CHAPTER 1

TAX POLICY, TAX SYSTEMS, REVENUE LAW AND INTERPRETATION OF STATUTES

1.0 WHAT IS A TAX?

Taxation in its various forms has existed since humankind began organising itself into civilised communities. Many of these payments were involuntary and had to be forced out of the taxpayer. The whole feudal system of paying the landowner in kind (through goods and labour) is not really different from today's payments to the tax authorities except that nowadays the tax authorities prefer money payments rather than payment in kind.

The Concise Oxford Dictionary defines a tax as a "contribution levied on persons, property or business for the support of government". Two other definitions in Australian cases are as follows:

(a) "a compulsory exaction of money by a public authority for public purposes enforceable by law" (in *Matthews v The Chicory Marketing Board* [(1938) 60 CLR 263]); and
(b) the process of "raising money for the purposes of government by means of contributions from individual persons" (in *R v Barger* [(1908) 6 CLR 41]).

The High Court of Australia in *MacCormick v FC of T* (84 ATC 4230) identified the following usual characteristics of a tax:

- it is a compulsory payment;
- the money is raised for government purposes;
- the exactions do not constitute payment for services rendered;
- the payments are not penalties;
- the exactions are not arbitrary; and
- the exactions should not be incontestable.

The dilemma posed by taxation has been most interestingly summarised in the following observation by Isaacs J in *R v Barger:*

> It is one of the empirical certainties of history that no structural society has ever arisen without taxation. The power of taxation is one which is particularly liable to abuse, either in the hands of an individual autocrat or of a sectional oligarchy such as may wield the sceptre of authority even under the forms of a modern Parliamentary system; but without that power no Government, as we understand the term, is possible. The power to tax is the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as is the air he breathes to a natural man. It is not only the power to destroy, but the power to keep alive.

It has long been recognised that, in order to govern effectively, a democratic government needs to raise revenue, and that one of the most effective means of doing so is by the imposition and collection of taxes. Such taxes may be imposed on income earned, wealth, consumption (or expenditure) transactions or on some other basis. It does not include fines or specific payments such as road tax, licence fees, permit fees/charges, toll charges and property assessments. Such payments are for specific services or rights, for example, the payment of road tax is not really a tax because it gives the owner of a vehicle the right to put his vehicle on the road. As for income tax, no specific right is transferred on payment of such a tax. It is a collection to be used by the government to meet the administrative and development expenditure of the country.

Taxes are generally split into two broad classifications by economists:

(a) Direct taxes – this is a tax which is paid directly by those on whom it is levied. Examples would be income tax, real property gains tax, estate duty, etc.

(b) Indirect taxes – this is a tax which is generally collected via some third party. An indirect tax is generally an addition to the price of a product/service and is collected by an intermediary who will then pay it over to the tax authorities. Examples of indirect taxes would be sales tax, service tax, excise duty, import and export duties and value added tax/goods and services tax.

In outlining the impact of taxation, the question of the incidence of taxation (or the burden of taxation) must be mentioned briefly. In this context, direct taxes (in particular, income tax) can fall into three different categories:

(a) Progressive – a tax is progressive if it takes an increasing proportion of income as income rises, so that the burden of tax is heavier on higher income earners. The Malaysian personal income tax is a progressive tax.
(b) Proportional – a tax is proportional if it takes the same proportion of income at all levels, so that a person pays the same average (or flat) rate of tax. The Malaysian corporate income tax is a proportional tax as it is fixed at a specific rate and this is 24% from the year of assessment 2016.
(c) Regressive – a tax is regressive if it takes a decreasing proportion of income as income rises, so that its impact is proportionally greatest on lower income-earners. Many indirect taxes are regressive in nature, for example, if the tax component of the price of a box of biscuits is RM1, this will represent tax at 10% on an income of RM10, but only 1% on an income of RM100.

A distinction must also be made in the context of income tax between marginal rates and average rates of tax. The marginal rate is the rate of tax payable on certain levels of income. For example, income between RM10,000 and RM20,000 might be taxed at 15%, income between RM20,001 and RM35,000 at 20% and so on. The average rate of tax, however, is the overall rate paid on total income. As a result of various deductions or exemption levels, the average rate of tax on total income might be only 12% although the marginal rate may be 20%.

In addition to the above categorisation, indirect taxes can be classified as follows:

(a) *Ad valorem,* i.e. where the tax is based on value. A fixed percentage of the value of a transaction is absorbed as taxation. An example is sales tax where a fixed rate of 10% is imposed on certain products.
(b) Specific rate, i.e. where a specific monetary amount is levied on each unit. An example is import duty of, say RM100, imposed on certain goods.

Having looked at some definitions of a tax and the categories of tax, one would also need to be aware of what criteria are generally used to evaluate a tax system. This is covered later in this chapter.

It is useful to put income and other taxes into a historical and social perspective before proceeding to a technical analysis. A historical and social perspective involves a brief examination of wider aspects of taxation – the history of taxation, a view of the socio-economic and political role of taxation, and the present structure of taxation in Malaysia.

1.1 HISTORICAL BACKGROUND

Based on the Heasman Report of 1947[1], income tax (in its modern form) was introduced by the British into the Federation of Malaya (as Malaysia was then known) with effect from 1 January 1948. This was in the form of the *Income Tax Ordinance 1947*. The provisions of the Ordinance were based substantially on the *Model Colonial Territories Income Tax Ordinance 1922* which was designed for the British Colonies at that time. The tax laws of many Commonwealth countries were initially based on this model legislation. The *Income Tax Ordinance 1947* was subsequently repealed and replaced by the *Income Tax Act 1967* which came into effect on 1 January 1968. The 1967 Act actually consolidated the three laws of income taxation which were then in existence in Malaysia – the *Income Tax Ordinance 1947* which was only applicable to Peninsular Malaysia, the *Sabah Income Tax Ordinance 1956* which was only applicable to Sabah and the *Sarawak Inland Revenue Ordinance 1960* which was applicable to Sarawak only. Since the formation of Malaysia in 1963, the three separate taxation laws in these three territories continued to be in existence until the introduction of the *Income Tax Act 1967*. Although the *Income Tax Ordinance 1956* of Sabah, the *Inland Revenue Ordinance 1960* of Sarawak, the *Income Tax Ordinance 1947* of Malaya and all subsidiary legislation made under the three Ordinances were formally repealed as from 1 January 1968, certain provisions of the three Ordinances were allowed to continue to apply (as transitional provisions) to all the three territories (as stated in Sch. 9 of the *Income Tax Act 1967*).

The 1967 Act introduced some significant changes which included the following:

(a) residents were taxed on a world income basis (but with effect from year of assessment 1974, with the exception of income derived from banking, insurance, and air or sea transport operations, this basis was abolished and replaced by the derived and remittance basis);
(b) the commencement and cessation provisions were abolished and the preceding year basis of taxation became applicable;
(c) business losses suffered in any year are deductible against income from all sources for that year and carry forward losses may only be set off against income from business sources in subsequent years;
(d) appointment of Special Commissioners for the hearing of appeals;
(e) increased penalties for tax evasion; and
(f) wider powers to counter tax avoidance.

In addition to income tax, an additional tax known as excess profit tax was introduced in 1975 on income in excess of a specific threshold. This tax has since been abolished.

Other than the *Income Tax Act*, the *Supplementary Income Tax Act 1967* was introduced to impose an additional tax, i.e. development tax with effect from year of assessment 1968. This tax was actually introduced in 1967 in the West Malaysian, Sabah and Sarawak Ordinances before the Ordinances were repealed and replaced by the *Income Tax Act 1967*. Tin profits

1 A report prepared by RB Heasman and completed on 22 July 1947 for the Governors of the Malayan Union and Singapore on the subject of whether income tax should be introduced in the two territories. The report included recommendations, draft legislation and proposals for administration and staffing of the establishments to operate the legislation.

tax which was first introduced in 1965 in the *Income Tax Ordinance 1947* (in S. 10A and the Fourth Schedule to the Ordinance) was, upon the repeal of the Ordinance, included in the *Supplementary Income Tax Act 1967*. In 1969, timber profits tax was introduced as a supplementary tax. All these taxes have since been abolished. The tax system was further reformed in 1967 by the introduction of the *Petroleum (Income Tax) Act 1967*. This Act removed from the scope of the general tax laws the taxation of companies engaged in exploration, development and production of oil or natural gas. These companies, because of the special nature of the industry, were taxed at the rate of 45% on their taxable income. The rate is now 38% with effect from year of assessment 1998. In order to create a more favourable tax climate for both foreign and local investments, the various tax incentives [under the *Pioneer Industries (Relief from Income Tax) Ordinance 1956* of Sabah and the *Pioneer Industries (Relief from Income Tax) Ordinance 1958* of Malaya] were codified and enhanced by the passing of the *Investment Incentives Act 1968* which became operative with effect from 1 January 1968. This Act offered a wide range of incentives including tax holidays for pioneer companies, investment tax credits and export allowances. Subsequently, the incentives structure was revamped through the introduction of the *Promotion of Investments Act 1986* which replaced the *Investment Incentives Act 1968*.

With a view to curbing the unhealthy speculation in the Malaysian property market during the early 1970's, the *Land Speculation Tax Act 1974* came into force on 6 December 1973. This legislation was repealed in 1975 and a new law entitled the *Real Property Gains Tax Act 1976* was passed by Parliament and became effective on 7 November 1975. Under this Act, tax is imposed on all gains, other than those exempted, derived from the sale of real properties situated in Malaysia. It was however not uncommon for property owning companies to avoid payment of real property gains tax by selling the shares of the company instead of the properties owned by the company. To prevent revenue loss from such arrangements, the *Share (Land Based Company) Transfer Tax Act 1984* was passed on 19 October 1984. This Act imposed a tax of 10% (later reduced to 2%) on the gross value (amounting to RM1 million or more) of every disposal of shares in a land-based company. Shares listed for quotation in a stock exchange in Malaysia or elsewhere were excluded. As a significant number of anomalies in the application of this Act had come to light, the Act was repealed with effect from 21 October 1988. As an alternative, a number of anti-avoidance provisions dealing with the sale of shares in a property-owning company have been introduced into the legislation on real property gains tax to ensure that gains derived from such sales are properly chargeable to tax. In 1990, various non-tax legislation and the *Labuan Business Activity Tax Act 1990* were enacted to set into motion the mechanism for creating an international offshore financial centre in Labuan.

Besides income tax, stamp duty and estate duty were governed by separate sets of legislation applicable to Peninsular Malaysia, Sabah and Sarawak. The relevant sets of legislation were:

	Stamp Duty	Estate Duty
Peninsular Malaysia	*Stamp Ordinance 1949*	*Estate Duty Enactment 1941*
Sabah	*Stamp Ordinance (Sabah, Cap. 137) 1952*	*Estate Duty Ordinance*[2]
Sarawak	*Stamp Ordinance (Sarawak, Cap. 132) 1933*	*Estate Duty Ordinance*[3]

However, in 1990 the stamp duty legislation was consolidated and the legislation applicable to the whole of Malaysia is now known as the *Stamp Act 1949*. As for estate duty, the legislation was abolished with effect from 1 November 1991.

1.2 CONTRIBUTION TO THE ECONOMY

Income tax is important to any country, especially to developing countries like Malaysia, since it is a major source of revenue and the laws are used to assist in the carrying out of the fiscal and economic policies of the Government. Income tax is one of the surest ways in which the Government of any country can obtain a source of revenue and from which the Government can budget its annual expenditure.

Direct taxes, such as income tax, are a major source of Government revenue. In Malaysia, direct taxes are expected to constitute around 68.4% of the nation's total tax revenue and about 55.6% of the nation's total revenue in 2016 (See Table 1.1). Indirect taxes, on the other hand, also contribute a substantial amount towards total tax revenue. For 2016, indirect taxes are expected to constitute 31.6% of total tax revenue and 25.7% of total revenue. From Table 1.1, it can be noted that on the average, tax revenue contributes about 70% of total revenue. However, the contribution of tax revenue to total revenue is forecasted to increase to 76% and 81% for 2015 and 2016 respectively. The share of indirect taxes in total tax revenue is expected to increase in 2015 and 2016 due to the introduction of goods and services tax from 1 April 2015.

Table 1.2 shows the breakdown of direct and indirect taxes into the various types of taxes. The importance of tax revenue is further illustrated by the fact that total tax revenue in 2016 is estimated to be around 15% of the Gross National Income (GNI) based at current prices (RM1,206,926 million per the 2015/2016 Economic Report) whereas total revenue forms around 19% of the GNP. However, in 1998 and 1999, tax revenue as well as total revenue fell due to the economic crisis which affected Asia in late 1997. With the improvement in economic growth from 2000, tax revenues increased coupled with the fact that the current year basis of income taxation meant that the income tax system is more responsive to the actual cash flow position of taxpayers i.e. income tax would be collected as and when income is earned rather than in the following year. In fact, direct tax revenue in 2001 increased dramatically and this has been attributed to the self-assessment system and increased enforcement activities. In 2009, revenue again fell due to the global financial crisis but this has since recovered. However, there has been a dip in 2015 due to a slight slowdown in the global economy.

2 Chapter 42 of the 1953 Laws of North Borneo.
3 Chapter 29 of the 1958 Laws of Sarawak.

TABLE 1.1
FEDERAL GOVERNMENT REVENUE
(RM million)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Direct Taxes (**A**)	70116	74915	78375	79008	102242	116937	120523	126743	116760	125566
$\frac{A}{C}$	72.9%	73.4%	73.6%	72.1%	75.8%	77.1%	77.3%	77.2%	68.7%	68.4%
$\frac{A}{E}$	49.4%	50.9%	49.4%	49.5%	55.1%	56.2%	56.5%	57.4%	52.5%	55.6%
Total Indirect Taxes (**B**)	26080	27080	28129	30507	32643	34706	35429	37462	53258	57987
$\frac{B}{C}$	27.1%	26.6%	26.4%	27.9%	24.2%	22.9%	22.7%	22.8%	31.3%	31.6%
$\frac{B}{E}$	18.4%	18.4%	17.7%	19.1%	17.6%	16.7%	16.6%	17.0%	23.9%	25.7%
Total Tax Revenue (**C**)	96196	101995	106504	109515	134885	151643	155952	164205	170018	183553
$\frac{C}{E}$	67.8%	69.3%	67.1%	68.6%	72.7%	72.9%	73.1%	74.4%	76.4%	81.3%
Total Non-Tax Revenue (**D**)	45594	45098	52135	50138	50534	56270	57418	56421	52437	42103
$\frac{D}{E}$	32.2%	30.7%	32.9%	31.4%	27.3%	27.1%	26.9%	25.6%	23.6%	18.7%
Total Revenue (**E**)	141790	147093	158639	159653	185419	207913	213370	220626	222455	225656

Notes: Direct Taxes = Income Tax (individuals, companies, other persons & petroleum) + others (stamp duty, RPGT, etc.)

Indirect Taxes = Export duties (rubber, palm oil, petroleum, others) + import duties and surtax + excise duty + sales tax + service tax + Goods and Services tax + others

Non-Tax Revenue = Includes such items as government commercial undertakings, interest and returns on investment, licences, service fees, road tax, fines and penalties, rental revenue from Federal Territories, contributions from foreign governments and international agencies, and petroleum royalties/gas payment

Source: Economic Reports (various years)
2016 – estimated figures

Table 1.2 also shows the relationship for the years 2003 to 2016 between the various elements of taxes to total tax revenue. As can be noted, income taxes (which include petroleum income tax) constitute an average of over 66% of tax revenue over the 14-year period. The next largest component is sales tax together with service tax (around 12%) followed by excise duty (at 8%) and import duties (around 3%). Prior to 1988, export duties contributed more than sales tax. The contribution of export duties is now lower due to the reduction and abolition of duties on exports of most primary commodities. However, its current contribution is due mainly to the export duty introduced in 1980 on petroleum products. The new goods and services tax is expected to contribute around 20%.

