CATATAN DIALOG DIANTARA MIT/MIA/MACPA/MAICSA/MATA DENGAN BAHAGIAN TEKNIKAL

Tarikh : 17 Jun 2002

Masa : 9.00 pagi–1.00 tengahari

Tempat : Bilik Mesyuarat Utama,
Lembaga Hasil Dalam Negeri,
Tingkat 16, Blok 11, Jalan Duta,
KUALA LUMPUR.

KEHADIRAN

WAKIL LHDN:

1. En. Lim Heng How	-	TKP, Teknikal & Perundangan (Pengerusi)
2. Pn. Nik Esah binti Nik Mahmood	-	Pengarah Bahagian Teknikal
3. Pn. Salmah bt Kassim	-	Pengarah Bahagian Undang-Undang
4. Pn. Norimah bt Senawi	-	KPP, Bahagian Operasi
5. Cik Puteh Mariah bt Haron	-	KPP, Bahagian Operasi
6. Pn. M Silverranie	-	KPP, Bahagian Teknikal
7. En. Joseph Teoh Hang Meng	-	KPP, Bahagian Teknikal
8. Pn. Noraini bt Jaafar	-	KPP, Bahagian Teknikal
9. En. Yaacob b Othman	-	Setiausaha

WAKIL PERSATUAN:

1. En. Beh Tok Koay	-	MICPA/MIA
2. Dr. Veerinderjeet Singh	-	MIT
3. En. Lee Yat Kong	-	MIT
4. En. Ong Lay Seong	-	MIT/MIA
5. En. Robin Noronha	-	MIT
6. Pn. Phoon Sow Cheng	-	MIT/MIA

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7. En. Robin Noronha	-	MIT/MIA
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9. En. Sam Soh Siong Hoon	-	MIA
10. En. Raymond Liew Lee Leong	-	MIA
11. En. Mohd Noor Abu Bakar	-	MIA
12. En. Peter Lim	-	MAICSA
13. En. Johnny Young	-	MIA
14. En. Mohd Haizam Abdul Aziz	-	MIA/MIT
15. Cik Illyana Adyani Khairudin	-	MIA
16. Pn. Norhaiza Jemon	-	MAICSA

PENDAHULUAN

Tuan Pengerusi mengucapkan selamat petang dan mengalu-alukan kedatangan wakil MIT, MIA, MICPA, MAICSA dan MATA ke majlis dialog ini. Wakil persatuan akauntan bertauliah seterusnya dijemput untuk mengemukakan isu-isu teknikal yang ingin dibincangkan iaitu :

1. **Interpretation of "Crediting"**

   The term "crediting" is used in various provisions of the *Income Tax Act, 1967* (ITA) with regard to withholding tax. However, we note that there has been no guidance on the meaning or interpretation of this term. The term "crediting" has been interpreted (in the Canadian case of *Compagnie Miniere Quebec Cartier v. MNR (84 DTC 1348)*, to mean more than the making of an accounting entry, and it involves "making a sum of money available to" the creditor.

   In view of the fact that the time frame within which withholding tax is payable rests on the meaning of this term, it is important to obtain the IRB"s clarification and guidance on the interpretation of the term "crediting", particularly under the current self assessment regime.

   Comment

   The IRB clarified that the term "crediting" refers to something more than a mere "book entry". An amount is considered as having been credited to a non-resident if it has been made available to or for the benefit of the non-resident. The term "paying/crediting" would therefore mean,

   (i) the date the amount is paid; or

   (ii) the date the amount is credited in the bank account of the recipient; or

   (iii) the date of a contra entry.

   (Assessment Branches will be informed)

2. Section 29 of the ITA–Basis Period to which "Income Obtainable on Demand" is Related

Pursuant to sec. 29 of the ITA (notwithstanding sec. 23 to 28), where a person is able to obtain the receipt of income on demand, that income shall be treated as received in the period when such a circumstance arises. Meanwhile, under sec. 27 of the ITA, interest income is taxable on a received basis in the period in which the interest income first becomes receivable. Therefore, under sec. 27 of the ITA, the charge to tax only arises when the interest income is received, although it could relate to an earlier period. However, under sec. 29 of the ITA, if that interest income is "obtainable on demand" in a particular period, the interest income would be taxable in that period, notwithstanding that it may not have been received in that period.

