully justified on commercial principles, cannot be deducted until they have been actually incurred; and
- It is incurred “wholly and exclusively in the production of income”. In practice, this is not interpreted so strictly as to disallow an expense for the reason that it is only partially incurred in the production of income. If a definite part or proportion of the expense can be regarded as incurred in producing income, such portion would be allowed as a deduction.

Deduction of Expenses

Allowable Deductions

Some of the allowable deductions are:-

- Cost of sales;
- Manufacturing, trading, administration, selling and financial expenses;
- Expenses incurred in respect of employees’ welfare including contributions to the Employees Provident Fund and other approved funds (subject to a limit of 19% of each employee’s remuneration);
- A justifiable share of regional office or head office revenue expenses;
- Expenses for repairs of premises, plant and machinery or fixtures or for the replacement of implements, utensils or articles employed in producing the income;
- Irrecoverable trade debts arising out of the business, including provisions for specific bad debts where attempts to collect the debts have failed;
- Expenses incurred on replanting crops;

- Interest on loans employed in producing income;
- Rent payable in respect of any land or building occupied for the purpose of producing income;
- Certain expenditure incurred on prospecting;
- Approved scientific research expenditure;
- Legal expenses incurred on debt collection and renewal of lease of premises; and
- Insurance premiums.

Non-Allowable Deductions

Expenses of a capital nature are generally not deductible. Apart from these, certain revenue expenditure is also disallowed. The non-allowable deductions include:-

- Expenses (preliminary and pre-operating) incurred prior to commencement of business;
- Domestic or private expenses;
- Income Tax;
- Expenditure or losses of a capital nature;
- Remuneration payable to members of the proprietor's family in excess of the commercial value of their services;
- Rental paid in excess of RM50,000 in aggregate for hire of a non-commercial vehicle (the restriction threshold is increased to RM100,000 if the vehicle is new and its total cost does not exceed RM150,000);
- Expenses incurred in the provision of entertainment other than entertainment provided to employees;
- Expenditure incurred in the provision of a benefit or amenity to an employee consisting of leave passage within or outside Malaysia;
- Contributions to approved schemes for employees in excess of 19% of the employee's remuneration;
- Contributions to non approved schemes; and
- Expenditure for which capital allowances (wear and tear allowance) can be given under the Income Tax Act, 1967.

Deduction for Incorporation Expenses

Under the Income Tax (Deduction of Incorporation Expenses) Rules, 1974, a company incorporated in Malaysia on or after 1 January 1973, with an authorised share capital not exceeding RM250,000 is permitted to deduct certain incorporation expenses, which are otherwise prohibited by the Income Tax Act, 1967. The type of allowable expenses are:-

- Costs of preparing and printing Memorandum and Articles of Association and the Prospectus including costs of circulating and advertising the Prospectus;
- Costs of registering the Company and statutory documentation including fees and stamp duties payable thereon;
- Cost of drawing up preliminary contracts and stamp duties thereon;
- Cost of printing and stamping debentures, share certificates and allotment letters;
- Cost of company's seal; and
- Underwriting commission.

Deduction for Pre-operating Expenses

A resident company undertaking investment in a business venture outside Malaysia and approved by the Minister of Finance is entitled to deduction against its aggregate income from all sources for qualifying pre-operational business expenditure in respect of:

- Conduct of feasibility studies;
- Conduct of market research or obtaining of marketing information;
- Overseas travelling expenses for purposes of conducting feasibility studies or market surveys; and
- Accommodation and sustenance expenses for the duration of the overseas trip up to a maximum of RM400 per day.

Where there is insufficient aggregate income for the qualifying pre-operational business expenditure to be deducted from, the unabsorbed expenditure will be carried forward to subsequent years of assessment.

Other Deductions

There are other specific deductions and double deductions available to resident companies. These are elaborated in Chapter 5.

Deduction for Expenditure of a Capital Nature

General Depreciation and amortisation of fixed assets for accounting purposes are not allowable as deductions for tax purposes; instead, tax deductions take the following form:-

- Mining depletion allowance;
- Deduction for prospecting expenditure; and
- Wear and Tear (Capital) allowances. (Please refer to Chapter 4).

Mining Expenditure A deduction is given against mining income over the life of the mine for capital expenditure incurred on:-

- The acquisition of mining rights;
- Searching, discovering, testing or winning access to deposits;
- The construction of works or buildings in relation to the mine; and
- Development, general administration or management before the commencement of actual production or during any period when minerals are not being mined.