TABLE 1.2
MALAYSIA: TAX RELIANCE INDICATORS (2003–2016)

Year	Total Tax Revenue %	Total Direct Taxes %	Income Tax %	Other Direct Taxes %	Total Indirect Taxes %	Export Duty %	Import Duty & Surtax %	Excise Duty %	Sales & Service Taxes %	Goods and Services Tax %	Other Indirect Taxes %
2003	100	66.29	62.41	3.88	33.71	1.78	6.03	7.75	15.41	–	2.74
2004	100	67.58	64.00	3.58	32.42	2.22	5.37	9.48	12.72	–	2.63
2005	100	66.44	63.02	3.42	33.56	2.58	4.20	11.56	12.77	–	2.45
2006	100	71.07	67.84	3.23	28.93	2.72	3.09	9.90	10.64	–	2.58
2007	100	72.88	69.57	3.31	27.12	2.59	2.39	8.84	10.86	–	2.44
2008	100	73.45	70.38	3.07	26.65	2.64	2.21	8.63	10.69	–	2.38
2009	100	73.59	70.34	3.25	26.41	1.08	1.98	9.45	11.22	–	2.67
2010	100	72.14	67.98	4.16	27.86	1.65	1.79	10.75	11.05	–	2.62
2011	100	75.80	71.72	4.08	24.20	1.54	1.50	8.54	10.06	–	2.56
2012	100	77.11	72.97	4.14	22.89	1.30	1.50	8.04	9.95	–	2.10
2013	100	77.28	72.65	4.63	22.72	1.24	1.62	7.82	10.27	–	1.77
2014	100	77.19	72.46	4.73	22.81	1.15	1.63	7.87	10.49	–	1.67
2015	100	68.67	63.74	4.93	31.33	0.62	1.60	7.16	4.49	15.88	1.58
2016	100	68.41	63.50	4.91	31.59	0.55	1.52	6.76	–	21.24	1.52

Source: Economic Reports (various years)
2016 – estimated figures

Table 1.3 shows an analysis of income tax revenue, i.e. the collection of income tax from individuals, companies and petroleum for the period 2003 to 2016. Companies (involved in non-petroleum activities) contribute the largest portion of income taxes (an average of over 52% over the period) whereas individuals contribute an average of 20% of income tax revenue. Petroleum income tax is a significant element, forming an average of around 26% of income tax revenue. Without such a source of income tax, the revenue situation of the country would be in a difficult position. Petroleum became a major source of income tax revenue from 1977. However, its share of income tax revenue had fallen due to a decline in oil prices, escalating costs and the lowering of the tax rate. Nevertheless, as part of the cyclical movements, revenue from petroleum increased in 2000 and 2001 due to an increase in oil prices and further exploration activities. However, in 2002 and 2003, its contribution to income tax revenue fell but an upsurge in world oil prices led to an increase from 2004 to the extent that it contributed around 27% of total income tax revenue. There was a dip again in 2010 due to the fall in prices and the global financial crisis in 2009 and this improved in the following years. However, a global fall in oil prices led to a significant fall in petroleum income tax revenue in 2015 and this is expected to have an impact in 2016 as well.

TABLE 1.3
INCOME TAX REVENUE (2003–2016)

Year	Income Tax Revenue *RM million*	Percentage of total income tax revenue			
		Individuals %	Petroleum %	Companies (including co-operatives) %	Petroleum & Companies %
2003	40502	19.7	20.9	59.4	80.3
2004	46119	19.46	24.89	55.65	80.54
2005	50789	17.03	28.68	54.29	82.97
2006	58774	17.35	35.17	47.48	82.65
2007	65658	17.76	31.15	51.09	82.24
2008	78475	19.07	30.83	50.10	80.93
2009	74917	20.81	36.35	42.84	79.19
2010	74451	23.92	25.13	50.95	73.85
2011	96732	20.89	28.69	50.43	77.15
2012	110662	20.76	30.6	46.34	76.94
2013	113300	20.3	26.26	51.35	77.61
2014	118996	20.5	22.65	54.8	77.45
2015	108362	25.98	8.79	63.04	71.83
2016	116558	25.96	8.0	63.81	71.81

Source: Economic Reports (various years)
2016 – estimated figures

The importance of petroleum to the economy can be seen in Table 1.4 where petroleum income tax and export duty on petroleum products are shown from 1988 to 2016 as a percentage of total tax revenue as well as total revenue of the country. If we were to incorporate collection of petroleum royalties and gas cash payments (of which separate statistics are unavailable), the overall contribution of petroleum is very significant. This dependence is critical as petroleum resources are declining and the need to develop a new source of tax revenue is essential in maintaining the tax revenue contribution. However, note the steep decline in 2015 and 2016 due to a global decline in oil prices. The new source of tax revenue is the goods and services tax introduced on 1 April 2015 and that assists in making up for the shortfall in petroleum revenue.

TABLE 1.4
REVENUE FROM PETROLEUM

Year	Petroleum Income Tax *RM million*	Export Duty on Petroleum Products *RM million*	Total *RM million*	% of Total Tax Revenue %	% of Total Revenue %
1988	2208	1149	3357	22.8	15.3
1989	1847	1432	3279	19.7	13.0
1990	2644	1910	4554	21.4	15.4
1991	4052	1981	6033	23.4	17.7
1992	3417	1646	5063	17.6	12.9
1993	2859	1429	4288	13.4	10.3
1994	2211	1098	3309	8.8	6.7

Year	Petroleum Income Tax *RM million*	Export Duty on Petroleum Products *RM million*	Total *RM million*	% of Total Tax Revenue %	% of Total Revenue %
1995	2185	751	2936	7.1	5.8
1996	2203	996	3199	6.8	5.5
1997	3861	1024	4885	9.1	7.4
1998	4046	563	4609	10.2	8.1
1999	2856	611	3467	7.6	5.9
2000	6010	996	7006	14.8	11.3
2001	9859	831	10690	17.4	13.4
2002	7636	768	8404	12.6	10.1
2003	8466	1106	9572	14.7	10.3
2004	11479	1539	13018	18.1	13.1
2005	14566	2029	16595	20.6	15.6
2006	20674	2325	22999	26.5	18.6
2007	20453	2271	22724	23.6	16.0
2008	24191	2703	26894	26.4	18.3
2009	27231	1104	28335	26.6	17.9
2010	18713	1745	20458	18.7	12.8
2011	27748	1997	29745	22.1	16.0
2012	33934	1928	35862	23.6	17.2
2013	29753	1632	31385	20.1	14.7
2014	26956	1577	28533	17.4	12.9
2015	9529	904	10433	6.1	4.7
2016	9331	900	10231	5.6	4.5

Note: Petroleum royalties/gas payments are not included. These are included under non-tax revenue

Source: Economic Reports (various years)
2016 – estimated figures

1.3 OBJECTIVES OF TAX POLICIES

Taxes have an important part to play in any government's economic and social policy and in designing tax policies, several objectives are normally borne in mind. These could be summarised as follows:

(a) Raising revenue to finance government expenditure.
(b) Ensuring that taxes are collected effectively and at minimum cost both to the government and taxpayers.
(c) Regulating the private sector of the economy to maintain the desired level of employment and increase economic development/growth.
(d) Regulating the activities of specific areas of the private sector so as to encourage activities which are beneficial to the country and to discourage those which are undesirable in the national interests.
(e) Regulating the distribution of income and wealth between different types and classes of citizens.
(f) Regulating specific activities of citizens which are thought to be undesirable, e.g., drinking, smoking, gambling, etc.

(g) Ensuring fairness and equity, i.e. the burden of tax is spread fairly and equitably among taxpayers.
(h) Ensuring that the Government in power will continue to get the support of the voters.

There is no easy way to growth and development. Tax changes might help to create the climate for development but they will not produce development by itself. This can only be achieved by using our resources in labour, capital and management more economically and skilfully than we have done in the past. It may be useful, at this stage, to have a brief look at the tax systems and policies of the then newly-industrialised countries (NICs)[4]. The evolution of the tax systems of four NICs, i.e. Hong Kong, Taiwan, South Korea and Singapore (also known as the "Four Asian Tigers") can be studied to determine how tax policy assisted the process of growth.

Although the choice of sound tax policies can go a long way to fostering the quintessential ingredients of growth-investment, saving, risk-taking and hard work – tax policy by itself is not and will never be a panacea for the economic ills of retrograde, stagnant or slow-growing developing nations. Financial leaders in all the above four NICs stress the importance of first getting the "basics" right in order for tax policy to play a positive role in stimulating economic growth. These "basics" are:

- Political stability
- Honest, dedicated and incorruptible government
- Efficient administration with a minimum of red tape
- The rule of law
- Labour stability
- Sensible trade union leaders
- Reliance on private enterprise
- A correctly-valued exchange rate
- An export orientation
- Prudent conduct of public finances
- Controlling the overall growth of public spending
- Avoiding the protection of inefficient industries through high import duties
- Focusing public spending on infrastructure, not programmes for redistributing income
- Positive interest rates to encourage saving
- Development of capital markets
- Minimum of subsidies and state-owned enterprises
- Monetary control
- Productive use of foreign aid for a limited period

When these "basics" are right, the incentives embodied in supply-side tax policies stimulate capital formation, attract investment, encourage risk-taking, and induce hard work. The four NICs got their "basics" right and were therefore able to utilise tax policy to stimulate high rates of economic growth.

An analysis of the tax systems of the "Asian Tigers" illustrates two alternative approaches to using tax policy to foster growth. The first model is that of a broad-based, low-rate, neutral

4 Veerinderjeet Singh & Lee Beng Fye, Malaysia: "Tax Reforms – An Overview and Recommendations – Pt. 1", *Asia-Pacific Tax and Investment Bulletin*, Vol. 7 No. 10, 1989, pp 449 & 450.

tax system with no capital gains taxation. This model gives primacy to the free play of market forces and the government plays a minimal role in directing economic activity through preferential tax treatment of one sector over another. It does not discriminate between resident and non-resident firms or individuals. Hong Kong exemplifies this model.

The second model or approach is more complex and is followed by Taiwan, Singapore and South Korea (to a certain extent). This model includes the widespread application of selective incentives given to domestic and foreign investors. Although this model encompasses systems of graduated personal and corporate taxes and complex schemes of indirect taxes, the rates are deliberately kept at low levels and capital gains are taxed extremely lightly (or not at all). Within the past few years, commissions/committees were formed in each country to review the tax structure. The consensus that emerged was in favour of greater tax neutrality and reduced reliance on selective incentives. Each review committee recommended gradual movement in the direction of a more broadly-based, lower rate system of taxation along the lines found in Hong Kong. It was felt that this move befits the country's greater level of development.

Malaysia, in its move towards full industrialisation, is following the second approach. Whether all the "basics" are in place is arguable but it is felt that attempts are being made to "get it right".

Tax policies therefore contribute to the overall economic development of Malaysia in two major ways, i.e. by:

(a) ensuring stable growth in revenue to finance the annual budget; and
(b) providing incentives within the tax system to promote growth, especially in the private sector.

Tax policies are determined by the Treasury (Ministry of Finance) which has a Tax Division to carry out the necessary studies, etc., with the assistance of the other departments within the Ministry (including the Inland Revenue Board and the Royal Malaysian Customs Department).

1.3.1 The Revenue Objective

The revenue objective of tax policies can be seen by first reviewing briefly past performance relating to the growth in the country's revenue.

Revenue growth in the 1970's was extremely good. Thus, total tax revenue from direct and indirect taxes increased by six times from RM2 billion in 1970 to RM12 billion by 1980, far exceeding the growth of the GNP. Indeed, if the petroleum sources of revenue were excluded, the tax revenue after 1980 would have shown little or no growth at all. It should be noted that revenue from petroleum (through income tax on petroleum companies and export duty on petroleum) is quite substantial. However, from 1994 to 1999, such revenue from petroleum generally declined to single-digit figures as a percentage of total tax revenue and total revenue (see Table 1.4). Nevertheless, in terms of absolute figures, this sector contributes a sizeable amount annually although future long-term contributions would be lower due to the depletion in reserves. From Table 1.3, it can be seen that although revenue from income tax (which forms more than 90% of revenue from direct taxes) continued to generally increase in absolute terms, the increase was slower than the growth in GNP. If this is compared with the earlier performance when income tax revenue greatly exceeded the growth in GNP, it appears that there had been a decline in the buoyancy of the income tax system in recent years. For the period 1970 to 1981, income tax revenue increased almost

nine-fold whereas GNP increased by about five times. For the period 1982 to 1992, income tax revenue doubled whereas GNP increased by 2.3 times. However, for the period 1992 to 1997, income tax revenue increased by 87% whereas GNP increased by about 88%. However, the buoyancy of the income tax system worsened in 1998 and 1999 due to the drop in tax revenue owing to the economic crisis and the drop in corporate earnings. In 2001, income tax revenue increased dramatically to improve the buoyancy of the tax system. From 2007 to 2013, GNP increased by 29% whereas income tax revenue increased by 21%. The buoyancy of the income tax system is thus low and this is attributed to the various incentives given as well as the small number of taxpayers paying personal taxes due to higher exemption thresholds. Notwithstanding this, the IRB had managed to increase its collection beyond the budgetted amounts over 2011 and 2014.

While revenue growth slackened, government expenditures continued to increase rapidly. Faced with the growing deficits in the balance of payments and in the public sector budget and in view of the uncertain economic prospects in the 1980's, the Government took a series of measures to control and reduce public expenditure. Thus, starting from 1982, major cuts were made in both the operating and development expenditure of the Federal Government. These measures resulted in reducing the deficits and strengthening the government's budgetary position. A similar scenario was apparent in 1998 and 1999 due to the Asian economic crisis and in 2009 and 2010 due to the financial crisis. The same scenario has appeared in 2015.

In considering the possibilities of raising revenue through new taxes to further strengthen the government's financial position, it was recognised that the options were rather limited given that in general the level of taxation in Malaysia was already high. Further increases in taxation would discourage investments and private sector initiative. Thus, tax increases aimed at raising additional revenue were made selectively in order not to have an adverse impact on the economy and the population as a whole.

The main tax increases were therefore limited to a few commodities which were considered as either luxury or non-essential goods such as cars, cigarettes, liquor as well as an increase in road taxes. The duties on these items are undoubtedly heavy, as they have been imposed not only for revenue purposes but also for protective reasons. The other major increase came in 1983 from the doubling of the rate of sales tax and service tax from 5% to 10%. The service tax was later reduced to its former level of 5% in the 1986 budget as part of the measures to assist the tourist industry. In recent years (from 1988), sales tax is being reimposed on a number of products which had been exempted from the tax. It was estimated that about 75% of imported and locally manufactured goods were exempt from sales tax. The reimposition of the tax is a measure to widen the scope of the tax and improve its effectiveness as a source of revenue. In a further move to broaden the tax base, the scope of service tax has been extended progressively to cover a number of professional / consultancy services, credit cards and paid television broadcasting services with effect from 1 January 1992, 1993, 1994, 1997, 1998, 2001, 2010 and 2011.

While keeping tax increases to the bare minimum, the Government at the same time reduced a number of taxes in order to provide relief from high levels of taxation. As an example, the export duties on agricultural commodities were substantially reduced, benefiting a large number of rubber, coconut and pepper smallholders. (In the 1991 Budget, export duty on rubber and pepper was abolished.) In the 1985 Budget, a major reduction in personal income tax rates was introduced for the higher income groups in order to make the Malaysian income tax rates comparable to the rates in other countries in the region. In 1987, excess profit tax on companies

was abolished (effective from the year of assessment 1988) so as to improve the investment climate. This was closely followed in 1988 by the reduction in the income tax rates for companies and non-resident individuals to 35% (from 40% previously) as well as the commitment in 1989 to eventually abolish development tax commencing with a 1% reduction in the rate of tax. In 1990, excess profit tax on all other persons was abolished and personal income tax rates were again lowered (effective from the year of assessment 1991). These changes in 1990 were made possible by higher revenue from the increase in petroleum prices.

In a further move to improve Malaysia's competitiveness with other countries in the region, development tax was abolished, corporate income tax rates were reduced to 34% and income tax rates for individuals and other persons were lowered. All these changes took effect from the year of assessment 1993. From year of assessment 1994, the corporate income tax and the rate for non-resident individuals was lowered to 32%. The corporate income tax rate was lowered to 30% with effect from year of assessment 1995. Personal tax rates were also lowered marginally with effect from years of assessment 1995 and 1996 to a top rate of 32% and 30% respectively. From year of assessment 1998, the corporate income tax rate was again lowered to 28%. Further, the petroleum income tax rate was lowered from 40% to 38%. The personal tax rates were also reduced marginally from years of assessment 2000 and 2002 to a top rate of 29% and 28% respectively. The rates were further lowered in years of assessments 2009 and 2010 to 27% and 26% respectively and to 25% for year of assessment 2015. However, from year of assessment 2016, the top rate was raised to 26% for chargeable income exceeding RM600,000 and to 28% for chargeable income exceeding RM1,000,000. This appears to be a sudden move to raise some revenue due to the poor economic scenario facing the nation. For the years of assessment 2007 to 2009, the corporate tax rate had been further lowered by 1% yearly. Thus, the rate from year of assessment 2009 onwards was 25%. From year of assessment 2016, the corporate rate has been lowered to 24%.

It can be seen, therefore, that despite the pressing need to strengthen the government's financial position, this did not lead to a general increase in taxation. The emphasis in strengthening the government's financial position was placed on reducing expenditures rather than on introducing new taxes.