In view of the self assessment system, the professional bodies wish to seek the IRB"s clarification on the following matters:

(i) the type of circumstances that would fall within the tax treatment governed by sec. 29 of the ITA;

(ii) the distinction between "income obtainable on demand" and "income that is receivable"; and

(iii) the distinction between amounts due from related parties and amounts due from third parties, in the context of item (ii) above.

Comment

The IRB clarified that "income obtainable on demand" and "receivable" can be distinguished as follows:

The former refers to a situation where at any particular time, the amount due i available and the payee is able to demand the payment at that time irrespective of the actual payment date. The latter can refer to a situation whereby the amount may be receivable but may not be payable until a specific date as pre-determined under an agreement.

The application of sec. 27 and 29 does not distinguish transactions between related parties and transactions with third parties.

3. **Paragraph 49, Schedule 3 of the ITA–"Relevant Interest"**

We understand that where a taxpayer rents and uses an industrial building and incurs renovation costs on the rented building, the taxpayer should be having a "relevant interest", and should be entitled to claim industrial building allowances (IBA) on the renovation costs. We also understand that it has been the practice of the IRB to grant IBA on the renovation costs under such circumstances. Nevertheless, the professional bodies would like the IRB to reaffirm that it is still the practice of the IRB to grant IBA on renovation costs incurred on an industrial building rented (and not owned) by the taxpayer.

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Comment

The IRB confirmed that renovation costs incurred by the tenant on an industrial building under the abovementioned circumstances will qualify for Industrial Building Allowance.

4. Financial Institutions–Amortisation of Premiums/Accretion of Discounts

For accounting purposes, premiums/discounts will be amortised over the life of the security. For tax purposes, we understand that any deduction/taxability would arise upon maturity or realisation of the security. However, due to the volume of such transactions undertaken by financial institutions, it is difficult in practice to apply the "realised" basis to each separate investment. We are of the opinion that the IRB should take a more practical and pragmatic approach by accepting the accounting basis and thus, adopting the accruals basis for the tax treatment of such items.

Comment

The IRB clarified that the accrual basis of accounting for amortisation of premiums or accretion of discounts (over the life of the security/instrument) is acceptable for tax purposes. However, the taxpayer must adopt a consistent basis of recognition of such income/expenditure.

5. **Provision for Diminution in Value of Stocks/Shares**

For banks, stockbrokers, share traders, etc., stocks/shares would be regarded as their "stock in trade". We understand that pursuant to sec. 35 of the ITA, a deduction should be available for the diminution in value of such stocks. For practical purposes, it is often the case that a provision is made rather than an actual write-down to take into account of the fact that the value may fluctuate. As this would result in the stocks being stated at their carrying values, we are of the opinion that a deduction should be allowed for this type of provision. We understand that a draft ruling on this issue has been prepared and in the interim, the professional bodies would like the IRB to confirm that a deduction would be allowed on the said provision.

Comment

Where a provision for diminution in value of stocks is made generally (for instance 20% or 30% of the stock value) the amount provided for would not be tax deductible.

On the other hand, where a provision for diminution in value of stocks is made to reflect the market value (i.e. for instance, by comparing the cost of stock with the market value at a particular time), the increase in the provision would be allowed for tax deduction.

Nevertheless, the IRB further clarified that in order to claim a tax deduction for a provision for diminution in value of stocks, the taxpayer would need to substantiate the basis in determining the diminution in value of stock.

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The IRB also reiterated that in the event the provision for diminution in value of stocks is no longer required, the amount is to be written back and will be brought to tax.

6. Withholding Tax

6.1 Regional Hubs

In recent years, a few large organisations have set up regional hubs to centralise their resources in respect of management and administrative services. This is often implemented with the view to minimising operating costs and maximising efficiency and productivity in order to achieve group synergy. The costs incurred by the regional centre for the shared services are normally recovered from the companies in the group by way of reimbursement of costs or charge of management fees.

