

MALAYSIAN INSTITUTE OF TAXATION (MIT)
MALAYSIAN INSTITUTE OF ACCOUNTANTS (MIA)
THE MALAYSIAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (MICPA)

2008 Post Budget Technical Issues To Be Raised With The Inland Revenue Board (IRB)

C. OTHER TECHNICAL ISSUES

1. Tax treatment of unabsorbed losses and capital allowances

A company with a substantial change in ownership/shareholders is not allowed to carry forward its accumulated losses and unabsorbed capital allowances.

The Institutes would like to know the tax implication on the subsequent disposal of those assets where their unabsorbed capital allowances could not be carried forward as stated above.

For example, the existing shareholders of a company which bought a heavy machinery for RM100,000 for its business in year 1, had decided to sell 70% of its shares to a new shareholder in year 3 after the company suffered huge losses in year 1 and 2, as shown below:-

Year	Accumulated Losses (RM)	Accumulated Capital allowance (RM)	Remarks
1	(20,000)	40,000	The unabsorbed losses and accumulated capital allowances are allowed to be carried forward to year 2.
2	(55,000)	60,000	The unabsorbed losses and accumulated capital allowances are allowed to be carried forward to year 3.
3	(85,000)	80,000	Substantial change in shareholders and the unabsorbed losses and accumulated capital allowances are disallowed from being carried forward to year 4.
4	-	-	Disposal of the heavy machinery for RM60,000

The Institutes would like to seek clarification on the calculation of the balancing charge/balancing allowance arising from the above scenario.

Answer:

Tax treatment of unabsorbed losses and capital allowances

1. Using the scenario given by the MIT (with the amendment on the disposal price), below is the calculation of balancing charge/balancing allowance.

Heavy machinery		Cost RM100,000 (rate 20%) RM	
Qualifying expenditure		100,000	
Year 1	Initial allowance	20,000	
	Annual allowance	<u>20,000</u>	
	(deemed claimed even though incurred losses)	<u>40,000</u>	
Residual expenditure		60,000	
Year 2	Annual allowance	<u>20,000</u>	
	CA b/f from year 1	40,000	
Residual expenditure		40,000	
CA c/f to year 3 from:			
(i) year 1		40,000	
(ii) current year		20,000	
Year 3	Annual allowance	<u>20,000</u>	
	(substantial change)		
	CA b/f from:		
	(i) year 1	40,000	
		(ii) year 2	
		20,000 (1)	
Residual expenditure		20,000	
CA c/f to year 4 from:			
(i) year 1		40,000	
(ii) current year		20,000	
Year 4	Disposed / Sold	<u>60,000</u>	
	Balancing charge	<u>40,000</u> (2)	

Note (*):

- (1) For the purpose of calculating balancing charge (BC) or balancing allowance (BA), CA b/f from year 2 is disregarded due to the substantial change in shareholding in year 3.
- (2) Therefore, the amount of BC is RM40,000 [not more than CA given that is RM 60,000 (i.e. CA which is disregarded in year 2 is not included)].

1. In the case where the residual expenditure is 0, then the BC is equivalent to the disposal price, i.e RM60,000.

2. However, the Ministry Of Finance (MOF) has made some amendments in policy regarding the tax treatment of brought forward losses and unabsorbed capital allowances. LHDNM has been informed of this amended policy via letter dated 7 December 2007. The amended policy is quoted as follows:-

“A company with a substantial change in ownership will be allowed to bring forward its unutilised losses and capital allowances to be absorbed in that year of assessment or in subsequent years of assessment EXCEPT in the case of dormant company.”

LHDNM has requested MIT and MATA to disseminate this above amended policy to their members via letter dated 7 January 2008.