With the scope for new taxes being limited, the future growth in revenue will have to rely more and more on the efficient implementation of existing taxes and possibly on widening the tax base for some of the taxes. In this connection, a number of measures were introduced over the years to reduce the leakages and loopholes in the various tax legislation and to improve the enforcement of tax collection as well as to reform the tax system. These measures include:

(a) the imposition of a withholding tax on non-resident contractors as a means of resolving the problems of taxing non-residents and preventing the leakage of government revenue;
(b) increasing the penalties for late payment of tax;
(c) introducing S. 4A (special classes of income) which also imposed tax on rental income on moveable property received by non-residents;
(d) imposition of the Share Transfer Tax in 1984 to close the loophole by which land-based companies could avoid paying the Real Property Gains Tax (RPGT). This was subsequently repealed in 1988 and changes were introduced in the RPGT Act to cover gains on sale of shares in real property companies;
(e) imposing a withholding tax on interest payments made to resident individuals (i.e. S. 109C);

(f) withdrawing the tax exemption on dividend income received by charitable institutions, trade unions and sports organisations which were exempt under Sch. 6 of the Act, and requiring charitable institutions to be approved as such by the Director General of Inland Revenue;
(g) implementing a compulsory tax instalment scheme for individuals and companies;
(h) disallowing deductions for entertainment and leave passage expenses;
(i) reviewing the incentives provided under the *Promotion of Investments Act* by tightening the conditions for enjoying such incentives and reducing the relief from taxation;
(j) widening the scope of service tax;
(k) introducing a schedular tax deduction scheme for employees in Peninsular Malaysia similar to what is practised in Sabah and Sarawak;
(l) introducing the current year basis of taxation from the year 2000;
(m) introducing self-assessment for companies from the year 2001 (and for other taxpayers from 2004);
(n) changing the scope of charge for resident companies to a territorial basis and later extending this in 2004 to all other persons;
(o) allowing group relief for 50% of current year unabsorbed business losses and restricting the carry forward of unabsorbed losses and capital allowances under certain circumstances from 2006;
(p) introducing the Framework for Tax Audits as well as the Framework for Tax Investigation on 1 January 2007;
(q) introducing advance rulings for income tax in 2007;
(r) introducing a Customs Appeal Tribunal as well as customs rulings in 2007;
(s) announcing the single-tier system of corporate taxation whereby the imputation system is abolished from year of assessment 2008 onwards with a six-year transition so that all companies will be in the single-tier system with effect from 1 January 2014;
(t) imposing withholding taxes on other gains and profits paid to non-residents in 2009; and
(u) introducing transfer pricing and thin captalisation (deferred to after December 2015 subject to further review) provisions in 2009.

It should be noted that these measures did not include any additional or new taxes. They are largely administrative measures aimed at facilitating a better collection of revenue. There is scope for making the existing taxes contribute more to government revenue by reviewing more closely the various reliefs and exemptions which are granted to taxpayers. Thus, in addition to the measures which have already been taken, further action is likely to be taken to identify other possible ways and means of making the tax system more efficient in raising revenue from the existing taxes. As such, the annual pre-Budget dialogue sessions held between the Treasury and various business and professional organisations would be one way of coming up with ideas in this area. It is also important to note that the Government shares the view that the tax system needs to be reviewed so as to make it more efficient as well as to update the tax legislation so that it is in line with international developments, etc. This led to the announcement of the Tax Review Panel in the 2005 Budget to study various aspects of the tax legislation as well as to work on the Goods and Services Tax which was intended to be introduced to replace the existing Sales Tax and Service Tax. In addition, various aspects related to enhancing service delivery were also looked into by a special task-force so as to improve the tax and non-tax administration in the country.

It would be noted from the earlier comments on the revenue position of the country that taxes on petroleum products are significant, especially if export duties and royalties (classified as non-tax revenue) are also included. In this context, it must be borne in mind that this source of revenue relates to non-renewable resources, which will become less important in the medium and long-term. As such, alternative sources would have to be developed in order to sustain growth in revenue in the future.

Finally, the Goods and Services Tax was introduced on 1 April 2015 and this tax is the new source of tax revenue that the Government hopes will assist in making up the shortfall due to the fall in petroleum revenue as well as assist in reducing and ultimately eliminating the fiscal deficit.

1.3.2 The Growth Objective

The second major objective of tax policies is to provide incentives within the tax system to promote the economic activities which are essential for the country's development. In this regard, the three main economic sectors which are emphasised under the incentives system are manufacturing, agriculture and tourism.

The incentives that are provided for economic development activities comprise:
(a) relief and exemptions from income tax which are aimed at enhancing the return on investment in the country, e.g. pioneer status, investment tax allowance, etc;
(b) double deductions and other incentives to encourage exports, export promotion activities as well as research and development;
(c) exemption from duties on imported materials, so as to make the local manufacturing industry competitive in the domestic as well as in the foreign markets;
(d) exemption from domestic indirect taxes, e.g. sales tax and excise duty on the export of locally-produced goods.

The range of incentives is therefore quite wide and is basically similar to that found in neighbouring countries.

In the implementation of the various incentives, the most important consideration is that they should be easily available. If there are too many procedures resulting in long delays in obtaining the incentives, then their significance in attracting investors, especially foreign investors, is diminished. Further, complicated systems work to the disadvantage of the smaller enterprises which do not have the administrative resources to cope with all the paper work and the negotiations. With this in mind, the Government has taken a number of steps to attempt to streamline and simplify the incentives as well as the procedures of implementing them so as to enable all industries to have equal access to the various incentives, thereby contributing towards a more balanced growth in the manufacturing, agricultural and tourist industries.

It is realised that attractive tax incentives alone are not sufficient to expedite the growth of investment. Thus, in addition to the review of tax incentives, measures have also been taken to revise and liberalise the regulations governing the licensing of manufacturing activities under the *Industrial Coordination Act* and the conditions relating to foreign equity participation in the manufacturing sector. Import duties on machinery and equipment and on raw materials not produced in the country have been abolished or reduced to make them available at a cheaper cost to local manufacturers.

In conclusion, it can be said that the tax policies in this country have been formulated to be supportive of the government's efforts to revive and stimulate the development of the private sector, in line with the strategies adopted under the various development plans. With the government reducing its expenditure and its role in the economy, economic growth will have to come mainly from the private sector. To this end, the overall reductions in taxes and the reliefs and exemptions introduced in recent years have made the tax policies in this country more favourable than before for the business sector.

1.4 CRITERIA FOR EVALUATING A TAX SYSTEM

The original aim of taxation was to provide the revenue necessary to finance government expenditure. At present, this is only one of several aims because the tax system is now used also for broader socio-economic purposes. As stated earlier, a government may attempt to accelerate the rate of economic growth through various tax policies. In addition, taxation may be used to maximise economic stability (i.e. to smooth out trade cycles or to reduce inflation, unemployment, etc.).

The revenue system has always been a part of the social process. For example, political changes, economic developments (such as the onset of a recession or "boom") and social factors (such as changes in attitudes to tax and tax avoidance) inevitably affect the tax system and vice versa.

To illustrate one aspect of this relationship, modern governments have recognised the impact which taxation can have upon social behaviour patterns, and intentionally use the tax system not only for direct fiscal purposes (the generation of revenue), but also for intentional non-fiscal purposes ("social engineering") – i.e. to influence or modify aspects of society or societal behaviour. For example, a government may seek to discourage certain activities it deems undesirable, and may therefore impose a high tax on petrol to reduce consumption and thus conserve a scarce resource. Alternatively, a government may seek to encourage activities which it sees as desirable by offering tax incentives or benefits – such as, to those engaging in mining activities or in manufacturing and exporting products.

However, taxation may also create or have unintended and undesirable results. For example, it is argued by some commentators that high income taxation lowers the incentive to work and save because a large portion of additional earnings goes to the tax authorities. It has even been suggested that high levels of taxation create social problems by causing a drop in birth rates[5] and vice versa[6].

Assuming that a country has or is considering creating a particular tax system, how does one evaluate the performance of that system? In other words, how does one identify a "good" tax system?

A number of criteria or basic requirements (or characteristics) have been suggested which tax designers should look for in arriving at an optimal tax structure or which can be used to judge the performance of a tax system. Adam Smith established three broad canons

5 See J.C.A. Dique, "Finance and Fertility: the Effects of Heavy Taxation on the Birth Rate", *The Medical Journal of Australia*, 1976 at p. 753.

6 M. Rothwell and K.M. Sharma, "Populate and Prosper" (Report on the 4th LAWASIA Conference), *Sydney Morning Herald*, 5 September 1975 at p. 6.

or principles of taxation: equity, economy (or efficiency) and certainty. All in, the criteria commonly suggested include:

(a) Equity or fairness;
(b) Efficiency/neutrality;
(c) Simplicity;
(d) Certainty;
(e) Flexibility;
(f) Suitability for achieving macro-level objectives; and
(g) Fiscal adequacy.

It is obvious that such attributes are not easily met in practice. Besides, the actual tax system of a country is often a compromise in trade-offs between various criteria or objectives. It is useful to examine each of these criteria in greater detail.

1.4.1 Equity or Fairness

This basically means that tax should be levied fairly so that the distribution of the tax burden is equitable, i.e. everyone should be made to pay his or her fair share. In general, everyone would expect a taxation system to be fair (i.e. equitable). A system which is perceived by taxpayers to be unfair or discriminatory is unlikely to enjoy widespread support. The problem is that there is a wide diversity of views on how to measure the "fairness" of a particular tax system.

Traditionally, two aspects of equity are identified:

(a) Horizontal equity – those who are in similar positions in terms of possessing equal wealth or income should be treated similarly, i.e. should pay the same amount of tax. Horizontal equity has great merit as an ideal. The difficulty is that while persons with the same level of taxable income can be required to pay the same amount in income tax, this will only be fair if taxable income is the appropriate measure or criterion of a taxpayer's economic well-being. Two individuals (A and B) each earning a total income of RM50,000 per annum may not be in the same overall economic position if A has no dependants whereas B has a dependant spouse and two children. Thus, A arguably is in a stronger financial position although under the current system each would pay almost the same amount of tax.

(b) Vertical equity – those persons who are in different positions in terms of wealth or income levels should be treated differently, with those who are better off bearing an appropriately heavier burden. This would mean that a person who has a higher level of income would have the capacity to pay higher taxes. This therefore leads to a more progressive tax rate structure (i.e. the progression principle would apply). Again, vertical equity also has great merit as an ideal but is often difficult to achieve in practice. Views may differ as to the appropriate degree of unequal treatment which the tax system should embody (e.g. how much more income tax should be paid by a person earning RM75,000 per annum than by a person earning RM45,000 per annum?).

Overall, it can be said that while most persons would accept equity or fairness as a most desirable attribute of a taxation system, it is often quite difficult to structure a taxation system in such a way as to ensure that both horizontal and vertical equities are simultaneously maximised.

1.4.2 Efficiency/Neutrality

One important aspect of efficiency is administrative efficiency whereby both administrative and compliance costs are minimised. Therefore, the means of gathering taxes should not be such that the cost of collection of taxes forms a rather large portion of the amount of tax collected. Collection should be as economic as possible. Further, the costs incurred by the taxpayer in meeting his liability should be minimal.

The tax structure should be such as to minimise interference with economic decisions in otherwise efficient markets. People should be free within legal limits to pursue whichever trade or economic activity they choose and taxation should not interfere with this principle. Thus, one trade should not be favoured against another unless there are sound economic reasons for this. When one says that the tax system should aim for "neutrality", this means that the tax system should be neutral as between alternative businesses or consumption choices. The impact of tax should not influence individual or business choices by distorting or altering the prices and therefore the attractiveness of:

- alternative goods;
- different types of activity;
- work against leisure;
- different modes of investment; or
- different types of business organisation.

In practice, neutrality is difficult to achieve as governments often deem it appropriate to intentionally interfere through taxation in free market dealings so as to increase output or consumption of specific goods or services it wishes to encourage, or to discourage the output or consumption of products it deems undesirable. Further, in a progressive tax rate structure, as higher rates of tax are applied to income, the disincentive effect would apply which means that taxpayers may decide that it is simply not worth working so hard, and may prefer leisure instead.

1.4.3 Simplicity

A tax system should permit fair and non-arbitrary administration and it should be understandable to taxpayers. A tax may be described as simple if the cost of official administration and collection, and the compliance costs (the costs in money and effort involved in a taxpayer meeting his obligations) are minimal. A taxpayer's compliance costs may be monetary (e.g. fees for advice or assistance paid to professional advisers), time costs (in keeping records or completing returns) or psychological costs (e.g. anxiety caused by inability to understand complex laws). In designing and evaluating tax policy, adequate account of compliance costs should be taken. It is likely that the level of compliance costs can play a crucial role in determining the practicability and the success of certain types of taxes.

Simplicity in a tax system would ensure that every taxpayer enjoys the full benefits of legitimate deductions and allowances. It will encourage compliance and minimise inequities.

1.4.4 Certainty

The taxpayer should be able to predict with reasonable accuracy the eventual tax bill from his economic activity so that he can budget accordingly. The concept of certainty is linked to the attribute of simplicity. There are four aspects of "certainty" which one can look into:

(a) Certainty of incidence, i.e. the degree of certainty with which the tax authorities can predict who will actually bear the burden of the tax.
(b) Certainty of liability, i.e. the ease and accuracy with which liability to tax can be assessed.
(c) Certainty of fiscal collection, i.e. the certainty with which the Treasury is able to predict the revenue which will be collected in a particular year as this will have an effect on the level of governmental economic activity and will also partly determine the level of the public sector borrowing requirements.
(d) Certainty of overcoming avoidance and evasion, i.e. the extent of avoidance and evasion, and the certainty with which the tax authorities can overcome avoidance and evasion techniques.

Therefore, a simple tax system would allow for certainty in terms of tax payable and collectible.

1.4.5 Flexibility

If the taxation system is to be used to achieve non-fiscal objectives, then the tax structure and rates need to be easily varied, and changes in tax should have a speedy and decisive impact on revenue yields and taxpayers' behaviour.

Sales tax, therefore, tends to be a flexible tax, since changes in sales tax rates can be made readily, and these changes then have a relatively swift impact upon taxpayers' behaviour (an increase in sales tax rates often leads almost immediately to price increases). Death duties and capital gains taxes, on the other hand, tend to have a delayed impact, since it may be many years before a liability for tax arises. In fact, the switch by Malaysia to a current year basis of income taxation from the year 2000 provides the opportunity of varying the tax structure and rates almost immediately unlike the delayed effect due to the preceding year basis.

1.4.6 Suitability for Achieving Macro-level Objectives

The tax structure should facilitate the use of fiscal policy to meet macro-level economic management objectives which a government might seek to achieve, such as the optimising of economic stability and growth, redistribution of income or wealth, raising of employment levels and the lowering of inflation.

1.4.7 Fiscal Adequacy

The tax structure should generate the amount of revenue needed by the government. No doubt some taxes are introduced to deter certain activities but taxes on income or similar bases must be able to generate sufficient funds to finance the development of a nation. Otherwise, such a tax would not be effective and the tax system would not be at its optimal level.

There is considerable potential for conflict between the above-stated criteria, and it is unlikely that one could ever find a tax system which simultaneously maximises each of these criteria. The conflict between simplicity and equity is often significant. Taxes which aim to maximise equity often tend to be complex. This may arise because the need for

CHAPTER 4

TAX ADMINISTRATION

4.0 INTRODUCTION

This chapter deals with the administrative machinery by which income tax is levied and collected. The various aspects covered include the organisational hierarchy of the IRB, its access to information, the issue of returns, assessments, collection and recovery of tax, the appeal process as well as offences and penalties imposed under the Act. Tax administration encompasses:

(i) the ascertainment of tax liability,
(ii) the collection of the tax, and
(iii) the settlement of tax disputes and the imposition of penalties for violation of tax laws.

The ascertainment of tax liability involves the determination of the tax base, submission of tax returns and the issuing of assessments or the deemed issuance of an assessment. Tax liability is determined either officially by the tax department or via self assessment by the taxpayer (as is the current position in Malaysia). Payment of taxes can be made (depending on the legal provisions) as and when income is earned, in instalments, at the time a tax return is filed or after an assessment is issued to the taxpayer. Failure to comply with tax laws may occur due to neglect, inadvertence, misunderstanding or deliberate intent to evade. Administrative and judicial penalties for such defaults range from the imposition of penalties on delinquent taxpayers to imprisonment. When disputes arise on the determination of tax liability, it is generally the courts which act as the final interpreters and arbiters.

A good tax system requires an effective tax administration. A well-designed tax which is poorly administered can become an instrument of injustice; on the other hand, proper and effective administration can partially offset the demerits of a poorly-designed tax. In view of the growing awareness of the vital role which taxation plays in a developing economy, substantive and major reforms in tax administration have and are being undertaken in many countries.

Generally, the fundamental objectives of the IRB are to administer the various tax legislations passed by Parliament, to ensure that they are carried into effect and to make the tax system work. In the course of achieving these objectives, tax administrators should:

- encourage and assist voluntary compliance with the requirements of the law
- maintain a dialogue with taxpayers and tax agents
- maintain public confidence in the integrity of the tax system
- deter tax evasion
- administer the tax laws fairly, uniformly, impartially and without unwarranted rigidity

In the United Kingdom (UK), a Taxpayer's Charter was initially introduced in 1986 and has subsequently been revamped. The Charter is intended to set out the standard of service that people can expect to receive from the tax authorities, i.e. the Inland Revenue. It is intended to make public services more responsive to the public. It is the belief of the authorities that taxpayers have a right to expect the Inland Revenue Department to be fair, helpful, efficient and accountable. The Malaysian IRB, for the first time, published a Corporate Plan (for the years 1993 to 1997). This plan introduced a Taxpayer's Charter, the corporate mission, objectives and philosophy of the IRB. The Taxpayer's Charter has recently been revamped into a Client Charter which sets out some timelines for submission of returns, payment of tax, making of appeals, resolution of disputes, etc.

4.1 ORGANISATIONAL HIERARCHY

4.1.1 Inland Revenue Board of Malaysia

The *Inland Revenue Board of Malaysia Act 1995* provides for the establishment and incorporation of the Inland Revenue Board of Malaysia. The Board enjoys some degree of autonomy especially in terms of financial and personnel matters. The corporatisation of the Inland Revenue Department through the establishment of the Inland Revenue Board was done so as to enable it to operate more efficiently and effectively. The corporatisation took effect from 1 March 1996. The IRB operates as a statutory body and is a part of the Ministry of Finance and is headed by a Chief Executive Officer who is also the Director General of Inland Revenue (DG). The organisational structure of the Ministry of Finance and the IRB are shown in Charts 4.1 and 4.2 respectively.