The amount of the deduction is calculated by dividing the residual expenditure at the end of a basis period by the remaining life of the mine at the beginning of that period.

(Residual expenditure at a particular date is the total qualifying mining expenditure incurred in respect of a mine before that date reduced by deductions given in arriving at the adjusted income for all basis periods ending before that date and any recovered expenditure in relation to the mine received on or before that date).

Where allowances have been given for Prospecting Expenditure (see below), mining allowances are not available in respect of the expenditure.

Prospecting Expenditure Any person who has incurred qualifying prospecting expenditure in Malaysia may, within three months after the beginning of the year of assessment in which the expenditure was incurred, elect to claim a deduction for that expenditure.

The claim must contain an identification of the eligible area and the amount of expenditure incurred.

A person may claim a deduction for qualifying prospecting expenditure incurred in the past but limited to expenditure incurred not more than ten years before the end of the basis year. Such a claim must contain a declaration that prospecting has permanently ceased and that the taxpayer has no intention to carry on any mining business in that area.

Qualifying prospecting expenditure is expenditure wholly and exclusively incurred in searching for, discovering or winning access to deposits of minerals or in testing any such deposits including the market value of plant and machinery used in prospecting even though such plant and machinery was not originally bought for that purpose, but excludes the cost of acquiring the site of deposits.

When the prospecting venture is successful, the whole of the prospecting expenditure will be added back to the aggregate income and mining allowance given instead.

Capital Expenditure on Approved Agricultural Projects Schedule 4A of the Income Tax Act, 1967 allows a person carrying on an approved agricultural project to elect so that the capital expenditure ('qualifying farm expenditure') incurred by him in respect of that project is deducted from his aggregate income from all sources. A claim of deduction will preclude any further claim for capital allowances under Schedule 3 of the Income Tax, 1967.

Qualifying farm expenditure includes capital expenditure incurred on:-

- Clearing and preparing land;
- Planting (but not replanting) of crops;
- Construction on a farm of a road or bridge;
- Construction on a farm of a building used for the welfare and accommodation of persons employed in the project; and
- Construction of a pond or installation of drainage or irrigation system.

The deduction applies only to qualifying farm expenditure incurred within a specific period on approved agricultural projects on a farm having a minimum hectarage as stipulated by the Minister of Finance.

For approved agricultural projects to enjoy this deduction, the specified period and minimum hectarage of production are as follows:-

<i>Project</i>	<i>Period (Year)</i>	<i>Minimum Hectarage</i>
Aquaculture (Prawns)	2	40
Crops		
-papaya	1	40
-bananas	1	40
-passion fruit	1	40
-star fruit	2	8
-guava (jambu)	2	8
-mangosteen	7	8
Floriculture	2	8

Effective Year of Assessment 2002, the deduction of qualifying farm expenditure is expanded to include the following agriculture projects.

<i>Project</i>	<i>Period (Year)</i>	<i>Minimum Area (Hectare)</i>
Cultivation of vegetables, tubers, roots, herbs, spices, crops for animal feed and hydroponic based products	3	40.00
Ornamental fish culture-open system (land/concrete pond)	2	5.0
Ornamental fish culture-enclosure system	2	0.25
Pond culture-fish and prawns (brackish water/fresh water)	2	20.0
Tank culture-fish (brackish water/fresh water)	2	1.0
Off-shore marine cage culture-fish	2	0.5
Marine cage culture-fish (brackish water/fresh water)	2	0.5
Cockle culture	1	10.0
Mussel and oyster culture	2	0.5
Seaweed culture	1	5.0
Shrimp hatchery	2	0.25
Prawn hatchery	2	0.25
Fish hatchery (sea water/brackish water/fresh water)	2	0.5

The statutory order in respect of the above has been gazetted in 2002.

Where there is insufficient aggregate income for the qualifying farm expenditure to be deducted from, the unabsorbed expenditure will be carried forward to subsequent years of assessment.

A person who has made an election for a deduction under Schedule 4A in respect of an agricultural project shall not be entitled to make a further election in respect of another project relating to the same crop or product.

Restriction of Motor Vehicles Capital Allowances and Rental Payments The qualifying expenditure on each non-commercial vehicle, that is, a vehicle not licensed or permitted to be used for the commercial transportation of goods or passengers, is restricted to RM100,000 (from 28 October 2000) if the motor vehicle has not been used prior to purchase and the total on the road cost does not exceed RM150,000. In other cases the qualifying expenditure on each non-commercial vehicle is restricted to RM50,000.

