



MALAYSIAN INSTITUTE OF ACCOUNTANTS  
FINANCIAL REPORTING STANDARDS IMPLEMENTATION COMMITTEE  
("FRSIC")

**FRSIC Issue No. 2 [2007]**

***Determination of Substantively Enacted Tax Rate for Year of Assessment 2008 and Thereafter***

The issue:

Whether the tax rate of 26% for year of assessment (YA) that was announced in 2007 Budget is regarded as "substantively enacted" in accordance with paragraph 45 and 46 of FRS 112<sub>2004</sub>?

Details of the issue:

In computing the deferred tax assets and liabilities, reference is made to paragraph 45 and 46 of FRS 112<sub>2004</sub>, which provides:-

"45. Deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, *based on tax rates* (and tax laws) that have *been enacted or substantively enacted by the balance sheet date*.

46. Current and deferred tax assets and liabilities are usually measured using the tax rates (and tax laws) that have been enacted. *In Malaysia, announcements of tax rates (and tax laws) by the Government in the yearly Budget have the substantive effect of actual enactment*, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws)."

In the 2007 Budget, the Government announced that the corporate tax rate would be reduced to 27% for 2007 and 26% for 2008. The proposed reduction in the corporate tax rate to 27% was included in the Finance Bill 2006 which has since been gazette as Finance Act 2006 on 31 December 2006. However the proposed further reduction to 26% for YA 2008 is not reflected in the Finance Bill nor the Finance Act.

Since reduction of tax rate for YA 2007 has been reflected in the Finance Act 2006, there is no doubt over applying tax rate of 27% to the temporary differences that are expected to reverse in YA 2007 in computing the deferred tax balances.

The question is which tax rate should be applied to the temporary differences that is expected to realised or reversed in YA 2008 and years subsequent to YA 2008 in arriving at the deferred tax asset/liability?

Current accounting practice as observed by the Submitter:

Alternative A: Use of 26% for YA2008 and Beyond

Some companies applied tax rates as announced in the 2006 Budget Speech in the computation of deferred tax, i.e. 27% for temporary differences expected to realize in YA 2007 and 26% for temporary differences expected to realize in YA 2008 and subsequent years.

Rationale for this is that FRS 112.46 states that the announced rate is substantially enacted, and therefore, FRS 112.45 requires its use for computation of deferred tax.

The government is unlikely to retract the announced rate of 26% because investments in the country are being made on that basis.

Also, the use of 26% is in line with advice by the Inland Revenue Board (IRBM) per the 2007 Post Budget Technical Dialogue between MIT/MIA/MICPA and IRBM held on 5 October 2006. Extract from the minutes of the Dialogue:-

"1. Review of company income tax rate

... The Institutes wish to highlight the following:-

- (a) the reduction of the tax rate to 27% is evidenced by clause 30(a)(ii) of the Finance Bill 2006 (Bill). However, the reduction of the tax rate to 26% was not mentioned in that clause. The reduction should be included in order to provide certainty, especially to foreign investors.
- (b) pending the gazetting of the Bill, the Institutes wish to confirm that taxpayers are allowed to apply the new tax rates in their preparation of the revised and initial tax estimates for years of assessment 2007 and 2008 respectively.

Answer

- (a) The IRBM responded that the reduction of the corporate tax rate from 27% to 26% will be amended in the next finance bill.
- (b) The IRBM confirmed that the new (proposed) corporate tax rate can be applied pending the gazette of the Bill."

Alternative B: Use of 26% for YA2008 and Beyond

Some other companies applied 27% for temporary differences expected to realise in YA 2007 and subsequent years.

These companies are of the view that FRS 112.46 does not apply to situations where the announcement is in respect of a period that is more than 12 months away. In addition, it is the government's prerogative to change the tax rate for YA 2008 nearer the time, depending on the economic situation of the country. As evidenced in other tax announcements such as GST, announcements about a future extended period cannot be considered "substantially enacted".

Lastly, it would be imprudent to allow companies to release provisions given the uncertainty and may misled investors.

**Reasons for the FRSIC to address the issue:**

- (a) This is a practical application issue affecting all companies in Malaysia with deferred tax asset or liabilities that are expected to realized or settled in YA 2008 and years subsequent to YA 2008.
- (b) There seems to be emerging divergent practice among the companies
- (c) Consistent application by companies would improve understanding of the financial reporting.
- (d) The issue could be resolved by issuing guidance on application.
- (e) This issue is not related to a current or planned MASB project.
- (f) This issue involves interpretation of FRS 112<sub>2004</sub>, which has force of law in accordance with Financial Reporting Act 1997.

**Submitter's proposal or recommendation to address the issue:**

[Applicable tax rate for YA 2008 is 26%](#)

The Finance Act 2006 state that the reduction in tax rate from 28% to 27% is effective for the year of assessment 2007 and subsequent years of assessment. Although the Finance Act 2006 appears contradictory to the 2007 Budget Speech, it is expected that the amendment to the law that is necessary for the reduction of the corporate tax rate to 26% effective from YA 2008 will be done before 2008. The Government's commitment to this change is indicated by the announcement of the plan to adopt this rate from YA 2008 in the 2007 Budget Speech. This is an important policy matter of far-reaching economic and political significance and it is not likely that the Government will renege on its announcement on this matter. Therefore the Budget Speech using the rate of 26% is deemed to have the substantive effect of actual enactment in accordance with FRS 112.46.

[Applicable tax rate for YA 2009 and subsequent YAs is 26%](#)

The 2007 Budget Speech is silent on corporate tax rate for YA 2009 and subsequent YAs. Following the expected legislative amendment to change the corporate tax rate to 26% with effect from YA 2008, this rate will prevail for subsequent years unless the Government enacts further legislative amendments to change the rate.

Submitted on:

26 January 2007

Corresponding FRSIC Consensus:

*FRSIC Consensus 1 - Determination of Substantively Enacted Tax Rate for Year of Assessment 2008 and Thereafter* [To view, click on the abovementioned Consensus title]