The IRB has been creating new departments from time to time as well as renaming certain divisions into departments and branches. Effective from 1 January 2015, the Corporate Tax Department was renamed the Large Taxpayer Branch (or Cawangan Pembayar Cukai Besar) in Peninsular Malaysia and Large Taxpayers Unit in Sabah and Sarawak. The Multinational Tax Department was renamed as the Multinational Tax Branch and the Petroleum Division was renamed as the Petroleum Branch. These changes were aimed at improving the quality of services in respect of large and high profile taxpayers and the handling of their tax files. In connection with the above, taxpayers' files were dispersed between the new Branches/Unit and other IRB branches according to specific criteria set-out by the IRB.

The functions of the Board are:

(a) to act as an agent of the Government and to provide services in administering, assessing, collecting and enforcing payment of various taxes;
(b) to advise the Government on matters relating to taxation and to liaise with the appropriate Ministries and statutory bodies on such matters;
(c) to participate in or outside Malaysia in respect of matters relating to taxation; and
(d) to perform such other functions as are conferred on the Board by any other written law.

It is also specified that no action or legal proceedings shall be brought against the Board in respect of any matter relating to any tax for which the Board is acting as agent of the Government. Any such action or proceedings shall be instituted by or against the Government.

4.1.2 Director General of Inland Revenue (DG)

It would be noted that the powers of the DG remain the same (i.e. as when the Inland Revenue Department existed). However, consequential amendments were made to the various legislation to allow the DG to delegate certain powers to the employees of the IRB, as and when necessary. This should be borne in mind when reading the rest of the chapter. Note that IRB and DG is used interchangeably in this book.

Section 134 of the Act gives the DG the responsibility for the management of income tax. The DG is appointed by the Minister of Finance. Under S. 136, the DG can delegate specified powers to the Deputy Directors-General, Assistant Directors-General, Senior Assistant

CHART 4.1
ORGANISATION STRUCTURE OF MINISTRY OF FINANCE

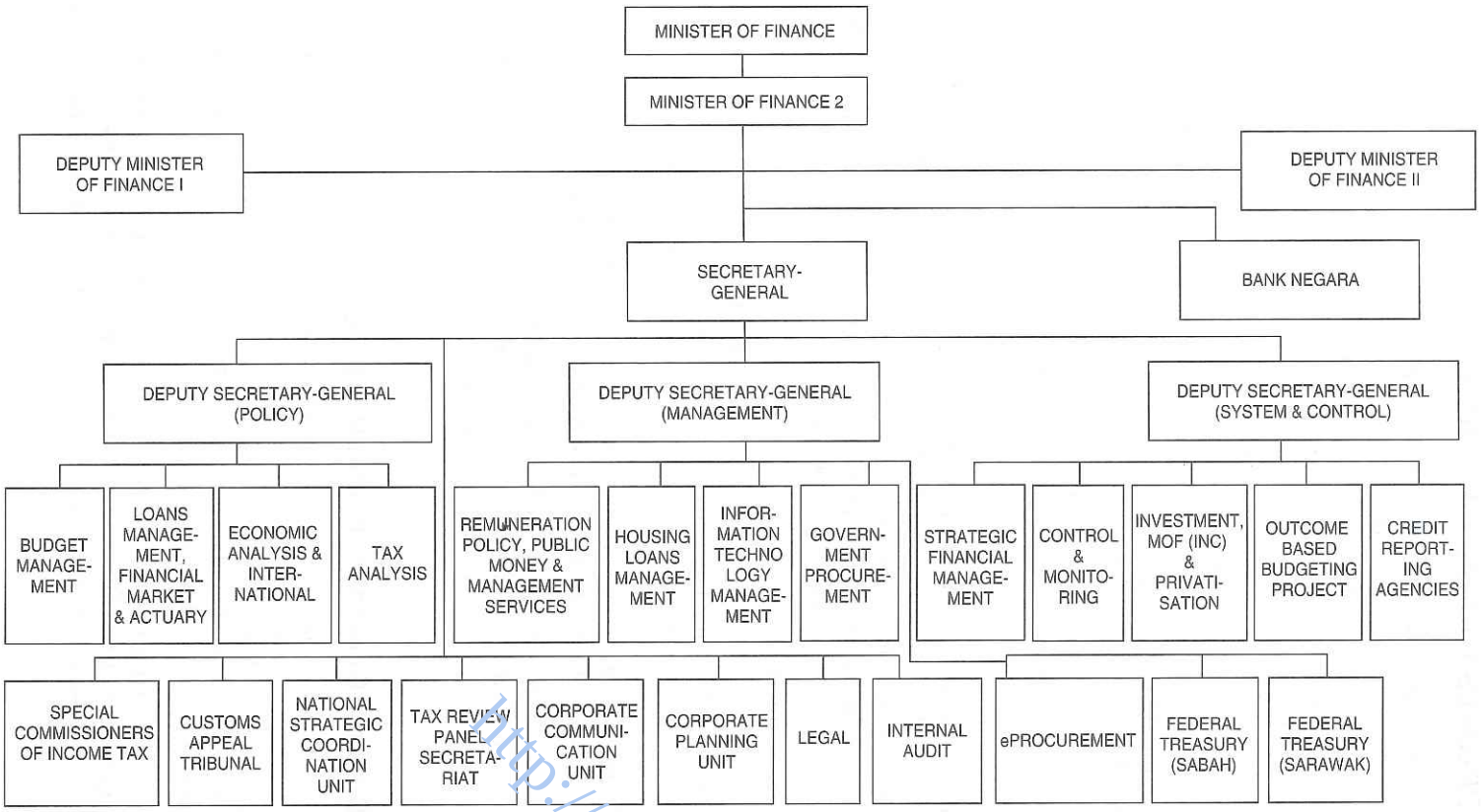

Chart 4.1

CHART 4.2
ORGANISATION STRUCTURE – INLAND REVENUE BOARD

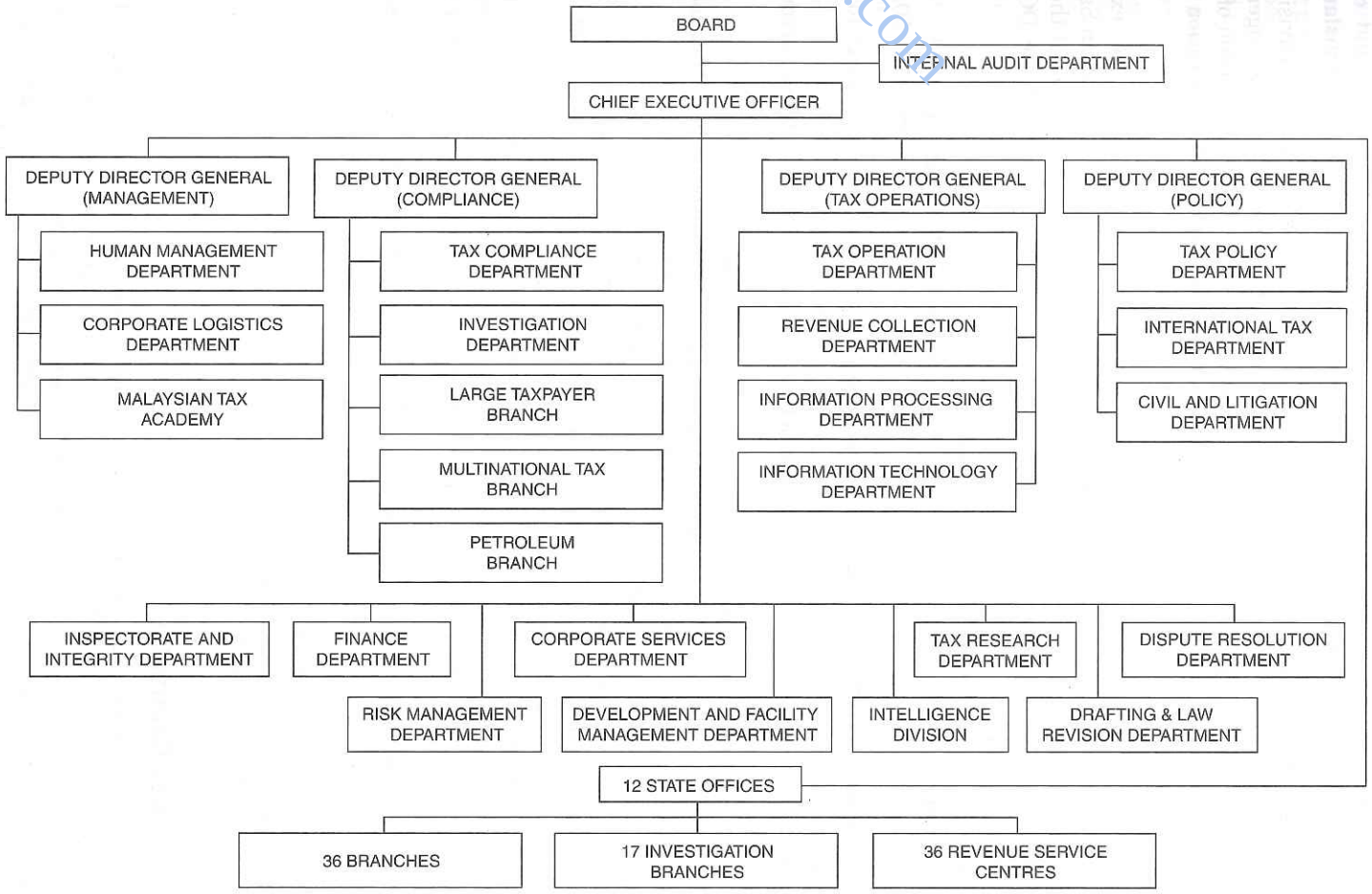

Chart 4.2

Directors and Assistant Directors. Apart from general administration, the Deputy Directors-General are also responsible for general supervision of the assessment and collection functions, enforcement of tax legislation and consideration of tax policy and legislation.

With regard to tax policy, this is basically the jurisdiction of the Tax Analysis Division of the Ministry of Finance. However, input is provided by the two revenue collection agencies, i.e. the IRB and the Malaysian Customs Department. In fact, the Research Division of the IRB carries out tax reform appraisals as well as research regarding tax administration methods and systems.

The Deputy Directors-General can exercise any of the functions of the DG except the prescribing of forms or a function exercisable by statutory order. The Directors in Sabah and Sarawak are responsible to the DG for the administration and organisation of the income tax offices in Sabah and Sarawak and can exercise all the functions of the DG except:

(a) the prescribing of forms;
(b) any function exercised by statutory order;
(c) the approval of institutions and organisations under S. 44(6) of the Act; and
(d) the approval of pension and provident funds, schemes or societies under S. 150.

The powers conferred on the DG by the Act are very wide and include the power to:

- call for submission of returns and all information relevant thereto (S. 77)
- require taxpayers to attend personally before him and to produce books, accounts, etc. (S. 78)
- call for statements of bank accounts, assets and all sources of income (S. 79)
- have full and free access to all land, buildings and places and all books and other documents, objects, articles, materials and things of a taxpayer (S. 80)
- require the keeping of records and books of accounts (S. 82)
- prevent a taxpayer from leaving the country without settling his tax liabilities (S. 104)
- make assessments, including additional or advance assessments (S. 90 to S. 92)
- approve or withdraw approval of any pension or provident fund (S. 150)
- give directions and initiate rules and regulations for special treatment of hire purchase transactions, transactions under which a debt is payable by instalments, lease transactions in respect of moveable property and any other transaction involving a debt or stock-in-trade [S. 36(1)]
- appoint agents to be assessable and chargeable to tax on behalf of a taxpayer (S. 68)
- allow tax to be paid in instalments (S. 103)
- impose penalties (S. 112 and S. 113)
- remit tax on grounds of poverty (S. 129)
- disregard certain transactions (S. 140)
- prescribe forms (S. 152)

4.1.3 Confidentiality

Section 138 of the Act provides that every classified person shall deal with classified material as confidential. Therefore, there is a duty of confidentiality with regard to the information obtained about the affairs of taxpayers. A "classified person" is defined to include not only IRB officials, the Auditor General and his officers, but also any person advising or acting for a person who is or may be chargeable to tax, and any employee of a person so acting or

advising who had access to classified material. Therefore, a duty of confidentiality is imposed on professional advisers such as accountants and lawyers. "Classified material" means any return or other document made for the purposes of the Act and relating to the income of any person or partnership and any information which comes to the notice of a classified person in his capacity as such.

Classified material can only be produced or used in Court or otherwise:

- for the purposes of the Act or another tax law;
- in order to institute or assist in the course of a prosecution for any offence committed in relation to tax or in relation to any tax or duty imposed by another tax law; or
- with the written authority of the Minister or of the person or partnership to whose affairs it relates.

In addition, the confidentiality provisions do not prevent:

(a) the production or disclosure of classified material to the Auditor General (or to public officers under his direction and control) or the use of classified material by the Auditor General, to such an extent as is necessary or expedient for the proper exercise of the functions of his office;
(b) the DG from publicising, from time to time in any manner as he may deem fit, certain particulars of a person who has been found guilty or convicted of any offence under the Act or dealt with under S. 113(2) with regard to incorrect returns or incorrect information or S. 124 with regard to compounding of offences.

Although, correspondence between a lawyer or an accountant and a client in connection with the giving of professional advice is covered by professional privilege, it should be noted that in Malaysia, under S. 142(5)(b), the claim of privilege cannot be raised in respect of any demand for information by the IRB where the information in question relates to the accounts or affairs of a client. Section 142(5)(b) provides that where any document, thing, matter, information, communication or advice consists wholly or partly of, or relates to, the receipts, payments, income, expenditure or financial transactions or dealings of any person (whether an advocate and solicitor, his client, or any other person), it shall not be privileged from disclosure to a Court, the Special Commissioners, the DG or any authorised officer if it is contained in, or comprises the whole or part of, any book, account, statement, or other record prepared or kept by a practitioner in connection with any client or clients of the practitioner or any other person.

4.1.4 Tax Agents

To enhance the competency of tax agents, a person who wishes to perform tasks relating to taxation is required to obtain a licence irrespective of whether the person is a licenced company auditor. The change (introduced via an amendment to S. 153 of the Act) aims to have more competent tax agents in the profession in the light of the more onerous obligations under the self assessment system. With effect from 21 February 2007, S. 153(6) of the Act was also amended to extend the validity period of any approval or renewal of the tax licence of a tax agent from the minimum 24 months from the date of approval or renewal to any other period as approved by the Minister of Finance. Based on the guidelines issued by the Ministry of Finance, the period was extended to 36 months. The IRB has also issued a code of ethics for tax agents (revised on April 2012) which covers various attributes such as integrity, competence and professionalism.

The IRB had announced its intention to only deal with approved tax agents under S. 153 of the Act on tax related matters. The professional bodies met with the Tax Division of the Ministry of Finance and Inland Revenue Board Malaysia on 2 December 2014 to discuss the conditions for engagement with IRB officers. Pursuant to the above-mentioned meeting, the following was agreed upon:

- The implementation date for the new approach was set for 1 February 2015.
- Under the agreed terms of engagement, all correspondence with the IRB should indicate the name and tax agent approval number.
- The IRB will only accept correspondence signed by authorised signatories including the relevant approved tax agent of the taxation firm. Such list should contain particulars required by the IRB (such as name, identity card number, designation, specimen signature, etc) and may be updated from time to time.
- The IRB had issued a letter dated 31 December 2014 and set out the standard format of the authorisation letter to be presented by the staff/officers of a tax agent firm/company when dealing with the IRB officers. The letter is mainly for situations where the licensed tax agent is unable to attend a technical discussion with regard to a specific client and as such, a suitably qualified staff is sent on behalf to discuss the matter with the IRB officer.

Subsequent to this, the IRB had suggested an alternative mode of registering tax agents and authorised signatories via the e-filing portal.

The Inland Revenue Board issued a media release in mid-2015 advising taxpayers to seek the services of tax agents approved by the Minister of Finance under S.153(3) of the *Income Tax Act 1967* to manage their tax matters. Services provided by unlicensed tax agents could lead to inaccurate or unclear tax advice including preparation of the income tax return form which does not comply with the tax law. In addition, unlicensed tax agents cannot represent taxpayers in audits or investigations conducted by the IRB or in dispute resolution hearings before the Special Commissioners of Income Tax. Any person who is guilty of an offence under the following provisions, shall, on conviction, be liable to the following penalties:

Provision	Penalty
Section 120(1)(d) – Any person who without reasonable excuse contravenes Section ..... or Section 153(1)..... shall be guilty of an offence.	On conviction shall be liable to fine of not less than RM200 and not more than RM20,000 or to imprisonment for a term not exceeding 6 months, or to both.
Section 114(1A) – Any person who assists in, or advises with respect to, the preparation of any return where the return results in an understatement of the liability for tax of another person shall, unless he satisfies the court that the assistance or advice was given with reasonable care, be guilty of an offence.	On conviction shall be liable to fine of not less than RM2,000 and not more than RM20,000 or to imprisonment for a term not exceeding 3 years, or to both.