The professional bodies are of the view that the aforesaid reimbursement of costs or management fee payments to non-residents should not fall within the ambit of sec. 109B(1)(b). If the IRB takes the view that withholding tax is applicable to those payments and in the event that the non-residents are not able to claim the tax withheld as a credit in their home countries, the tax suffered would be an added cost to the group and may defeat the purpose of setting up the regional centre to undertake shared services. For multi-national conglomerates, the use of shared service centres for "backroom activities" is an essential part of the efforts to reduce costs and increase competitiveness of its businesses.

The professional bodies would like to confirm that the above would not attract withholding tax under sec. 109B(1)(b) of the ITA.

Comment

The IRB confirmed its previous position and reiterated that the aforesaid reimbursements and management fee payments fall under sec. 4A and therefore, are subject to withholding tax, other than payments for day to day administrative and routine services.

6.2 Reimbursements of Out-of-Pocket Expenses

A non-resident consultant comes to Malaysia to perform work for a short period of time (i.e. no PE arises and therefore sec. 109B applies) for a local entity. The consultant incurs air fare, taxi fare, hotel accommodation and meal expenses, etc., and these expenses are reimbursed by the local entity. The IRB had stated in an earlier dialogue that reimbursements of out-of-pocket expenses made to a non-resident would be subject to withholding tax under sec. 109B since it is concerned about the possibility of abuse and withholding tax evasion by taxpayers, by incorporating elements of a fee in the reimbursements.

The professional bodies had earlier expressed the view that withholding tax should not be applicable under the following circumstances:

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(i) where the Malaysian taxpayer directly bears/pays the out-of-pocket expenses instead of the non-resident; or

(ii) where the non-resident bears/pays the out-of-pocket expenses (which are later reimbursed by the local entity), provided that such expenses can be substantiated by documentary evidence such as receipts, invoices, etc.

The professional bodies would like to seek the IRB's confirmation that withholding tax would not be applicable in the above circumstances.

Comment

The IRB re-confirmed its decision made earlier (Dialogue No. 2/2001) that the reimbursement of out-of-pocket expenses form part of the gross income of a non-resident and therefore falls within the ambit of withholding tax.

The IRB acknowledged the comments raised by the respective professional bodies but indicated that the IRB is reluctant to allow reimbursements to be excluded from withholding tax due to the possibility of abuse.

Nevertheless the IRB will reconsider the above issue in greater detail.

6.3 Public Ruling on the Scope of Withholding Tax

Section 109B(1)(b) of the Act provides that withholding tax is required to be deducted from the payments made to non-residents in respect of the following:

- technical advice, assistance or services rendered in connection with technical management or administration of any specific, industrial or commercial undertaking, venture, project or scheme.

The scope of sec. 109B(1)(b) has been a controversial issue. We note that in practice, the IRB has been taking a wide interpretation of this section. As a result, withholding tax is applicable on a wide range of payments made to non-residents. In practice, most taxpayers would deduct the withholding tax to avoid the imposition of a penalty by the IRB for non-compliance with the withholding tax provisions. This inevitably increases the costs of operations and may be seen as a disincentive to those businesses affected by such a withholding tax.

The professional bodies would like to suggest that the IRB issue a public ruling to set out clearly the scope of the withholding tax. It would be very useful if the types of payments which fall within the ambit of the above provision are clearly specified, particularly in respect of the reimbursement of costs or management fee payments by multinational conglomerates for the shared services to non-residents. This will facilitate tax compliance under the self assessment system.

Comment

A public ruling would be prepared with regard to withholding tax under sec. 109B.

7. Private Usage of Motor Vehicles in Controlled Companies

We understand that it has been the practice of the IRB to disallow a deduction for the private usage of motor vehicles in the case of controlled companies. We are of the opinion that if this treatment is adopted, then it should not be necessary for the private usage of such vehicles to be reported as benefits in kind in the relevant employees" Forms EA. In other words, if the company has paid the tax on this private usage of motor vehicles, the employee should not be assessed on it as well. In light of the self assessment system, the professional bodies seek clarification from the IRB on this matter.