Commercial licenced vehicles qualify for full deduction of the rental paid. The deductible expenses for rental of private motor vehicles shall be increased from RM50,000 to RM100,000 per vehicle (with effect from Year of Assessment 2002 onwards), subject to the following:

- The vehicle is new (i.e. has not been used by any person for any purpose prior to the rental); and
- The total cost of the vehicle does not exceed RM150,000.

However, where these conditions are not fulfilled, the existing restriction of RM50,000 shall continue to apply.

Balancing Allowances and Charges On the disposal of a fixed asset, if the disposal value exceeds the tax written down value, the difference gives rise to a balancing charge; if vice versa, the taxpayer is entitled to a balancing allowance. A balancing charge is restricted to the total capital allowances given to the taxpayer on the asset.

In the case of non-commercial motor vehicles, the disposal value is proportionately reduced, thus:-

$$\text{Disposal Value} \quad \times \quad \frac{\text{Qualifying Expenditure}}{\text{Cost of Asset}}$$

Withdrawal of Capital Allowances Where an asset is disposed of within two years of its purchase, the IRB may, for the year of assessment in the basis period of which the disposal is made, withdraw the allowances already given on the asset by way of a balancing charge.

Acquisition of Proprietary Rights Effective from Year of Assessment 1997, the cost of acquisition of proprietary rights, granted or registered under the relevant written laws, is allowed a tax deduction.

To qualify for a deduction:-

- The proprietary rights must be used for the purposes of the business of a manufacturing company; and
- The manufacturing company must be at least 70% owned by Malaysian citizens.

A manufacturing company, for purposes of ascertaining its adjusted income, will be allowed a deduction of 1/10 of the cost of the acquired proprietary rights for 10 consecutive years of assessment. Where the proprietary rights cease to be used in the basis period for a year of assessment, no deduction shall be made for that year of assessment.

To accelerate the acquisition of the latest technology, with effect from Year of Assessment 2002, the annual deduction allowed for capital expenditure incurred to acquire proprietary rights be increased from 10% to 20% and be allowed over a period of 5 years. The statutory order for this deduction has been gazetted in 2002.

Cost of Developing Websites

With effect from YA2002, it is proposed that the cost of developing websites be allowed as an annual deduction of 20% over five years. The statutory order in relation to the proposed deduction has yet to be gazetted.

Promotional Items

The provision of promotional samples of products qualifies for a tax deduction. Promotional gifts are deductible if they are given at trade fairs or industrial exhibitions held outside Malaysia for the promotion of exports from Malaysia. Promotional gifts are also deductible if they are given out free at any sport or cultural events open to members of the public for business promotion.

In addition to the above, expenditure incurred on promotional gifts within Malaysia is allowed as a deduction provided the gifts incorporate a conspicuous advertisement or logo of the business.

Investment Holding Company

An investment holding company (IHC) is defined as a company whose activities consist wholly in the making of investments and whose income is derived therefrom.

Section 60F of the Income Tax Act 1967 was introduced to allow an IHC resident in Malaysia to claim a tax deduction for certain permitted expenses. The permitted expenses include directors' fees, wages, salaries and allowances, management fees, secretarial, audit and accounting fees, telephone charges, printing and stationery costs and postages and rent and other expenses incidental to the maintenance of an office.

The quantum of permitted expenses deductible for tax purposes is restricted to the lower of:

- 5% of the Company's total gross income consisting of dividends, interest and rent; or
- $25\% \times \frac{\text{Permitted expenses} \times \text{Gross income chargeable to tax}}{\text{Total gross income consisting of dividends, interest and rent} + \text{Gains from realisation of investments}}$

However, the above can only be deducted against current year taxable income and any unabsorbed expenses cannot be carried forward. From Year of Assessment 2001, the financial year shall constitute the basis period for that year of assessment.

Anti-Avoidance

Statutory Provisions

The main source of anti-avoidance legislation in Malaysia is found in Section 140 of the Income Tax Act, 1967. The Director General may disregard or vary any transaction and make any necessary adjustments as he thinks fit if he has reason to believe that any transaction has the direct or indirect effect of:-

- Altering the incidence of tax which is payable or suffered by or which would otherwise have been payable or suffered by any person;

- Relieving any person from any liability which has arisen or which would otherwise have arisen to pay tax or to make a return;
- Evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by this Act; or
- Hindering or preventing the operation of this Act in any respect.