Taxpayers can check the list of approved tax agents and validity of their approvals by the Minister of Finance at the IRB's website.

4.2 CURRENT YEAR BASIS OF ASSESSMENT

As a measure to modernise and streamline the tax administration system with the view to accelerate income tax payments, the following changes were announced in the 1999 Budget:

- the preceding year basis of assessment of income tax was changed to the "current year" basis effective from the year 2000;
- income derived (other than dividends irrespective of whether such income is a business or a non-business source) in the year 1999 was waived from income tax.

This change was aimed at increasing the efficiency and responsiveness in the collection of income tax to ensure that the cash flow to the Government reflects the current performance of the economy. Such a measure should also help to increase the level of tax compliance amongst taxpayers since the new system, in theory, allows the taxpayer to match tax payments more closely to their cash flow situation.

4.3 SELF ASSESSMENT

In the 1999 Budget, it was announced that the official assessment system (under which taxpayers were assessed to income tax under the *Income Tax Act 1967* by the IRB based on the tax returns filed by them) was to be replaced by the self assessment system in stages as follows:

Type of taxpayer	*Year of implementation*
Companies	2001
Businesses, partnerships and co-operatives	2004
Salaried individuals	2004

The self assessment system is essentially a process by which taxpayers are required by law to determine the taxable income, compute the tax liability and submit their tax returns based on tax laws, policy statements and guidelines issued by the tax authorities. The introduction of the self assessment system shifted the responsibility of determining and computing the amount of tax liability from the IRB to the taxpayer.

Basically, under the self assessment system, tax returns are not subject to detailed technical scrutiny by the IRB. However, there is an expanded programme of checking and verifying tax returns on a post-assessment basis, particularly by way of tax audits and the implementation of a penalty system to enforce compliance with tax laws.

This change was aimed at relieving the increasing workload of the IRB to allow the IRB to concentrate on areas with high tax risks and revenues. This has had a significant impact on taxpayers who must equip themselves in ensuring full disclosure as a self assessment regime is accompanied with severe penalties for non-compliance and under-declaration of income.

The *Income Tax (Amendment) (No. 2) Act 1999* set out the provisions for submission of tax returns, assessment of tax payable, payment of estimated tax by instalments and some penalty provisions under the self assessment system. The self assessment system for companies was effective from year of assessment 2001 (current year basis). The *Income Tax (Amendment) Act 2002* set out the amendments to introduce self assessment for non-corporate taxpayers which took effect from year of assessment 2004.

4.3.1 Self Assessment – Companies

4.3.1.1 Instalment Payment Scheme

(i) The instalment payment (under S. 107C) is on a 12-monthly basis. If a company commenced operations in a year of assessment, the instalment scheme would be for the number of months in the basis period.

(ii) The due date of the first instalment payment is the tenth day of the second month of the basis period. For a company which commences operations in a year of assessment, the first instalment would be due on the tenth day of the sixth month of the basis period for the year of assessment. The due date for payment of instalments of the estimated tax payable was extended by 5 days to the fifteenth day instead of the tenth day of the month with effect from 1 January 2015. This initiative is part of a larger move by the Government to try and synchronise the due dates for payment of taxes, EPF and SOCSO contributions as well as the payments to the Human Resource Development Fund.

(iii) The estimate of tax payable by instalments is determined by the Company in a prescribed form (Form CP 204) to be submitted 30 days before the start of the basis period. The estimate of tax payable for year of assessment 2001 should not be less than the tax payable for year of assessment 1999. However, a company which commences operations in a year of assessment is required to furnish an estimate of its tax payable within 3 months of the date of commencement. For subsequent years of assessment, the estimate cannot be lower than the estimate/revised estimate for the preceding year of assessment. The DG will then issue the notice of instalment payment (CP 205) together with the instalment remittance slip (CP 207). Failure to submit an estimate of tax payable is an offence and legal proceedings can be initiated by the DG.

From year of assessment 2002 onwards, where the estimated tax payable is the same as that for the preceding year of assessment or higher, the IRB does not issue Forms CP 205/207. The taxpayer is required to pay the instalments for the relevant months in respect of the estimated liability and can obtain Forms CP 207 from the relevant IRB branches.

With effect from year of assessment 2006, companies are allowed to furnish estimates of tax payable for a year of assessment of not less than 85% of the revised estimate of tax payable for the immediately preceding year of assessment or if no revised estimate is furnished, the estimate shall not be less than 85% of the estimate of tax payable for the immediately preceding year of assessment. This has been effected by amending S. 107C(3) of the Act. This change will enable companies to take into account expected changes in the economic situation that may affect their future financial performance.

The IRB, in practice, does consider applications (via a letter submitted with the Form CP 204) by taxpayers to pay instalments lower than the prescribed minimum amount according to the merits of each case. Such consideration will also be given to cases where the company suffers losses in the current year even though the company was making profits in the preceding year. Upon approval, the IRB will issue the instalment scheme (CP 205).

With effect from year of assessment 2008, new small and medium enterprises (SME) are given exemption from submitting their estimates of tax payable and making instalment payments for 2 years of assessment beginning from the date of commencement of operations [S. 107C(4A)]. They are required to make full income tax payment at the point of submission of the income tax return. An SME is defined as a company with a paid-up capital in respect of ordinary shares of RM2.5 million and below at the beginning of the basis period for the relevant year of assessment. With effect from the year of assessment 2010, an SME was re-defined (in S. 107C) as a company:

- in which not more than 50% of the paid up capital in respect of ordinary shares is directly or indirectly owned by a related company;
- which does not directly or indirectly own more than 50% of the paid up capital in respect of ordinary shares of a related company; or

- in which not more than 50% of the paid up capital in respect of ordinary shares of the first mentioned company and the related company is directly or indirectly owned by another company.

"Related company" in this context is defined as a company which has a paid up capital exceeding RM2.5 million in respect of ordinary shares. The effect of the change is that a company which does not meet the new definition will be restricted from enjoying the preferential tax rate for a SME of 20% and 25% and will also be required to furnish a tax estimate upon commencement of business.

However, the IRB was unable to identify an SME when:

- imposing a penalty on underestimated tax liability pursuant to S. 107C(10) ; or
- issuing a notification of legal proceedings for offences committed under S. 120(1)(f).

As such, the IRB has amended the Form CP204 to allow a taxpayer to inform the IRB of its 'SME' status without furnishing the estimate of tax payable. The amendment was effective from 3 March 2011.

With effect from year of assessment 2014, where a SME first commences operations in a year of assessment and the SME has no basis period for that year of assessment and for the immediate following year of assessment, the SME is not required to furnish an estimate of tax payable for that year of assessment and for the immediate two following years of assessment.

Example:

A SME commences operations on 1 November 2014 and closes its first set of accounts on 31 January 2016 (15 months accounts).

Year of assessment	2014	2015	2016	2017	Legislation
Basis period	No	No	Yes	Yes	Section 21A(4)(c)
Estimate of tax payable	Not required	Not required	Not required	Required	New Section 107C(4A)(c)

This amendment is a consequence of the amendment made to S. 21A(4) of the Act related to basis periods.

Where a company fails to furnish an estimate of tax payable for the relevant year of assessment, it shall be guilty of an offence and shall, on conviction, be liable to a fine ranging from RM200 to RM2,000 or to imprisonment for a term not exceeding six months or to both. In addition, the DG is empowered to direct payment on account of tax which is or may be payable by instalments.

With effect from year of assessment 2011, where a company (except a small and medium enterprise) first commences operations and the basis period for that year is less than six months, the company is not required to furnish an estimate of tax payable. However, the DG may direct instalments to be paid for that year.

Further, a penalty of 10% of the tax payable will be imposed on a company where for a year of assessment:

- no estimate of tax is furnished by that company and no direction is given by the DG to make payment by instalments;
- no prosecution has been instituted in relation to failure in furnishing such an estimate; and
- tax is payable by that company pursuant to an assessment for that year of assessment.

Such a penalty shall be due and payable upon furnishing the tax returns of that company.

The DG is empowered to direct a company (as well as a trust body or a co-operative body) to make payment by instalments on account of tax before the sixth month of the basis period for the year of assessment where the company fails to furnish an estimate of tax payable. However, the above time frame to direct payment by instalments is removed from the year of assessment 2012. With the removal, the DG can direct payment by instalments for a year of assessment at any time during the basis period. The amount directed by the DG is deemed to be the revised estimate for the purposes of determining the under-estimation penalty under S. 107C(10) stated in (v) below. Where the amount is directed by the DG before the ninth month of the basis period, revised estimates may be furnished in the sixth month and/or ninth month of the basis period, as the case may be. This change allows the DG more flexibility to direct payment of tax by instalments under S. 107C.

With effect from year of assessment 2015, the IRB will not issue Form CP204 to companies. With the coming into operation of the Finance Act 2014, Form CP204 by companies shall be furnished only via electronic medium or electronic transmission. Other taxpayers may choose to file the CP204 manually.

(iv) Any revision to the estimated tax payable must be made in the sixth month of the basis period and not earlier. In addition to the sixth month revision, the revision of the estimated tax payable in the ninth month (for companies) is allowed with effect from year of assessment 2003. The revision would have to be made by submitting Form CP 204A. In such a case, the taxpayer can proceed to make the instalment payments (if any) according to the proposed revision without waiting for the revised instalment scheme (CP 206) to be issued.

With the coming into operation of the Finance Act 2014, the Form CP204A by companies shall be furnished only via electronic medium or electronic transmission. Other taxpayers may choose to file the Form manually.

(v) Public Ruling (PR) No. 7/2011: Notification of Change in Accounting Period of a Company/ Trust Body/ Co-operative Society provides guidance on the notification procedure on the change in accounting period of a company, trust body or co-operative society, and is effective from the year of assessment 2012 onwards.

The following are some of the salient features:

- Changes in the accounting period of a company, a trust body or a co-operative society will change the basis period for a year of assessment. Such changes in the basis period will affect the estimate of tax payable for the current year of assessment.
- The following procedures are to be adopted when there is a change in the accounting period:
  - (a) Notify the DG regarding the change in accounting period by way of Form CP204B:
    - one month before the beginning of the new accounting period if the accounting period is shortened; or
    - one month before the end of the original accounting period if the accounting period is extended;
  - (b) Submit CP204B together with CP204A on the revised tax estimate if submission is made in the sixth or ninth month of the basis period;
  - (c) Only CP204B is required to be submitted in the months other the sixth or ninth month and the DG will issue a Notice of Instalment Payments (Form CP205);

  - (d) Justification should be provided if the new revised estimate is less than the original estimate or revised estimate and the instalments for the new basis period are reduced.
  - (e) The revised estimate would not be acceptable if any notification is made after the end of a basis period. The original monthly instalments shall continue to be payable until Form CP204B is received by the DG.
  - (f) If the accounting period is extended and the revised instalment is less than the original instalment, the instalment to be paid for the extended period is the original instalment.

(vi) Penalties are imposed on late payment of tax instalments and on under-estimation of tax liability. The IRB does appreciate the difficulties faced by companies in certain industries in providing reasonable estimates of tax payable due to, for example, significant fluctuations in foreign exchange rates or significant decline in demand. Where the company can provide evidence that the difference between the estimated tax payable and the actual tax payable is due to uncontrollable/external factors, a penalty may not be imposed even though the difference between the estimate of tax payable and the actual tax payable exceeds 30% of the actual tax payable. This depends on the actual facts of a case.

(vii) The balance of tax payable (i.e. actual tax payable per tax return less amounts due under the instalment scheme) is due and payable on the due date for submission of the tax return (i.e. the last day of the sixth month from the date following the close of the accounting period). However, with effect from year of assessment 2003, the filing of corporate tax returns, as well as the settlement of the balance of tax payable, was extended to 7 months from the date following the close of the accounting period.

Examples

(a) DEF Sdn Bhd has a financial year end of 30 June 2015. Its basis period for year of assessment 2015 is 1 July 2014 to 30 June 2015. The estimated tax payable would need to be submitted by 31 May 2014 and it would have to be settled by 12-monthly instalments commencing on 10 August 2014.

(b) JKL Sdn Bhd commenced operations on 1 February 2015 with 31 December 2015 as the financial year end. Its basis period will be 1 February 2015 to 31 December 2015 (11 months). The estimated tax payable would need to be submitted by 30 April 2015. It would be required to pay its estimated tax payable by 11 monthly instalments commencing on 10 July 2015. If the company qualifies as a small and medium enterprise, then it is excluded from submitting its estimated tax payable for the first 2 years of assessment.

(c) ABC Sdn Bhd has a financial year ending on 30 June 2015. Its basis period will be from 1 July 2014 to 30 June 2015 (12 months). The estimated tax payable for year of assessment 2015 is RM120,000. The monthly instalment of RM10,000 has commenced from August 2014. A revised estimate of tax payable of RM190,000 was submitted on 26 December 2014. The remaining instalments will be revised as follows:

	RM
Revised estimate	190,000
(August–December 2014, i.e. RM10,000 x 5)	(50,000)
Balance of instalments payable	140,000
Monthly instalments for the remaining months = $\frac{140,000}{7}$	20,000

Where the tax instalments paid exceeds the revised estimate, the remaining instalments will cease.

(d) If ABC Sdn Bhd (in the above example) did not submit a revised estimate and the actual tax payable per the tax return is RM200,000, the penalty for underestimation will be as follows:

	RM
Tax payable	200,000
Estimated tax payable	(120,000)
Difference	80,000
30% of RM200,000	(60,000)
Excess	20,000
Penalty of 10% on excess	2,000

4.3.1.2 Filing of Tax Returns

Every company [under S. 77(1A)] is required to furnish its tax return to the IRB within seven months from the date following the close of its accounting period (which constitutes the basis period for the year of assessment in question under the current year basis of assessment).

The tax return submitted from year of assessment 2001 onwards is deemed to be a notice of assessment served on the company on the date of submission. Thus, no notices of assessment are issued by the IRB. It has also been indicated by the IRB that if there are grounds (such as error or mistake) to revise a return, this can be done by invoking S. 131. Provisions have since been made to allow a self-amendment of a tax return (S. 77B).

4.3.1.3 Specific Penalties under Self Assessment

(a) Providing Reasonable Facilities and Assistance

Public Ruling 7/2000 in respect of providing reasonable facilities and assistance was issued on 16 June 2000 by the IRB and applies in respect of S. 80 of the Act which empowers the IRB to gain access to buildings, books and documents. It was amended (with effect from 1 January 2000) via the *Income Tax (Amendment) (No. 2) Act 1999* with the addition of the following provision:

> "(1A) Where the Director General exercises his powers under subsection (1), the occupiers of such lands, buildings and places shall provide the Director General or an authorised officer with all reasonable facilities and assistance for the exercise of his powers under this section."

Based on the above-mentioned ruling, the facilities and assistance which a person should provide to the DG or an authorised officer includes free and full access to lands, buildings etc., explanation of the office system and accounting system where required, access to physical and/or electronic records, documents and book of accounts, information on location of documents, etc. and use of facilities such as copier, telephone as well as facilities for copying of electronic records. This is to facilitate tax audits by the IRB.

Failure to provide reasonable facilities or assistance or both is an offence and the offender, upon conviction, may be liable to a fine of RM1,000 up to RM10,000 or to imprisonment for a term of up to one year or both.

(b) Assistance or Advice Relating to an Understatement of Tax Liability

The introduction of the self-assessment system for income tax and recent legislative changes has the effect of placing a greater burden and liability on taxpayers and their advisors.

Section 114 was amended (with effect from 1 January 2000) to include the following provision via the *Income Tax (Amendment) (No. 2) Act 1999*:

> "(1A) Any person who assists in, or advises with respect to, the preparation of any return where the return results in an understatement of the liability for tax of another person shall, unless he satisfies the court that the assistance or advice was given with reasonable care, be guilty of an offence and shall, on conviction, be liable to a fine of not less than two thousand ringgit and not more than twenty thousand ringgit or to imprisonment for a term not exceeding three years or to both."

The IRB has issued Public Ruling 8/2000 in respect of this amendment. The ruling took effect from 1 January 2001.

4.3.1.4 Public Rulings

The Public Rulings issued by the DG to date are listed below.