2. Permitted expenses of Investment Holding Company

Section 60F(1) of the Income Tax Act 1967 (ITA) states that where an investment holding company is resident for the basis year for a year of assessment there shall be deducted in arriving at the total income before any deduction falling to be made under paragraph 44(1)(c) an amount in respect of expenses incurred by that company in the basis period for that year of assessment, which amount shall be determined in accordance with the formula—

$$A \times \frac{B}{4C}$$

where

A is the total of the permitted expenses incurred for that basis period reduced by any receipt of a similar kind;

B is the gross income consisting of dividend, interest and rent chargeable to tax for that basis period;

C is the aggregate of the gross income consisting of dividend (whether exempt or not), interest and rent, and gains made from the realization of investments for that basis period; and

Section 60F(2) of ITA defines "permitted expenses" as expenses incurred by an investment holding company in respect of—

- a. directors' fees;
- b. wages, salaries and allowances;
- c. management fees;
- d. secretarial, audit and accounting fees, telephone charges, printing and stationary costs and postage; and
- e. rent and other expenses incidental to the maintenance of an office,

which are not deductible under subsection 33(1) of the Income Tax Act 1967.

The Institutes would like to confirm that since wages, salaries and allowances paid to employees are permitted expenses, it would therefore also include incidental expenses such as EPF, SOCSO contributions, etc paid for the employees.

Answer:

'Permitted expenses' under subsection 60F (2) of Income Tax Act 1967 means expenses incurred by an Investment Holding Company in respect of —

- (a) directors' fees;**
- (b) wages, salaries and allowances;**
- (c) management fees;**
- (d) secretarial, audit and accounting fees, telephone charges, printing and stationary costs and postage; and**
- (e) rent and other expenses incidental to the maintenance of an office,**

which are not deductible under subsection 33(1) .

Under subsection 33(1) , only expenses wholly and exclusively incurred in the production of income are deductible for tax purposes . For Investment Holding Company expenses are normally restricted to interest incurred on loans obtained to finance income producing investments and other direct property expenses.

W.e.f YA 1993 section 60F permits deduction of a certain portion of specified administrative expenses referred to as permitted expenses.

'Permitted expenses' is clearly defined under subsection 60F (2). Only wages, salaries and allowances are allowed under paragraph 2(b) . Therefore expenses such as EPF,SOCSO contributions,etc paid for the employees are not permitted expenses.

3. Standard Guidelines for Stamping of Shares

At present, the IRB in Kuching requires a transferee of shares to supply the latest audited annual financial statements of the company which must fall within six months from the date of transfer. Where the latest audited financial statements do

not fall within the six month period, a twelve-month management accounts is required to be prepared to fall within six month from the date of transfer.

For example, if a company's audited annual financial statements are prepared up to 31 December 2006, the transferee is required to supply to the IRB unaudited financial statements with a statutory declaration by a director for the period of 1 year from 1 March 2006 to 28 February 2007 being the latest financial statements within the 6 months in order to get the share transfer duly stamped in respect of transfer made on 31 August 2007.

The Institutes would like to request the IRB to accept the audited financial statements of the company for the latest financial year for stamp duty purposes as the statements will be prepared up to a date within 12 months from the date of transfer. This will significantly enhance the stamping process.

Answer:

This problem is not restricted to IRB Kuching only. IRB is studying the best and easiest method for both parties to determine the value of shares transferred.

4. Income Tax (Construction Contracts) Regulations 2007
Income Tax (Property Development) Regulations 2007

The Income Tax (Construction Contracts) Regulations 2007 and Income Tax (Property Development) Regulations 2007, which were gazetted on 23 August 2007, are both effective from year of assessment 2006.

The Institutes would like to seek clarification on the following matters:

- (a) The appropriate procedures to be followed by those who had filed their tax returns for the years of assessment 2006 and 2007 before the above regulations were gazetted on 23 August 2007.
- (b) If the taxpayer is required to file a revised tax computation pursuant to the new regulations above:-
 - i. we understand that no penalty will be imposed due to the revision.
 - ii. we understand that no penalty will be imposed if the additional tax liability arising from the revised tax computation (due to compliance with the above regulations) exceeds 30% of the estimated tax liability.

Answer:

- (a) **The tax payer concerned is advised to submit its revised tax computations to the respective branch.**

- (b)**
 - i. Any adjustment made due to the implementation of the regulations should not be penalised. However, the taxpayer should inform LHDNM of any revision made due to compliance of the regulations.**
 - ii. In relation to subsection 107C(10), the respective LHDNM branch should inform the Unit / Cawangan Pungutan of the revision made due to the regulations.**