Comment

Separate principles of taxation govern the two issues raised by the professional bodies. If the motor vehicles are used for private purposes then the expenses are not wholly and exclusively incurred in the production of income and therefore not treated as an allowable deduction in determining the taxable income of a company. On the other hand, if a director or an employee of a company (including a controlled company) is being provided with a motor vehicle and petrol which can be used not only for business but also for private purposes, the motor vehicle is a benefit in-kind and is assessable to tax under sec. 13(1) (b). There is no provision in the Act which provides that if a company has paid the tax on the private usage of motor vehicles, its employees should not be assessed on it as well.

8. **Paragraph 71, Schedule 3 of the ITA**

(i) Pursuant to para. 71, sch. 3 of the ITA, the Director General of Inland Revenue (DGIR) may withdraw any allowance and impose a balancing charge to an asset which was owned by a person for a period of less than two years. We understand that in a reply to an inquiry made to the then DGIR (Mr. S. Sundaram), he confirmed in his letter dated 14 July 1969 (reference no.: HQ/594/mss) as follows:

"I confirm that the paragraph will not be applied in the normal case of a bona fide sale to a third party of an asset which has been disposed off because it was unsuitable or no longer required for the purpose of the business.

On the other hand, para. 71 will be applied in a case such as prestige car owned by a company for use of a director or by a self-employed professional person where an attempt at tax avoidance is evident".

In view of the above, in the recent dialogue with the Operations Division of the IRB on 15 April 2002, it was confirmed that the stand taken by Mr S. Sundaram was still in practice, and that para. 71 would not be applicable to a bona fide disposal of assets. On the other hand, para. 71 would only be applicable on the disposal of luxury assets.

The professional bodies would like the Technical Division of the IRB to reconfirm the views of the Operations Division of the IRB.

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(ii) Paragraph 71 of sch. 3 of the ITA states that "*where a person has incurred qualifying expenditure in relation to an asset which is owned by that person for a period of less than two years ...*".

We understand that recently, members of the professional bodies had encountered situations whereby different interpretations on the term "two years" were used by different IRB officers (i.e. some officers interpret "two years" as being two years of assessment, while some officers interpret "two years" as being two calendar years based on the exact number of days).

In view of the self assessment system, the professional bodies would appreciate it if the IRB could provide a clarification on this matter.

Comment

(i) The IRB confirmed that the above position has not changed.

(ii) The words "two years" refer to two calendar years based on exact number of days.

9. **Pioneer Status Incentive–Determination of Production Day**

A company would normally assume a particular production day (for the purpose of the Pioneer Status Incentive) based on the relevant known criteria and subsequently prepares/submits its tax return on this basis while waiting for MIDA to notify the company of the actual production day. However, subsequent to the filing of the tax return, if MIDA specifies a later production day which results in a higher tax liability, we are of the opinion that penalties should not be imposed and that the company should be allowed to revise its tax return since at the time the tax return was filed, MIDA had yet to come out with a confirmation on the production day of the company.

The professional bodies would like the IRB to confirm that no penalty would be imposed and that the company would be allowed to revise its tax return under such circumstances.

Comment

MIT will determine the production day when the company has met all criteria set and submits its audited accounts. The criteria are made known to the company when the application for the incentive is approved.

If the company has complied with all the required conditions, the pioneer certificate will be issued (which states the production day) in less than a month.

Where the company has prepared its accounts based on its production day and the production day subsequently determined by MITI is a later date, no penalty will be imposed.

However, where a company makes a false claim or where a company fails to substantiate the claim, penalty will be imposed.

10. Insurance Companies – Actuarial Surplus Arising/Transferred

From years of assessment 1995 to 1998, any actuarial surplus arising to insurance companies was taxable on an "arising" basis. However, with effect from year of assessment 1999, we understand that this treatment was changed and actuarial surpluses are only taxable as and when they are transferred. Since an actuarial surplus may have been taxed prior to year of assessment 1999 when it initially arose, and it may be taxed again subsequent to year of assessment 1999 when it is later transferred, this would result in the actuarial surplus being taxed twice. Please refer to the example set out below:

		Amount RM
YA1995	Balance as at 1 January 1994	NIL
	Add: Actuarial surplus arising for YA1995	6,803,021
YA1996	Balance as at 1 January 1995	6,803,021
	Add: Actuarial surplus arising for YA1996	6,846,401
YA1997	Balance as at 1 January 1996	13,649,422
	Add: Actuarial surplus arising for YA1997	4,513,065
YA1998	Balance as at 1 January 1997	18,162,487
	Add: Actuarial surplus arising for YA1998	22,594,771
		40,757,258
	Less: Actuarial surplus transferred	(4,000,000)
YA1999	Balance as at 1 January 1998	36,757,258
	Less: Actuarial surplus transferred	(6,000,000)
YA2000 (PYB)	Balance as at 1 January 1999	30,757,258
	Less: Actuarial surplus transferred	(4,000,000)
YA2000 (CYB)	Balance as at 1 January 2000	26,757,258
	Less: Actuarial surplus transferred	(8,000,000)
YA2001	Balance as at 1 January 2001	18,757,258

Total actuarial surplus that arose in YA1995 to 1998 = RM40,757,258

Total actuarial surplus that was transferred in YA1999 to 2001 = RM18,000,000

The actuarial surplus transferred arose from the brought forward balance which has already been taxed in accordance with the legislative provision from YA1995 to

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1998. Therefore, to assess the amounts transferred of RM18,000,000 leads to double taxation.

The professional bodies would like the IRB to confirm that no double taxation would arise on actuarial surplus which was already taxed prior to year of assessment 1999.

Comment

The IRB informed that the above issue is a policy matter and has been referred to the Ministry of Finance for consideration.

11. Paragraph 62, Schedule 3 of the ITA

Some companies write off their fixed assets in the following circumstances:

(i) although the assets may be usable, they have no resale value due to their condition.

(ii) the assets are obsolete or in disrepair, and are discarded as it is not cost effective to upgrade or repair the assets.

(iii) the assets are no longer in existence as they have been discarded due to wear and tear or cannibalized for the repair of other similar assets or are lost.

Normally, such assets have no market value or disposal value. However, we understand that some IRB officers have been applying the provisions of para. 62 of sch. 3 of the ITA, to disallow claims for balancing allowance on the write off of these assets. Paragraph 62 states that where an asset is disposed off, its disposal value shall be taken to be its market value at the date of disposal. We understand that IRB officers have adopted the stand that the market values of these assets are deemed to be equal to their tax written down values.

The professional bodies would like to request the IRB to give due consideration to the circumstances in which an asset is written off in determining claims for balancing allowance. The professional bodies would also like to suggest that the IRB provide guidelines on the type of supporting documentation required when making the claims for balancing allowance.

Comment

The IRB confirmed that the following can be used to determine the market value of an asset at the time of disposal/write off for the purposes of claiming a balancing charge/balancing allowance:

(i) insurance claims; or

(ii) a valuation from an independent valuer

The IRB further clarified that the above would apply in establishing the market value of large assets such as factory machinery, etc.

However, this may not be appropriate for the disposal or write off of small assets with a low value (such as chairs, tables, etc.), as the value of these assets would not justify the cost of an independent valuation.

12. Capital Expenditure of Nominal Value

Pursuant to Public Ruling 2/2001, expenditure on assets that have an expected life span of not more than 2 years (implements, utensils and articles) is to be dealt with on a replacement basis in which the cost of replacing such assets is to be allowed as deductible expenditure under sec. 33(1)(c) in determining the adjusted income of the business.

However, it is noted that some companies have a policy of writing off of capital expenditure incurred below a certain nominal amount (depending on the policy adopted) to the profit and loss accounts. These items may have an expected life span of more than 2 years and hence, do not fall under the criteria stipulated in the Public Ruling 2/2001. However, in light of the self assessment regime, we are of the opinion that, in administering the law, the IRB should take into consideration the ways in which businesses are being operated and that there should be some form of harmonisation between accounting treatment and tax treatment.

Since the issue here merely involves the deferment of income rather than the loss of income to the IRB, we are of the opinion that the IRB should allow companies to claim an outright deduction of this type of capital expenditure based on the accounting policy adopted by the companies. This will also make it easier to prepare tax computations and thus, assist in lowering compliance costs.

Comment

The IRB is currently not in favour of such a treatment and requested the professional bodies to make representations to the Ministry of Finance.