PR No.	Name of ruling	Issued/ Updated
4/2000 **Revised**	Keeping Sufficient Records (Companies & Co-operatives)	30.06.2001
5/2000 **Revised**	Keeping Sufficient Records (Individuals & Partnerships)	30.06.2001
6/2000 **Revised**	Keeping Sufficient Records (Persons Other than Companies & Co-operatives)	30.06.2001
7/2000	Providing Reasonable Facilities and Assistance	16.06.2000
8/2000	Wilful Evasion of Tax and Related Offences	30.12.2000
1/2001 **Replaced by 5/2014**	Ownership of Plant & Machinery for the Purpose of Claiming Capital Allowances	27.06.2014
2/2001 **Replaced by** 12/2014 and 6/2015	Computation of Initial & Annual Allowances in Respect of Plant & Machinery	31.12.2014 27.08.2015
3/2001 **Replaced by** 7/2015	Appeal against an Assessment	22.10.2015
4/2001	Basis Period for a Non-Business Source (Individuals & Persons Other than Companies)	30.04.2001
5/2001 **Replaced by** 8/2014	Basis Period for a Business Source (Co-operatives)	01.12.2014
6/2001	Basis Period for a Business Source (Individuals & Persons other than Companies/Co-operatives)	30.04.2001
7/2001 **Replaced by** 8/2014	Basis Period for Business and Non-Business Sources (Companies)	01.12.2014
1/2002	Deduction for Bad & Doubtful Debts & Treatment of Recoveries	02.04.2002

PR No.	Name of ruling	Issued/ Updated
2/2002 **Replaced by** 11/2013	Allowable Pre-Operational & Pre-Commencement of Business Expenses	18.11.2013
1/2003	Tax Treatment of Leave Passage Addendum	05.08.2003 23.08.2007
2/2003	"Key-Man" Insurance	30.12.2003
1/2004 **Replaced by** 4/2011	Income from Letting of Real Property	10.03.2011
2/2004 **Replaced by** 3/2013	Benefits-In-Kind	15.03.2013
3/2004 **Replaced by** 4/2015	Entertainment Expense	29.07.2015
4/2004 **Replaced by** 11/2012	Employee Share Option Scheme Benefit	13.12.2012
5/2004	Double Deduction Incentive on Research Expenditure Addendum	30.12.2004 03.04.2008
1/2005	Computation of Total Income for Individual	05.02.2005
2/2005	Computation of Income Tax Payable by a Resident Individual Addendum Second Addendum	06.06.2005 06.07.2006 03.01.2008
3/2005	Living Accommodation Benefit Provided for the Employee by the Employer Addendum	11.08.2005 05.02.2009
4/2005 **Replaced by** 1/2014	Withholding Tax on Special Classes of Income	23.01.2014
5/2005 **Replaced by** 4/2012	Deduction for Loss of Cash & Treatment of Recoveries	01.06.2012
6/2005	Trade Association Addendum	08.12.2005 01.07.2009
1/2006 **Replaced by** 2/2013	Perquisites from Employment	28.02.2013
2/2006	Tax Borne by Employers	17.01.2006
3/2006 **Replaced by** 1/2009 and 2/2009	Property Development & Construction Contracts	22.05.2009

PR No.	Name of ruling	Issued/ Updated
4/2006	Valuation of Stock in Trade and Work in Progress – Pt. 1	31.05.2006
5/2006 **Replaced by** 3/2009	Professional Indemnity Insurance	30.07.2009
6/2006	Tax Treatment of Legal and Professional Expenses	06.07.2006
1/2008 **Replaced by** 10/2014	Special Allowances for Small Value Assets	21.12.2014
2/2008 **Replaced by** 6/2012	Reinvestment Allowance	12.10.2012
1/2009	Property Development	22.05.2009
2/2009	Construction Contracts	22.05.2009
3/2009	Professional Indemnity Insurance	30.07.2009
1/2010	Withholding Tax on Income under Para. 4(f)	19.04.2010
1/2011	Taxation of Malaysian Employees Seconded Overseas	07.02.2011
2/2011	Interest Expense and Interest Restriction	07.02.2011
3/2011 **Replaced by** 10/2015	Investment Holding Company	16.12.2015
4/2011	Income From Letting Of Real Property	10.03.2011
5/2011	Residence Status Of Companies And Bodies Of Persons	16.05.2011
6/2011	Residence Status Of Individuals	16.05.2011
7/2011	Notification Of Change In Accounting Period Of A Company/Trust Body/ Co-Operative Society	23.08.2011
8/2011	Foreign Nationals Working In Malaysia – Tax Treatment	16.11.2011
9/2011	Co-Operative Society	16.11.2011
10/2011 **Replaced by** 8/2013	Gratuity	25.06.2013
11/2011	Bilateral Credit And Unilateral Credit	20.12.2011
12/2011	Tax Exemption On Employment Income Of Non-Citizen Individuals Working For Certain Companies In Malaysia	20.12.2011
1/2012	Compensation For Loss Of Employment	27.01.2012
2/2012	Foreign Nationals Working In Malaysia – Tax Treaty Relief	03.05.2012

CHAPTER 9

EXEMPT INCOME

9.0 INTRODUCTION

In the previous chapters, we have discussed the various types of receipts which are liable to tax as well as those which are not. A receipt is not liable to tax if it does not fall within the charging section of the *Income Tax Act 1967*, e.g. a capital receipt does not fall within the scope of the charging section.

An exempt receipt is one which falls within the scope of the charging section but is taken out of that scope by a specific provision in the Act. Such a receipt will not form part of the gross income of a person and is therefore excluded from the tax computation.

The term "exemption from tax" should be distinguished from "remission of tax". In the case of a remission of tax, a receipt which is liable to tax will form part of the gross income of a taxpayer but the income tax applicable to that receipt may be reduced or abated either in full or in part. Section 129(1) of the Act deals with the remission of tax. It is provided that the tax paid or payable by any person may be remitted wholly or in part:

(a) by the DG on the grounds of poverty; or
(b) by the Minister of Finance on the grounds of justice and equity.

Any tax that is remitted is not regarded as tax payable for the purposes of any other provisions of the Act. Where a person has paid any of the tax and is then granted a remission of such tax, a refund of the amount paid will be made [S. 129(2)].

9.1 SECTION 127

Section 127 of the Act is the principal section which deals with exemption of income from tax. Section 127(1) states that any income specified in Pt. 1 of Sch. 6 of the Act shall be exempt from tax. Prior to year of assessment 1988, Pt. II of Sch. 6 set out various institutions, persons, authorities or funds whose income was exempt from tax. This was, however, deleted with effect from year of assessment 1988. The Dewan Rakyat has the power to delete or to add any paragraph or item in Sch. 6.

Under S. 127(3), the Minister has the power to:

(a) exempt interest payable on any loan charged on the Consolidated Fund or on a State Consolidated Fund, either generally or with reference to persons of a particular class;
(b) exempt any class of persons from all or any of the provisions of the Act or in respect of specific types of income;
(c) declare any part of the armed forces to be a reserve force so as to enjoy an exemption under Para. 9 of Pt. 1 of Sch. 6; or
(d) amend the list of commodities specified under Para. 18 of Pt. 1 of Sch. 6 which qualifies for exemption in respect of income derived thereon by a non-resident from trading through consignees.

Section 127 (3A) grants the power to the Minister to exempt any person from all or any of the provision of the Act, either generally or in respect of any income of a particular kind or any class of income of a particular kind.

The above power of the Minister is exercised by way of statutory orders (or legislative notifications) which are published in the Government Gazette. As a procedural requirement

[under S. 127(4)], such statutory orders must be laid before the Dewan Rakyat. It should be noted that with the deletion of Pt. II of Sch. 6, any institution, authority, fund or person that wishes to obtain exemption would have to make a submission to the Minister and if deemed suitable, the Minister would grant the exemption by way of statutory order under S. 127(3).

In the case of *Ketua Pengarah Hasil Dalam Negeri v Perbadanan Kemajuan Ekonomi Negeri Johor* [(2003) MSTC 4059], the issues were:

- whether exempt income under S. 127 of the Act relates to gross income or chargeable income, and
- whether the IRB was entitled to apportion approved gifts/donations (under S. 44(6) of the Act) between exempt and taxable income.

The taxpayer was a statutory body involved in several activities. The taxpayer had been granted an exemption from tax pursuant to S. 127 of the Act on all its income except dividend income. During the years in question, the taxpayer made some approved donations, for which it sought a deduction against its taxable dividend income. The IRB however, restricted the deduction, by apportioning the donations against the other exempt income and the taxable dividend income. The taxpayer appealed on the basis that the donations should not be apportioned and should be fully deductible from the aggregate income of the entity. The High Court held that income under S. 127 refers to gross income. It also held that the IRB was not entitled to apportion the approved gifts/donations and that the full deduction should be allowed against the aggregate income.

The Court of Appeal [see (2009) MSTC 4399] reversed the decision and held that an exemption can only arise in respect of chargeable income and not gross income. Quite strangely, the Court also held that although not expressly provided for, the power to apportion expenses is implied in S. 33(1) of the Act, and therefore, it held that the IRB was not incorrect in apportioning the donations made against the exempt income and the dividend income. Reference was made to the previous decisions of *Lower Perak Co-operative Housing Society Bhd v KPHDN* [(1994) 2 MLJ 713 and the *Daya Leasing Sdn Bhd v KPHDN* [(2005) MSTC 4,124]. As such, this would now have to be applied in all relevant tax computations in determining the tax liability of a taxpayer in similar circumstances.

When the Act was first enacted in 1967, certain exemptions allowed under repealed law (such as the *Income Tax Ordinance 1956* of Sabah, *Inland Revenue Ordinance 1960* of Sarawak and the *Income Tax Ordinance 1947* applicable to West Malaysia) were deemed to continue under the transitional and saving provisions in Sch. 9 of the Act (even though changes were made to the provisions to withdraw the exemptions). This was the interpretation made by the then Supreme Court in *National Land Finance Co-operative Society Ltd v DGIR* [(1994) 1 MLJ 99] and the Court of Appeal in *Malaysian Co-operative Insurance Society Ltd v KPHDN* [(2000) MSTC 3792]. In general, the Courts held that the proviso withdrawing the exemption retrospectively was hazy instead of being stated clearly so as not to leave room for doubt as to its meaning. As there was a doubt, the ambiguity must be construed in favour of the taxpayer as the exemption had not been removed by sufficiently clear words to achieve that purpose. In a move to formally end these exemptions, S. 127A was introduced to stipulate that such exemptions shall cease with effect from year of assessment 2001. As such, this precludes continued reliance on exemptions granted before the enactment of the Act. Any person affected by this change would have to apply for a new exemption under S. 127.

With effect from year of assessment 2001, S. 129A was introduced to expand the Minister's powers so as to be able to provide for specific relief in relation to the treatment of expenses, losses and capital allowances in arriving at the chargeable income of a person. This would give the Minister the power to permit the transfer of tax losses or capital allowances to another entity (which is currently not provided for in the Act other than the limited group relief provisions) such as may be necessary in the context of the mergers in specific industries.

Any income which is exempt under S. 127 is disregarded for the purposes of the Act except with regard to S. 107A, S. 108 (this was deleted from year of assessment 2008 due to the single-tier system), S. 109 and S. 109B which deal with withholding tax (or deduction of tax) on contract payments, dividends, interest, royalties and S. 4A income. In such a case, any tax that may have been deducted from such income will be refunded under S. 111 (dealing with overpayment of tax).

Finally, it should be noted that the payment of dividend, interest, bonus, salary or wages, wholly or partly out of income exempt under S. 127 does not mean that the recipient of such payments will also be exempt from tax. For the recipient to be exempt, this must be specifically stated in a specific section in the Act, in the relevant paragraph of Sch. 6 or in a statutory order.

Besides the exemption of income under Sch. 6 or by way of statutory order, there are other specific provisions in the Act which grant exemptions. These include exemption of shipping profits, venture capital companies, unit trusts, etc.

9.2 EXEMPTIONS IN SCH. 6

As stated above, Pt. 1 of Sch. 6 sets out the types of income specifically exempt from tax. These are listed below.

9.2.1 Official Emoluments or Income

The official emoluments or official income of the following persons are exempt from tax:

(a) A Ruler or Ruling Chief as defined in S. 76 of the Act (Para. 1). These include:
- the Yang Di-Pertuan Agong;
- the Raja Permaisuri Agong;
- the Timbalan Yang Di-Pertuan Agong or other Ruler exercising the functions of the Yang Di-Pertuan Agong;
- a State Authority or any person exercising its functions;
- the Undang of Sungei Ujong, the Undang of Jelebu, the Undang of Johol, the Undang of Rembau or the Tunku Besar of Tampin.

(b) The Consort of a Ruler of a State having the title of Raja Perempuan, Sultanah, Raja Permaisuri, Tengku Ampuan, Tengku Permaisuri or Permaisuri. Where there are two or more consorts of a Ruler of a State having the above titles, the exemption is given only to the one recognised as the official Consort (Para. 1A).

(c) A former Ruler or Ruling Chief (excluding a former Governor or Yang di-Pertua Negara of a State) or a Consort of a former Ruler of a State previously having the title of Raja Perempuan, Sultanah, Raja Permaisuri, Tengku Ampuan, Tengku Permaisuri or Permaisuri (Para. 1B).

(d) A person exercising the functions of a State Authority in a temporary or acting capacity (Para. 2).

The exemption is only by reference to the official emoluments or income of the above persons. Any private income such as dividends, rents or interest is subject to tax.

9.2.2 Diplomatic and Consular Staff (Para. 3 and Para. 4)

Income is exempted by virtue of

- the *Diplomatic Privileges (Vienna Convention) Act 1966*;
- an order made under Pt. III of the *Diplomatic and Consular Privileges Ordinance 1957*;
- The *Foreign Representatives (Privileges and Immunities) Act 1967*.

The official emoluments of consular officers and consular employees (as defined in the *Diplomatic and Consular Privileges Ordinance 1957*) in the service of a country to which Pt. IV of that Ordinance applies, are exempt from income tax, to the extent provided by any consular convention between Malaysia and that country or, in the absence of a consular convention, to the extent that reciprocal treatment is accorded by that country to persons exercising corresponding functions in the service of Malaysia.

Therefore, only the persons employed by a foreign government and who are members of the Embassy or High Commission staff will be exempted. Malaysians engaged locally and employed by an Embassy or High Commission are not exempt and will be subject to Malaysian tax. Wives of diplomatic persons who work in Malaysia will also be liable to Malaysian tax unless the wives themselves are covered by diplomatic privilege.

9.2.3 Government, State Government and Local Authority (Para. 5 and Para. 6)

The income of the Government or a State Government or a local authority is exempt from tax.

9.2.4 Pensions

The following types of pension are exempt from tax:

(i) wound and disability pensions granted to armed forces personnel (including service in the armed forces of a Commonwealth country) and pensions granted to wives or dependent relatives of members of any of those forces killed on war service (Para. 7);

(ii) disability pensions granted in respect of war service injuries to members of civil defence organisations in any territory comprised in Malaysia on 1 January 1968 (Para. 8);

(iii) widows' and orphans' pensions provided under any written law or paid under an approved scheme to or for the benefit of the widow, widower (from year of assessment 2011), child or children of a deceased contributor to the scheme (Para. 16);

(iv) pensions derived from Malaysia by a person (prior to year of assessment 1999, the person had to be resident in Malaysia) on reaching retirement (Para. 30):
   (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, provided the retirement is effected under the following circumstances:

   (i) on reaching the age of 55; or
   (ii) on reaching the compulsory age of retirement from employment specified under any written law; or
   (iii) if the DG is satisfied that the retirement was due to ill-health.

   Where a person receives more than one pension, the exemption applies to only the higher or the highest pension paid;

(v) pension or gratuity derived from Malaysia and paid to a person resident in Malaysia under any written law applicable to the President, Deputy President or member of the Senate, the Speaker, Deputy Speaker or member of the House of Representatives, Speaker or member of the State Legislative Assembly. The exemption applies provided that the following conditions are fulfilled (Para. 30A):
   (a) the person has reached the age of 55 or if the DG is satisfied that the person ceased to hold the specified position due to ill-health; and
   (b) where the person is also eligible for exemption under Para. 30 (see (iv) above), the exemption is restricted to only one pension, being the higher or the highest one.

9.2.5 Bounty Payments (Para. 9)

Sums payable out of monies provided by Parliament by way of bounty to members of any of the following reserve forces are exempt from tax:

- Royal Malaysian Naval Volunteer Reserve;
- Malaysian Territorial Army;
- Royal Malaysian Air Force Volunteer Reserve.

9.2.6 Commonwealth Forces and Civil Servants (Para. 10)

The emoluments of any person who is a member of the armed forces of a Commonwealth country or in the service of the government of a Commonwealth country will be exempt from tax if the following conditions are satisfied:

(a) the person is in Malaysia performing his duties as a member of those forces or as a person in that service;

(b) the emoluments are payable out of the public funds of that Commonwealth country; and

(c) the emoluments are subject to tax in the Commonwealth country concerned.

Of course, it should be noted that the exemption only applies to emoluments attached to the individual's employment. It does not apply to any other income derived by him in Malaysia.

9.2.7 Co-operative Society (Para. 12)

Income of a co-operative society in respect of:

(a) a period of five years commencing from the date of registration of the co-operative society; and

(b) thereafter if the members' funds as at the first day of the basis period are less than RM750,000 (prior to year of assessment 1997, this was RM500,000), is exempt under Para. 12. Any dividend paid, credited or distributed to a member by a co-operative society is also exempt from tax (Para. 12A).

This exemption was effective from year of assessment 1977. Prior to this, a co-operative society was exempt from tax if it was registered and all of its transactions were restricted to its members or other registered co-operative societies.

9.2.8 Dividends (Para. 12B)

Any dividend paid, credited or distributed to any person where the company paying such dividend is not entitled to deduct tax under the Act is exempt from tax with effect from year of assessment 2008. In addition, any expenses incurred in relation to such dividend are disregarded for the purpose of the Act.

This paragraph has been introduced due to the introduction of the single-tier system of corporate taxation whereby there is no longer any requirement to deduct tax upon paying or distributing dividends. Of course there is a six-year transitional period for the switch over to the single-tier system.

9.2.9 Profits of a Limited Liability Partnership (Para. 12C)

Any profits paid, credited or distributed by a Limited Liability Partnership to its partners are exempted from tax.