In applying the provisions of Section 140, the Director General must first have reason to believe that a transaction has the effect of altering the incidence of tax etc. The onus of proof therefore lies with the IRB once the taxpayer establishes a prima facie case that the transaction is genuine.

Apart from the above general anti-avoidance provision, the Income Tax Act 1967 contains other specific anti-avoidance provisions relating to disposal of fixed assets between associated persons, transfer or sale of stocks on discontinuance of business, settlements, controlled companies, transactions with non-residents, non-receipt of certain income which becomes due and payable and the deemed derivation of certain special classes of income.

Transfer Pricing

There is presently no direct transfer pricing legislation in Malaysia. However, transfer pricing transaction can be caught under Section 140 where the Director General may disregard or vary any transaction and make any necessary adjustments as he thinks fit if he has reason to believe that the transfer price is not reflective of the arms' length price and if profits are transferred between companies within a group through artificial inter-company arrangements in order to minimise the group's income tax liability.

The Director General is given wide powers to examine domestic and international transactions to protect Malaysia's revenue. The tax treaties which Malaysia has negotiated with various countries provide for such powers of examination.

Section 141 further allows the Director General to assess and charge a non-resident to tax in the name of a resident where the Director General considers that, due to the close connection between the tax resident and the non tax resident and due to the substantial control exercised by the non tax resident over the tax resident, the resident has no income liable to income tax or a smaller income than that which might be expected to arise from the business.

Franking of Dividends

Under Section 108 of the Income Tax Act, 1967, every company resident in Malaysia is required to deduct income tax at the current corporate tax rate of 28% from any taxable dividend paid to any shareholder. However, a resident company is entitled to frank the said income tax to be deducted out of actual tax paid on its profits. For this purpose, every resident company is required to maintain a special memorandum account known as the 'Section 108 Account' to keep track of the amount of tax franking credits available (Refer to Chapter 8).

With effect from 1 January 2001, the amended Section 108 provisions require the Section 108 account to be maintained by reference to "tax paid" (rather than "tax on chargeable income" as used previously) by the company in the "basis period" (rather than "Year of Assessment" as used

previously). The Section 108 account also includes franking credits on dividends received from other companies. Furthermore, under the new Section 108, companies have an obligation to submit statements showing movements on their Section 108 accounts within six months following the close of their basis periods.

The amount of credit utilised in franking dividends must be debited to the Section 108 account. This must be done when the dividend is paid or credited to the shareholders during the basis period (ie. financial year). Should the Section 108 account show a shortfall, the amount of shortfall must be paid to the Inland Revenue Board as a debt due to the government by the end of the 6th month from the close of the accounting period. Failure to settle the shortfall within the stipulated period will give rise to a 10% penalty imposed on the outstanding amount.

The requirement to frank dividends does not apply to dividends funded from tax exempt income e.g. income sheltered from tax by tax incentive which can be utilised for paying tax exempt dividends.

An Example of a Corporate Income Tax Computation

Company: XYZ Manufacturing Company Sdn Bhd
 Tax Reference: C 1234567-89
 Year of Assessment: 2001

	Add RM	Deduct RM	RM	Notes
<i>Profit per accounts</i>			22,000,005	
Stamping Fees - Loan Agreement	4,589			1
Interest Income		85,025		2
Rental Income		25,998		2
Capital Items Expensed Off	15,556			1
Employee EPF in Excess of 19%	5,025			3
Gain on Disposal of Fixed Assets		205,466		4
Donations	5,000			5
Entertainment - Clients	62,552			6
Club Membership Entrance Fees	75,000			7
Unrealised Exchange Loss	467,578			8
Unrealised Exchange Gain		65,896		8
Interest Restriction	48,487			9
General Provision for Doubtful Debts	100,000			10
Depreciation	7,052,032			11
Dividend Income		450,000		2
Lease Principal		45,978		12
Double Deductions				
- Approved Training		125,006		13
- Marine Cargo Insurance		26,880		14
- Employment of Handicapped Persons		46,998		15
Balance c/f	7,835,819	1,077,247		