13. **Reinvestment Allowance (RA)**

We would like the IRB to confirm that if a company wishes to revise its ta; payable by claiming RA on capital expenditure incurred in prior years, the company may do so by revising its tax returns submitted earlier pursuant to sec. 131 of the ITA (i.e. for relief in respect of error or mistake) without any penalty being imposed.

Comment

The IRB confirmed that no penalty would be imposed in such situations.

14. **Section 113(2) of the ITA**

We are of the opinion that, as a matter of principle, penalties should not be imposed on technical adjustments made on tax computations prior to YA2001 (i.e. prior to the implementation of the self assessment system). However, some members had encountered situations whereby a tax deduction which was initially claimed on repairs and maintenance was later reclassified as capital expenditure by the IRB subsequent to a field audit. We understand that a penalty under sec. 113(2) was imposed by the IRB in such a situation.

Prior to the implementation of the self assessment system (i.e. prior to YA2001), as the onus of determining the taxpayer"s tax liability lies with the IRB, it has been

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the practice of the IRB in the past not to impose penalties on technical adjustments made subsequent to a field audit by the IRB.

However, we understand that some IRB officers have recently deviated from this past practice by imposing penalties on technical adjustments made subsequent to a field audit by the IRB on tax computations prior to YA2001. We are of the opinion that penalties should not be imposed on technical adjustments made on tax computations prior to YA2001 and we are also of the view that there should be some guidance given to all IRB officers on how tax audits should be conducted with regard to tax computations prior to YA2001.

Comment

A technical adjustment generally arises due to a differing interpretation of the tax legislation by the taxpayer, either due to a provision not being clearly defined or due to the existence of conflicting case law.

The IRB confirmed that no penalty will be imposed in the event of a pure technical adjustment as this would not involve an intention to evade taxes.

However, whether a transaction is merely a technical adjustment or an intentional act to evade tax will very much depend on the circumstances of each case and will vary on a case to case basis.

It was proposed that a separate dialogue be held with Bahagian Audit Cukai.

15. **Interest Income Assessable Either Under Section 4(a) or Section 4(c) of the ITA**

Some companies are required to place funds in fixed deposits as a guarantee in order to obtain banking facilities used for **business purposes** (and not for investment purposes). We are of the opinion that the interest income from the fixed deposits derived therefrom should be assessable as part of the business source under sec. 4(a) instead of as a non-business source under sec.4(c) of the ITA. However, we understand that different IRB officers have been taking different views on the treatment of this particular income..

The professional bodies wish to seek confirmation from the IRB that the interest income derived from funds placed in fixed deposits as a guarantee in order to obtain banking facilities used for **business purposes** (and not for investment purposes) should be assessable as business source under sec.4(a) instead of non-business source under sec.4(c) of the ITA. In considering this issue, the IRB should take into consideration the fact that nowadays, there are various circumstances where companies are required by certain authorities to place funds in fixed deposits that generate interest income in order to obtain facilities (or even contracts for contractors) for business purposes (and not investment purposes).

Comment

The IRB noted the views of the professional bodies that under current business practices, financial institutions will generally request a company to place a fixed deposit to serve as a security deposit before approving any loan facilities or

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working capital for its business purposes and therefore, the interest income received should not be deemed to be a non-business source of income.

However, IRB maintains the view that interest derived from fixed deposit under the above circumstances would generally be deemed to be a non-business source and therefore taxable under sec.4 (c).

16. Definition of Entertainment to Exclude Advertising and Promotion

Pursuant to sec. 39 of the ITA, entertainment is defined to include:

(a) the provision of food, drink, recreation or hospitality of any kind; and

(b) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in (a) above.

Since the introduction of the non-deductibility of entertainment expenses, we note that the IRB has adopted a wide interpretation of entertainment, with the result that certain advertising or promotion expenses incurred for the purposes of business have been regarded as entertainment, and not allowed as a tax deduction. With effect from year of assessment 1995, the Act was amended to exclude from the definition of entertainment, promotional gifts consisting of articles incorporating the conspicuous advertisement or logo of the company. (However, the Act is silent on the tax deductibility of advertising and promotion expenses.)