9.2.10 Religious Institutions and Charities (Para. 13)

The income (other than dividend income) of:

(a) an institution or organisation approved under S. 44(6) so long as the approval remains in force; or

(b) a religious institution or organisation which is not operated or conducted primarily for profit and which is established in Malaysia exclusively for the purposes of religious worship or the advancement of religion;

is exempt from tax.

It should be noted that a religious institution or organisation (as stated in (b) above) does not need to be approved by the DG.

The income (other than dividend income) of a charitable institution, trust body of any trust or body of persons is exempt from tax if that institution, trust body or body of persons is established in Malaysia for charitable purposes only and is approved by the DG. Further, the institution, trust body or body of persons must apply its income (whether exempt or otherwise) solely for its charitable purposes within Malaysia. Such amount applied in a year of assessment must not be less than a specified percentage (as permitted by the DG) of the income for the basis period for that year of assessment. This and other conditions are stipulated when the DG grants approval under S. 44(6).

The exemption is normally not extended to income derived from a business carried on by a charitable institution, trust body or body of persons unless the business or work is carried on:

(a) in the course of carrying out a primary purpose of the institution, trust body, body of persons or organisation; or

(b) mainly by persons for whose benefit the institution, trust body, body of persons or organisation was established.

With effect from 1 January 2014, the term "other than dividend income" will be removed due to the introduction of the single-tier system wherein dividends would no longer be taxable on recipients. This is due to the transitional provisions during the six-year transitional period (to 31 December 2013) for the shift from the imputation system to the single-tier system.

9.2.11 Death Gratuities and Injury Compensation (Para. 14)

Sums received by way of death gratuities or as consolidated compensation for death or injuries are exempt from tax.

9.2.12 Compensation for Loss of Employment and Restrictive Covenants (Para. 15)

This exemption (in whole or in part) is extended to compensation for loss of employment, and any sum received in consideration of a covenant entered into by the employee restricting his right to take up other employment of a similar nature.

In the case of compensation for loss of employment, full exemption is given if the DG is satisfied that the payment is made on account of ill-health. Otherwise, the exemption is restricted to an amount of RM10,000 for payments made to individuals who have ceased employment on or after 1 July 2008 (RM6,000 from year of assessment 2003 and prior to this, it was RM4,000), for each completed year of service the person has served with the same employer or with companies in the same group. The DG may regard the period of employment with the same employer as including employment by different employers where the control and management of the business remains substantially with the same person or persons or where the businesses of the different employers are conducted by or through a central agency.

The exemption does not apply to payments by a controlled company to a director who is not a full-time service director. This is intended to prevent abuse of the exemption. With effect from year of assessment 2007, the term "compensation for loss of employment" is defined to include any payments received by an employee from an employer pursuant to a separation scheme where employees are given an option for an early termination of an employment contract provided that such separation schemes do not expressly or impliedly provide for the employee to be reemployed by the same employer or any other employer.

Retrenchment benefits thus qualify for the partial exemption of RM10,000 per completed year of service. In order to qualify as compensation for loss of employment, the payment must be compensatory in nature, i.e. it must result from the action of the employer. Thus, payments made on a voluntary retrenchment exercise would not qualify for the exemption (except as stated above). Further, payments made to an employee retrenched at or after retirement age would not be classified as compensation for loss of employment. The employee must be eligible to be re-employed or have an expectation of being re-employed.

9.2.13 Trade Unions (Para. 17)

The income (other than dividend income) of a trade union is exempt from tax provided:

- it is registered under any written law relating to trade unions;
- the income does not consist of gains or profits from a business carried on by the trade union.

With effect from 1 January 2014, the dividend income derived by registered trade unions is exempted from income tax under the single-tier system.

9.2.14 Commodity Traders (Para. 18)

The income derived by a non-resident person from trading in Malaysia through consignees in Malaysia in specified commodities produced outside Malaysia is exempt from tax. The specified commodities are rubber, copra, pepper, tin, tin ore, gambier, sago flour or cloves.

9.2.15 Interest on Savings Certificates, Securities or Bonds (Para. 19, Para. 33A, Para. 33B, Para. 34A, Para. 35 and Para. 35A)

The following types of interest income are exempt from tax:

(a) interest paid or credited to any person in respect of any savings certificates issued by the Government (Para. 19),

(b) interest income (paid or credited to any individual) from investment in Merdeka Bonds issued by the Central Bank of Malaysia (Para. 34A with effect from year of assessment 2004). This is in line with the Government's effort to help senior citizens and uniformed personnel on mandatory retirement to receive higher returns on their investment,

(c) interest or discount paid or credited to any individual in respect of securities or bonds issued by the Government [Para. 35(a)] or guaranteed by the Government (from year of assessment 2003),

(d) interest or discount paid or credited to any individual in respect of debentures, other than convertible loan stock, issued by public companies listed on the Kuala Lumpur Stock Exchange (Para. 35(b) with effect from year of assessment 1992). This was amended and from year of assessment 2003 refers to debentures (other than convertible loan stock) approved by the Securities Commission, and from year of assessment 2010, the term "or Islamic securities" was inserted after "debentures",

(e) interest paid or credited to any individual in respect of bonds (other than convertible loan stock) issued by a company rated by Rating Agency Malaysia Berhad (Para. 35(c) with effect from year of assessment 1993) or Malaysian Rating Corporation Berhad (with effect from year of assessment 1997) which are independent credit rating agencies. This was deleted with effect from year of assessment 2003, or

(f) interest paid or credited to any individual in respect of Malaysian Savings Bonds (Bon Simpanan Malaysia) issued by the Central Bank of Malaysia (Para. 35(d) with effect from 16 February 1993).

With effect from year of assessment 1996, the exemptions in (c), (d) and (f) above were extended to any unit trust and listed closed-end fund. With effect from year of assessment 2006, tax exemption has been extended to discount income received on the above-mentioned securities and debentures.

The exemption of interest for non-resident individuals as well as unit trusts and closed-end funds should attract capital inflow into Malaysia's bond market and develop the domestic capital market. With effect from 11 September 2004, tax exemption is also available on interest income derived by a non-resident company (other than such interest accruing to a place of business in Malaysia of such company) from the following:

(i) ringgit-denominated Islamic securities and debentures, other than convertible loan stocks, approved by the Securities Commission;

(ii) securities issued by the Government of Malaysia (Para. 33A).

This aims to expand the domestic bond market and diversify alternative sources of financing. This together with the permission given to supranational agencies such as the World Bank, International Finance Corporation and Asian Development Bank, as well as foreign multinationals, to issue ringgit-denominated bonds, etc. are meant to assist Malaysia in becoming a regional financial centre.

Under Para. 33B introduced with effect from year of assessment 2008, interest paid or credited to any person in respect of Islamic securities originating from Malaysia, other than convertible loan stock, issued in any currency other than Ringgit and approved by the Securities Commission or the Labuan Financial Services Authority (added in with effect from year of assessment 2010), is exempted from tax.

With effect from year of assessment 1999, interest income of a unit trust (derived from Malaysia and paid/credited by any bank or financial institution licensed under the *Banking and Financial Institutions Act 1989* or the *Islamic Banking Act 1983*) is exempt from tax (Para. 35A). This change is intended to further enhance the development of unit trusts as a collective investment vehicle. With effect from the year of assessment 2015, this exemption will also include interest from any development financial institution regulated under the Development Financial Institutions Act 2012.

Upon coming into operation of the Finance Act 2015, the term 'Islamic securities' in the provisions above (Para. 33A,33B and 35) is substituted with the term 'sukuk'. Also, the phrase 'approved by Securities Commission' is substituted with the phrase 'approved or authorised by, or lodged with, the Securities Commission'.

9.2.16 Approved Scheme (Para. 20) and Deferred Annuity (Para. 20A)

The income of any approved scheme is exempt from tax. This exemption applies to pension and provident funds set up by various organisations for their staff. The approval would be given by the DG and it is normally a requirement that the scheme must invest its funds in specific types of investments.

With effect from the year of assessment 2012, such tax exemption on income earned by retirement scheme funds is extended to deferred annuity schemes established in accordance with the Retirement Savings Standards approved by Bank Negara Malaysia by the life insurer or *takaful* companies. The annuity funds have to be maintained separately from the life funds or *takaful* family funds. This is aimed at encouraging individuals to invest more in annuity schemes for retirement purposes. This amendment is stipulated in Paragraph 20A to Schedule 6 of the Act.

An amendment to Paragraph 20A (from year of assessment 2015) adds the following "and any adjusted loss from the investment in respect of the deferred annuity shall be disregarded for the purposes of the Act". This is to avoid a situation in which the deferred annuity income is tax exempt, but the loss can be deducted (offset) from statutory income of the life insurance fund/family takaful which are taxable.

9.2.17 Short-term Employees (Para. 21 and Para. 22)

The employment income of a non-resident individual is exempt from tax if the employment is exercised in Malaysia:

- for a period or periods not exceeding 60 days in a basis year;
- for a continuous period (not exceeding 60 days) which overlaps two successive basis years;
- for a continuous period (not exceeding 60 days) which overlaps two successive basis years and for a period or periods which together with that continuous period do not exceed 60 days.

The 60-day rule only refers to the number of days during which the individual exercises his employment. It does not include the number of days he is on vacation in Malaysia.

The exemption does not apply if employment income is derived from Malaysia for a period or periods which amount to more than 60 days in the relevant basis year or basis years. It also does not apply to the income of any public entertainer unless he is paid out of the public funds of the government of a foreign country. A public entertainer includes any professional entertainer, artiste, sports person or other individual who entertains whether in public or private for profit on stage, radio or television, at a stadium or sports ground.

9.2.18 Education Allowances (Para. 23)

Education allowances paid to designated officers under the following Agreements do not attract tax:

- Overseas Service (North Borneo) Agreement 1961;
- Overseas Service (Sarawak) Agreement 1961.

9.2.19 Scholarships (Para. 24)

Any sums paid by way or in the nature of a scholarship or other similar grant or allowance to an individual are exempt from tax. It is irrelevant whether or not the amount is received in connection with the recipient's employment.

9.2.20 Gratuities

Gratuities paid on retirement from an employment are exempt from tax in the following circumstances:

(i) Where;
  (a) the DG is satisfied that the retirement was due to ill-health;
  (b) the retirement takes place on or after the age of 55 or on reaching the compulsory age of retirement (under any written law) provided that in both cases the employment has lasted ten years with the same employer or with companies in the same group; or
  (c) the retirement takes place on reaching the compulsory age of retirement pursuant to a contract of employment or collective agreement at the age of 50 but before 55 and that employment has lasted ten years with the same employer or with companies in the same group. This part was effective from 11 September 2004 and from that date to year of assessment 2007, the exemption was limited to RM6,000 for each completed year of service. After year of assessment 2007, this limit has been removed and the amount received is fully exempt.

The DG may regard the period of employment with the same employer as including employment by different employers provided that the control and management of the business remains substantially with the same person or persons or the businesses of these different employers are conducted by or through a central agency (Para. 25).

(ii) Where the gratuity is paid out of public funds on retirement from an employment under any written law (Para. 25A). Further, with effect from year of assessment 1993, sums received by way of payment in lieu of leave paid out of public funds on retirement are also exempt from tax.

Where the gratuity is paid out of public funds on termination of a contract of employment (less the employer's contribution to the Employees Provident Fund, if any, and interest thereon), the gratuity is also exempt from tax (Para. 25B).

From the year of assessment 2016, an exemption of RM1,000 per completed year of service applies to gratuity on retirement which is not covered in the provisions stated above. This exemption essentially applies to those who opt for early retirement or termination of contract of employment (Para. 25D).

9.2.21 Perquisites in the Form of Awards (Para. 25C)

From year of assessment 2007, a perquisite consisting of long service, past achievement, service excellence, innovation or productivity (included in 2008) award (whether in money or otherwise) provided to an employee pursuant to his employment is exempt from tax up to a maximum amount or value of RM2,000 (prior to 2008 it was RM1,000) for each employee for a year of assessment. The exemption in respect of long service award applies only after the employee has exercised an employment for more than 10 years with the same employer.

9.2.22 National or State Amateur Sports Organisation (Para. 26)

The income of any national or state amateur sports organisation certified to be affiliated to the Olympic Council of Malaysia is exempt from tax. The affiliation must be certified by the President or Secretary of the Council. This exemption does not apply to dividend income with effect from the year of assessment 1987.

With effect from 1 January 2014, the dividend income derived by National/State amateur sports organisations is exempted from income tax. This is due to the introduction of the single-tier system of corporate tax which replaces the imputation system over a six-year period.

9.2.23 Interest on Approved Loan (Para. 27)

Interest income derived from Malaysia on an approved loan by a person not resident in Malaysia is exempt from tax. Thus, such interest is not subject to withholding tax under S. 109. Approved loan status is mainly granted to government-related borrowings. The loan must be specifically approved by the Minister of Finance as an approved loan pursuant to S. 2 of the Act. The following loans are eligible to qualify as approved loans:

(a) loan or credit made to the Government, State Government, local authority or statutory body;
(b) loan or credit made to any person where the loan or credit is guaranteed by the Government or State Government; and

CHAPTER 15

REAL PROPERTY GAINS TAX

15.0 INTRODUCTION

With the main objectives of curbing speculation in land and in order to check the spiralling prices of land and houses in Malaysia, a Land Speculation Tax was introduced with effect from 6 December 1973. The legislation was entitled *Land Speculation Tax Act 1974* and its administration was carried out by the then Inland Revenue Department. This Act was operative from 6 December 1973 to 6 November 1975. Thereafter, it was replaced by the *Real Property Gains Tax Act 1976* (RPGT Act) with effect from 7 November 1975.

Whilst the *Land Speculation Tax Act* covered only short-term gains derived from disposal of land, the RPGT Act covers both short- and long-term gains. Whilst the Land Speculation Tax was charged at a single rate of fifty per cent on certain gains arising on a disposal made within two years after acquisition, the real property gains tax (RPGT) is generally charged at graduated rates in a descending order according to the holding period of the real property.

The RPGT is a form of capital gains tax which is imposed on the disposal of an interest in real property in Malaysia. The acquisition and sale of real property can be construed as a trade or a business and be subject to income tax (see Chapter 6 on the discussion of characteristics of trade or business, i.e. badges of trade). However, if the transaction is not considered to be a business for income tax purposes, then RPGT would be applicable. This approach is clearly spelt out in the case of *MR Properties Sdn Bhd v KPHDN* [(2005) MSTC 4119] where the High Court stated that RPGT was only levied in a situation where the *Income Tax Act* was not applicable and as such, there is no possibility of an overlap between the two types of taxes.

All the Assessment Branches of the IRB are involved in the enforcement of the RPGT Act. In terms of contribution to national tax revenue, the amount of real property gains tax collected is negligible. However, this does not contradict with the main objective of the Act, that is, it is not so much a source of revenue but a means to deter unhealthy speculation in the real property market.

Under the *Real Property Gains Tax (Exemption) (No. 2) Order 2007*, the Government granted an exemption to any person in respect of any disposal of a chargeable asset after 31 March 2007. This was a move to stimulate the property sector and it was expected that the exemption would be removed when conditions are appropriate. *The Real Property Gains Tax (Exemption) Order 2009* revoked the *earlier Real Property Gains Tax (Exemption) (No.2) Order 2007* which meant that real property transactions (including those involving shares in real property companies) were now subject to RPGT. This order (which was effective from 1 January 2010) essentially provided for an effective rate of 5% to be applied on chargeable gains. The *Real Property Gains Tax (Exemption) (No. 2) Order 2009* which took effect from 1 January 2010 replaced the order above. It is basically the same as the revoked order except that it also provides for the exemption of RPGT in respect of a chargeable asset which is disposed of after five years from its date of acquisition.

The *Real Property Gains Tax (Exemption) (No. 2) Order 2009* was then revoked by the *Real Property Gains Tax (Exemption) Order 2011* wherein effectively the RPGT rate was increased to 10% for disposals within two years and 5% for disposals after a two year period but not exceeding five years for any disposal of a chargeable asset on or after 1 January 2012. Disposals after five years from the date of acquisition continue to be exempt from RPGT.

As a measure to further curb real estate speculation activities, the rate of tax was further increased for the disposal of a chargeable asset (i.e. real property and shares in real property companies) from 1 January 2013 to 15% and 10% for the categories stated above. Disposals made after a five year holding period continue to be exempt. This represents a gradual increase in the effective tax rate on disposals though it has not yet reached the original top rate of 30% as yet. The previous *Real Property Gains Tax (Exemption) Order 2011* has been revoked by the *Real Property Gains Tax (Exemption) Order 2012*.

With effect from 1 January 2014, the 2012 exemption order was revoked and the rates in the RPGT Act were amended such that the top tax rate of 30% applies to disposals by companies within 3 years of the date of acquisition of a chargeable asset followed by a 20% rate (in the fourth year), 15% (in the fifth year) and 5% for disposals in the sixth year onwards. For individuals (citizens or permanent residents), the rates are the same except that the rate is nil for disposals in the sixth year onwards. For non-citizens, the rate is 30% except for disposals in the sixth year from the date of acquisition where the rate will be 5%.

15.1 CHARGEABILITY

RPGT is chargeable on capital gains made on the disposal of real property (referred to as chargeable asset). The charging section under the RPGT Act is S. 3 and it provides that the RPGT is charged on a chargeable gain accruing on the disposal of any chargeable asset by a chargeable person in a year of assessment.