	<i>Add</i> <i>RM</i>	<i>Deduct</i> <i>RM</i>	<i>RM</i>	<i>Notes</i>
Balance b/f	7,835,819	1,077,247		
<i>Adjusted Business Income</i>			28,758,577	
Less: Available Capital Allowance/ (Add: Net Balancing Charges)			-6,423,012	11
<i>Statutory Business Income</i>			22,335,565	
Less: Reinvestment Allowance			-4,568,995	16
Business Loss brought forward			-125,123	
			17,641,447	
<i>Non-Business Income</i>				
Dividend Income		450,000		2
Interest Income		85,025		2
Sundry Income		0		
Less: Related Interest Expense		-48,487		9
		486,538		
Rental Income		25,998		2
		512,536		
<i>Aggregate Income</i>			18,153,983	
Less: This Year's Business Loss			0	
			18,153,983	
Less: Approved Donations			-3,000	5
<i>Chargeable Income</i>			18,150,983	

	<i>Add</i> <i>RM</i>	<i>Deduct</i> <i>RM</i>	<i>Notes</i>
<i>Tax Payable</i>			
Income Tax 18,150,983 at 28% =		5,082,275.24	20
Less: Section 110 relief (28% X 450,000)	126,000.00		17
Less: Section 132/133 relief	0.00		
	_____	-126,000.00	
<i>Net Tax Payable</i>		_____	
		4,956,275.24	
		=====	
 <i>Section 108 Account</i>			
			18
Balance b/f		0.00	
Add: Income Tax Paid		4,500,000.00	19
Add: Tax set off under Section 110 less Section 132/133 relief		126,000.00	
Less: Tax deducted from Dividends Paid		0.00	
Balance c/f		_____	
		4,626,000.00	
		=====	

Notes to Tax Computation

- Note 1 Expenses of a capital nature do not rank for a tax deduction. Capital allowances may be claimed on qualifying capital expenditure.
- Note 2 Dividend, interest and rental income are usually treated as separate and non-business sources of income.
- Note 3 Contributions to the Employees' Provident Fund (EPF) are only claimable up to the limit of 19% of the employees' gross salary.
- Note 4 Gains on disposal of fixed assets are not taxable and losses on disposal of fixed assets are not deductible as they are capital in nature. However, disposals of real property may be subject to Real Property Gains Tax.
- Note 5 Donations are not allowable unless they are made to approved institutions. With effect from Year of Assessment 2001, the amount of deduction on any gift of money made to approved institutions shall not exceed 5% of the aggregate income of the company (The example assumes that only RM3,000 of donations are made to approved institutions).
- Note 6 Entertainment incurred on clients is not deductible. However, entertainment incurred on the company's own staff is deductible.
- Note 7 Entrance fees are not deductible because they are capital in nature. Subscriptions to relevant professional bodies and trade associations are deductible.
- Note 8 Exchange gains and losses are only taxable or deductible if they are trade related and realised.
- Note 9 Interest incurred which relates directly or indirectly to non-income producing investments or non-trade debtors is not deductible.
- Note 10 A provision for doubtful debts is not allowable unless it is for specific trade debts, and action has been taken to recover the debts.
- Note 11 Depreciation is not an allowable expense, however, capital allowances at specified rates may be claimed for qualifying assets.
- Note 12 Lease principal payments made in the year are allowable as a deduction in full, except for non-commercial motor vehicles which are restricted to RM100,000 (maximum).
- Note 13 Double deduction is allowable for training carried out at an approved training institution and at non-approved institutions provided approval has first been obtained from the Malaysian Industrial Development Authority.
- Note 14 Double deduction is allowable for insurance premiums paid for the importation and exportation of goods provided the insurance is taken up with a locally incorporated insurance company.
- Note 15 Double deduction is allowable for the salaries of handicapped employees.

- Note 16 Reinvestment allowance is given for qualifying capital expenditure incurred for the expansion, modernisation, automation or diversification project in manufacturing and agricultural sectors for fifteen consecutive years of assessment.
- Note 17 Section 110 of the Income Tax Act, 1967 allows for tax deducted at source on dividend income to be utilised to set-off against income tax payable for the year.
- Note 18 Section 108 of the Income Tax Act, 1967 requires the keeping of an account of all income taxes paid, tax deducted on dividends paid and Section 110 credits on dividends received for the purpose of franking dividends.
- Note 19 Assumed that tax actually paid through instalments in the basis period is RM4,500,000 therefore balance of RM456,275.24 will be credited to Section 108 account in subsequent year of assessment.
- Note 20 Corporate tax rate = 28%.