Non-deductibility of certain advertising and promotion expenses has increased the cost of operating a business for companies, as these expenses are usually incurred to increase the sales of products or services, for example:

(i) provision of incentives (e.g. local/overseas trips) to dealers/salesmen who meet sales targets;

(ii) promotional events at public venues to launch or provide new products c services.

We are of the opinion that the expenses incurred on advertising and promotion with the intention to improve the company"s profile and promote its products and services should not be regarded as entertainment.

The professional bodies would also like to suggest that the IRB issue a public ruling to specify the scope of entertainment expenses and examples of the types of entertainment expenses that are not allowable.

Comment

The IRB informed that generally "promotional and advertisement" expenses in promoting a business is tax deductible under sec. 33(1) of the **Income Tax Act, 1967.**

On the issue of "entertainment", the IRB has questioned the deductibility of certain "promotional" expenses incurred by taxpayers (such as incentive trips, non-related free products, etc.) which are, in essence, entertainment expenses.

Nonetheless, in view of the Self Assessment System and the need for clarity, the IRB has informed that a public ruling will be issued on the matter.

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The IRB further requested the professional bodies to assist in compiling examples in respect of the type of promotional expenses that are generally incurred by taxpayers.

17. Draft Public Rulings

The IRB had in November 2000 issued draft public rulings on the following subjects for comment:

(i) allowable pre-operational and pre-commencement of business expenses for companies; and

(ii) rent from letting of real properties.

The professional bodies would appreciate it if the IRB could advise on the status of these public rulings.

Comment

The IRB informed that the public ruling on item (i) has been issued whereas the public ruling for item (ii) is in the final stage of completion and the final draft will be forwarded to the professional bodies for their views and comments.

18. **Tax Incentives to Increase Export of Services**

In the previous dialogue held with the Technical Division of the IRB on 13 November 2001, the IRB had clarified that qualifying services which relate to the above incentive are:

(i) private health care and education services that are undertaken within Malaysia, (i.e. the patients and students would be coming to Malaysia from outside Malaysia); and

(ii) as for other services (i.e. legal, accounting, etc.) the incentive will apply if such services are performed outside Malaysia.

Subsequent to the dialogue, the *Income Tax (Exemption) (No. 9) Order 2002* (the Order) was issued in January 2002. The Order defines qualifying services as services which are provided to foreign clients, from Malaysia, and in relation to the provision of private health care and private education, the services to be provided to foreign clients are to be provided either in Malaysia, or provided from Malaysia.

The professional bodies would like to seek clarification on the following matters:

(i) With regard to private health care and education services, the Order defines qualifying private health care and education services as services provided to foreign clients which are to be provided either in Malaysia, or provided from Malaysia. In this regard, the professional bodies would like to seek clarification on the distinction between the term "in Malaysia" and the term "from Malaysia";

(ii) With regard to services other than private health care and education services (i.e. legal, accounting, etc.), contrary to the stand taken by the IRB during the previous dialogue (i.e. services must be performed *outside* Malaysia), the

Order defines qualifying services as services which are provided to foreign clients *from* Malaysia. In this regard, the professional bodies would like to seek clarification on this discrepancy;

IRB clarified the following terms:

(a) "in Malaysia" means that services are provided in Malaysia, e.g. a foreign client seeks medical treatment and being admitted in a private hospital in Malaysia or a foreign student is undergoing a course in a Malaysian private educational institution;

(b) "from Malaysia" means that the services are provided from Malaysia by a person in Malaysia to a foreign client outside Malaysia e.g through internet / distance learning or mails, etc.

(c) "services performed outside Malaysia" must be in relation to any contract to export services from a person in Malaysia to a foreign client if the contract requires the services to be rendered or performed overseas.

(iii) Would there be a prescribed form to be issued by the IRB?

The professional bodies would also like to suggest that the IRB issue a guideline to assist taxpayers in the application of the above incentive.

The IRB confirmed that a prescribed form (Form BT/PET/2002) has been issued and will consider issuing a guideline on the matter.

19. **Approved Operational Headquarters Company**

Income tax is charged at the rate of 10% on the chargeable income of an approved operational headquarters company in relation to the source consisting of the provision of qualifying services.

The professional bodies would like to seek the IRB"s confirmation that the tax charged for the years of assessment prior to YA 2001, as well as the tax paid in YA 2001 and subsequent years, can be included as part of the sec. 108 credit (compared aggregate).

Comment

The IRB confirmed that the tax paid can be included in the sec. 108 credit computation.

20. **Segregation of Expenses for Business and Non-Business Purposes**

We understand that under the self assessment regime, taxpayers are required to identify and segregate expenses incurred for business and non-business purposes.

However, we note practical problems have been encountered by small businesses in complying with this requirement.

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Illustration

A single mother rents a shop floor for the purpose of carrying on a business and she also lives at the premises with her children. She has a car which is used for both business and domestic purposes.

Practical difficulty is encountered in segregating the expenses incurred for business and non-business purposes, such as the following:

(i) Utility Bills and Rental

Should the allocation of the expenses incurred be based on floor area utilisation or the duration of usage (i.e. business hours vs non-business hours)?

(ii) Car Expenses

Should the allocation of the expenses be based on mileage or hours of usage of the car? It is quite normal that the taxpayer may drop off her children at school on the way to a business appointment.

The professional bodies would like to propose that for practical reasons, the allocation of expenses for business and non-business purposes be based on a justifiable ratio rather than a detailed computation for each item.

Comment

The IRB clarified that it is willing to accept any allocation which is based on a consistent and reasonable basis of apportionment.

As an illustration in a case where half of the time a car is used for business purposes and the other half of the time the car is for private usage, then the fair basis of allocating the related expenses (such as fuel, maintenance, etc.) will be 50%.

21. Basis Period for Unit Trust Entities

The professional bodies are of the opinion that for practical purposes, it may be more sensible if the tax computations prepared prior to year 2004 are prepared based on the financial year as the basis period for a particular year of assessment, so that it is in line with the basis stipulated in the *Income Tax (Amendment) Bill 2001* (i.e. preparation of tax computations based on financial year). Please refer to item 9 of "Our Comments on the *Income Tax (Amendment) Bill 2001*" for our detailed comment on this matter.

Comment

As a concession, the IRB confirmed that the IRB is agreeable for tax computations of unit trusts to be computed by taking the financial year as being the basis period provided the basis is consistently applied.

OUTSTANDING ISSUES

The following issues were raised in the earlier dialogues with the Technical Division of the IRB which have not been resolved:

1. Investment Holding Companies

   (25 August 2000 Dialogue refers)

   Pursuant to sec. 60F of the ITA, a company whose activities consist wholly of making and deriving income from investments, is an investment holding company (IHC).

   Nonetheless, recently there have been situations whereby the IRB have treated a company having both management services and investment holding activities as an IHC under sec. 60F. The IRB have instead allowed a deduction of expenses up to the amount of management fee income earned.

   The professional bodies wish to clarify with the IRB that in the event that a company is having both management activities and investment holding activities (i.e. the company is not one whose activities consist wholly of making investments), the company is not an IHC under sec. 60F but is carrying on a business activity as per sec. 4(a) of the ITA instead, and therefore deduction of expenses should not be restricted up to the amount of management fee income earned.

   The professional bodies are still awaiting clarification from the IRB on the above matter.

   Comment

   The IRB informed that the determination of the tax treatment would be based on a case to case basis.

2. **Deduction on Cost for Developing Websites**

   (13 November 2001 Dialogue refers)

   As an effort to encourage the usage of information and communication technology, an annual deduction of 20% is allowed on the cost of developing websites.

   The professional bodies would like to seek clarification on the type of costs that would qualify for such deduction as currently the cost of developing a website would include expenditure on computer hardware and software, which would normally be eligible for capital allowances of 40%.

   Alternatively, the professional bodies would like to recommend that instead of identifying the expenditure incurred on the development of a website (other than computer hardware and software) and allowing a 20% annual deduction, the IRB should consider the total development cost of a website as being eligible for the same capital allowance rate as that for computer hardware and software.

   The professional bodies are still awaiting clarification from the IRB on the above matter.

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Comment

The IRB clarified that hardware and software costs presently qualified for accelerated capital allowance. Costs of developing website other than costs on hard ware and software will be considered under the new rules at the rate of 20% annual deduction.