15.1.1 Chargeable Asset

The term "real property" is defined in S. 2 to mean any land situated in Malaysia and any interest, option or other right in or over such land. Land is defined in S. 2 of the Act to mean:

(a) the surface of the earth and all substances forming that surface;
(b) the earth below the surface and substances therein;
(c) building on land and anything attached to land or permanently fastened to anything attached to land (whether on or below the surface);
(d) standing timber, trees, crops and other vegetation growing on land; and
(e) land covered by water.

A person may not be owning a piece of land directly and various people may have rights of ownership in respect of the same land. Each of these rights is a separate asset for real property gains tax purposes. Further, a right to acquire land is itself an asset. Similarly, the benefit of a contract to purchase and the benefit of an option are assets which are capable of attracting liability to the tax. In fact, the Act has made it very clear by defining "asset" and "option" as follows:

"asset" includes an interest or right in or over an asset;

"option" includes an option in a case where:

(a) the grantor binds himself to sell what he does not own and, because the option is abandoned, never has occasion to own; and
(b) the grantor binds himself to buy what, because the option is abandoned, he does not acquire.

The basic rule is that real property gains tax is payable on any net increase in the value of a chargeable asset between the time of its acquisition and the time of its disposal. The word "acquire" is defined in S. 2 to include:

"acquire by way of purchase, grant, exchange, gift, settlement or otherwise".

The definition for "acquire" is inclusionary and not definitive.

By contrast, the word "dispose" is definitive and it is defined in S. 2 as:

"dispose" means sell, convey, transfer, assign, settle or alienate whether by agreement or by force of law.

However, both the definitions are sufficiently wide for practical application and it even extends over the creation and transmission of equitable interest. It is also significant to note that a person is said to have effected a disposal even if property is transferred against his will or without his control e.g. compulsory acquisition, or devolution of interest upon succession of title.

In *KPHDN v The Pataling Ruber Estates Ltd* [(2011) MSTC ¶30-031], the sale and purchase of land was aborted, but reflected in the purchaser's audited accounts. The High Court held that the disposal was not complete since the word 'disposal' in S. 3(1) of the RPGT Act means transfer of ownership. Entries in the accounts are not conclusive and cannot override principles of law. Thus, RPGT only arises when there is a disposal of real property. There is no disposal without transfer of ownership.

In the case of *Mudek Sdn Bhd v Kerajaan Malaysia* [(2014) MSTC ¶30-071], Mudek Sdn Bhd (the appellant) entered into a Sale and Purchase Agreement with Yeng Chong Realty Sdn Bhd (Purchaser). However, the appellant alleged that the Purchaser had not fulfilled the condition of sale and the appellant had filed 2 suits in the High Court for default in payment of the purchase price.

The High Court had allowed the Government of Malaysia to enter summary judgment in respect of the claim for debt arising from a chargeable gain pursuant to the RPGT Act. The main issue raised by the appellant was that there was no chargeable gain as stated in S. 3 of the RPGT Act, and the property has not been disposed of. The essence of the appellant's argument was that because of non-payment, the property had not been disposed of yet within the meaning of S. 2 of the RPGT Act, so that no chargeable gain had arisen upon which the respondent (Kerajaan Malaysia) could raise an assessment in accordance with S. 3 of the Act.

An appeal was made to the Court of Appeal which allowed the appeal and held that the RPGT Act is only triggered if there is a disposal within the meaning of S. 3 of the Act. Paragraphs 15 and 16 of Schedule 2 of the RPGT Act in relation to S. 7 (chargeable gains and allowable losses) further fortifies the argument that there must be complete disposal or receipt of the purchase price before liability can be attached. The Court thus held that the appellant had succeeded in raising a triable issue and the matter should be returned to the High Court for a full trial.

"Company" means 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.

"Body of persons" means an unincorporated body of persons (not being a company) including a Hindu Joint family but excluding a partnership. The definition of "partnership" is "an association of any kind (including joint adventures, syndicates and cases where a party to the association is itself a partnership) between parties who have agreed to combine any of their rights, powers, property, labour or skill for the purpose of carrying on a business and sharing the profits therefrom, but excludes a Hindu joint family although such a family may be a partner in a partnership". This definition is basically similar to that found in S. 2 of the *Income Tax Act 1967*. One other special feature of the RPGT Act [S. 2(3)] is that the acquisition or disposal of a building includes the acquisition or disposal of the land on which the building stands (unless the context otherwise requires).

Ang Lay Kim @ Ang Imm v Pengarah Lembaga Hasil Dalam Negeri Malaysia Johor Bahru [(2009) MSTC 4436] involved the disposal of property by a trustee (who was also a co-owner of the property), who at the time of disposal was no longer a Malaysian citizen. In this case, the plaintiff and his sisters inherited a portion of a property from their late mother. The plaintiff held the portion of land belonging to his sisters as trustee. Several years later, the plaintiff sold the property and distributed the gains derived evenly between himself and his sisters. The IRB subjected the gain to RPGT at the rate of 30% on the basis that the plaintiff, as trustee, was not a Malaysian citizen.

The plaintiff contended that inherited property should not be subject to RPGT on its disposal, and that the rate of RPGT used was not appropriate. It was held by the High Court that the disposal was subject to RPGT. The fact that the property was inherited still fell within an 'acquisition' for RPGT purposes. Further, as a trustee, the plaintiff was a chargeable person and on the basis that he was a non-citizen at the time of disposal, the appropriate rate of RPGT was 30%.

15.1.2 Chargeable Gains

RPGT is to be charged in respect of chargeable gains accruing on the disposal of any real property (referred to as chargeable asset).

The tax is to be charged on every ringgit of the total amount of chargeable gains accruing to a chargeable person in a year of assessment in respect of each category of disposal of chargeable assets in accordance with the tax rates specified in Sch. 5.

This means that the chargeable gains accruing on each disposal of a chargeable asset is to be determined, and then tax is computed according to the appropriate rates listed in Sch. 5. For example, if there are ten disposals of chargeable assets, then there will be ten separate computations of chargeable gains and tax payable. The total amount of tax assessed on all chargeable gains in respect of all categories of disposal made in a year of assessment is called "total tax assessed". At this stage, allowable losses were not taken into account yet. From 1 January 2010, an allowable loss arising from the disposal of chargeable assets is set-off against chargeable gains from subsequent disposals. Any unutilised allowable loss can be carried forward for offset against future chargeable gain until it is fully utilised.

Section 7 provides that a chargeable gain arises on the disposal of a chargeable asset when the disposal price exceeds the acquisition price. Where the disposal price is less than the acquisition price, there is an allowable loss and when the disposal price and the acquisition price are equal, there is neither a chargeable gain nor an allowable loss.

Chargeable gain	=	disposal price – acquisition price if disposal price > acquisition price
Allowable loss	=	acquisition price – disposal price if disposal price < acquisition price

Any gain which is chargeable or exempted from income tax is excluded from the scope of the RPGT Act by virtue of the definition of the term "gain" in S. 2. In the case of a unit trust, a gain refers to that which is not treated as income under the income tax law. It follows therefore that RPGT and income tax are mutually exclusive. Housing developers whose business profits are chargeable to income tax are therefore outside the scope of real property gains tax except if property is held as a fixed asset to generate income.

With regard to the time of accrual of a chargeable gain, Para. 14 of Sch. 2 specifies that the chargeable gain or allowable loss is deemed to accrue to or suffered by the disposer at the time of disposal whether the consideration is payable by instalments or not.

In the case of *AT Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* [(2004) MSTC 3515], the company purchased 1,453 acres of agricultural land on 29 April 1979. The land was subdivided into several lots for housing and commercial purposes. It was classified as fixed assets and kept separate from trading land. A portion of the said subdivided land was sold in 1980. In 1984, the taxpayer suffered financial distress and by October 1987 had ceased construction activities. Subsequently, the subject lots were rezoned to industrial land and petrol station to enhance their value. From 1991 to 1994, there were 14 transactions involving these rezoned lands.

The IRB raised assessments on 15 November 1997 on the disposal of lots under the RPGT Act for the years 1991, 1993 and 1994 and subsequently on 17 August 1998, it issued assessments under the *Income Tax Act* for the years 1995 and 1996 on the disposal of the same lots. On 26 June 1999, the IRB unilaterally issued reduced RPGT assessments for the years of assessment 1991 and 1993. The issues before the Special Commissioners were:

(a) Whether the gains were subject to income tax under S. 4(a) of the *Income Tax Act* or to RPGT.
(b) Whether the IRB had power under the RPGT Act to unilaterally issue reduced assessments in respect of assessments raised.
(c) Whether the IRB can maintain two assessments.

It was held that gains from the disposal of the lots were subject to income tax. Considering the intention at the time of acquisition of the said lots, the only inference that could be drawn was that of "an adventure in the nature of trade". The manner in which accounts are kept is admissible to show intention, but must be weighed against other available evidence to decide the nature of the transaction.

The taxpayer contended that a forced sale vitiated the intention to trade. It was rejected on the basis that the sale was not occasioned by sudden emergency or unanticipated need for funds as the lots were sold in 1993 and 1994, a lapse of almost 10 years from the onset of the financial distress.

On the second and third issue, the Special Commissioners felt bound by the High Court decision in the case of *Teruntum Theatre Sdn Bhd v KPHDN*.

The findings were:

(a) if gains are found to be income in nature as opposed to capital in nature, then RPGT cannot be chargeable and the IRB has the power to review or revise an assessment in such a case. Section 20 of the RPGT Act is relevant only for purposes of the RPGT Act only. Hence if any assessment under the RPGT Act is a nullity, there is no prohibition against the IRB issuing the subsequent assessments under the Act;

(b) the IRB has power to review and revise a RPGT assessment which includes vacating or discharging an assessment on the grounds that no RPGT is payable on the gains. Where such an assessment was made and subsequently it was discovered that there was no chargeable gain within the meaning of the RPGT Act, the IRB must discharge the assessment;

(c) there was no question of double taxation as the IRB had informed the taxpayer that the RPGT assessment would be amended and the amount of tax paid would be transferred to the taxpayer's account.

The taxpayer has appealed to the High Court.

15.1.3 Chargeable Persons

Section 6 provides that every person whether or not resident in Malaysia for a year of assessment shall be chargeable with RPGT in respect of a chargeable gain accruing to him in that year on the disposal of any chargeable asset. Person includes an individual, a company, a partnership, a body of persons and a corporation sole. A limited liability partnership (LLP) is included as a chargeable person for RPGT purposes under S. 2 under the 2013 Budget. Hence, disposal of a chargeable asset by a LLP will be subject to RPGT. The effective date of this amendment is the date on which the *Limited Liability Partnerships Act 2012* comes into operation.

Schedule 1 of the RPGT Act lays down the various categories of chargeable persons and their responsibilities in respect of the chargeability to RPGT.

(a) Body of persons and partnerships
A body of persons or a partnership is chargeable to RPGT as a separate entity. The precedent partner or the manager, the secretary or treasurer, as the case may be, is assessable and chargeable with the RPGT payable by the partnership or body of persons.

(b) Co-proprietorship
A disposal by one of the co-proprietors of his share of the chargeable asset is deemed to be part disposal of an asset by him alone and only he is assessable and chargeable to RPGT on the chargeable gain resulting from such disposal.

(c) Incapacitated persons
A receiver and a trustee, guardian, curator or committee having the direction, control or management of any property on behalf of an incapacitated person is assessable and chargeable with RPGT.

(d) Non-residents
A person who is absent from Malaysia is assessable and chargeable to RPGT either directly or in the name of his attorney, factor, agent, receiver or manager in Malaysia.

(e) Rulers and ruling chief
Any person nominated by a Ruler or Ruling Chief as the person executing the functions of administrator of the private property of the Ruler or Ruling Chief is assessable and chargeable to RPGT on behalf of the Ruler or Ruling Chief.

(f) Companies
The manager or other principal officer in Malaysia, the directors or the secretary of a company are jointly and severally assessable and chargeable to the RPGT payable by the company.

(g) Hindu Joint Family
The manager or *karta* of a Hindu Joint Family is assessable or chargeable with the tax in respect of any chargeable gains accruing to the family.

(h) Estate of a deceased person/Trust
The executor of the deceased person's estate is assessable and chargeable with RPGT in respect of any chargeable gain accruing on the disposal by the executor of any chargeable asset of the estate. The same applies to the trustee of a trust. Where there is more than one executor or trustee, they shall be jointly and severally liable for the tax.

(i) Limited Liability Partnership (LLP)
The compliance officer (who is appointed amongst the partners of a LLP) of a LLP shall be jointly and severally assessable and chargeable with the tax payable by the LLP. This took effect upon the coming into operation of the *Finance Act 2013*.

Under the 2013 Budget, directors are made jointly and severally liable for any unpaid RPGT which is liable to be paid by the company during the tenure of their appointment. The said liability only applies to a director who is concerned with the management of the company's business and is, either on his own, or with his associates, the owner of, or is able to control (directly or indirectly) more than 50% of the ordinary share capital of the company. This took effect upon the coming into operation of the *Finance Act 2013* and are aimed at easing the financial responsibility on officers who do not have any controlling interest in the company.

Section 14(4) of the RPGT Act was amended so as to allow the Director General to make assessments on the executor provided that these are not made more than three years after the end of the year of assessment in which the Director General is informed in writing by the executor (via a prescribed form) of the death of the chargeable person. This administrative amendment is meant to allow more time within which the person can be assessed. This amendment took effect upon the coming into operation of the *Finance (No. 2) Act 2010*. Pursuant to the amendment of S.74(3) of the *Income Tax Act 1967* and S.14(4) of the RPGT Act, as introduced by the *Finance Act 2011*, the IRB issued a prescribed Form CP57 (Notification of the Demise of Taxpayer). With effect from 27 January 2011, assessments and additional assessments must be issued by the IRB within three years after the end of the year of assessment in which the Director General of Inland Revenue is informed in writing by the executor of the death of a taxpayer using the Form CP57. The Form is to be submitted to the IRB Branch where the taxpayer's income tax returns are filed.

Section 16 of the RPGT Act provides that under the following circumstances, an assessment may be made on the acquirer instead of on the disposer:

(a) where the consideration on the disposal of a chargeable asset consists of another asset (whether chargeable or not); or

(b) there is a failure by both the disposer and the acquirer to submit a return to the DG on the disposal of a chargeable asset; or
(c) where the consideration on the disposal of a chargeable asset is, for the purposes of the RPGT Act, deemed to be the market value of the asset.

The amount of RPGT to be assessed is equal to the amount of RPGT payable by the disposer. A sum equal to 10% of the RPGT payable is also imposed in the case of (b) above and this is deemed to be an increase in tax [S. 21(4)]. However, the acquirer is entitled to recover (as a debt due to him) from the disposer the amount of any payment made under such an assessment and the DG is required to furnish a certificate specifying the amount paid.

15.1.4 Year of Assessment

A chargeable person is assessed for a year of assessment in respect of the chargeable gains in that year. A year of assessment is a calendar year commencing on the first day of January and ending on the last day of December. Since the *Real Property Gains Tax Act* came into effect only on 7 November 1975, the first year of assessment under the Act was the period beginning on 7 November 1975 and ending on 31 December 1976 and thereafter the year of assessment is the calendar year. As such, the year of assessment 2016 is the period from 1 January 2016 to 31 December 2016.

15.2 RATES OF TAX

RPGT is chargeable on the total amount of chargeable gains accruing to a chargeable person in respect of each category of disposal of chargeable asset. It is levied at a graduated rate depending upon the length of time a chargeable asset is held prior to its disposal. The rates of tax are set out in Sch. 5 of the RPGT Act.

In the case where the disposer is a company, the following rates apply (with effect from 27 October 1995):

Category of disposal	Rate of tax
Disposal within two years after the date of acquisition of the chargeable asset	30%
Disposal in the third year after the date of acquisition of the chargeable asset	20%
Disposal in the fourth year after the date of acquisition of the chargeable asset	15%
Disposal in the fifth year after the date of acquisition of the chargeable asset or thereafter	5%

Where the disposer is any other person, the following rates shall apply (with effect from 27 October 1995):

Category of disposal	Rate of tax
Disposal within two years after the date of acquisition of the chargeable asset	30%
Disposal in the third year after the date of acquisition of the chargeable asset	20%

Disposal in the fourth year after the date of acquisition of the chargeable asset	15%
Disposal in the fifth year after the date of acquisition of the chargeable asset	5%
Disposal in the sixth year after the date of acquisition of the chargeable asset or thereafter	Nil

An individual who is not a citizen and not a permanent resident is subject to a rate of tax of 30% on every ringgit of chargeable gain on the disposal of a chargeable asset acquired by him. This only applies to a disposal made after 27 October 1995. From 17 October 1997, a disposal by such an individual after five years will be subject to a rate of tax of 5% instead of 30%.

With effect from 1 January 2010, the rate was fixed at 5% regardless of the holding period of the chargeable assets. This was subsequently reviewed so that all chargeable assets held for more than five years would not be subject to RPGT. This applied to all chargeable persons and to all chargeable assets including shares in a real property company. The *Finance Act 2010*, however, did not amend the tax rates which ranged from nil to 30%. Instead an exemption order was issued to apply a formula so that a portion of the chargeable gain would be exempt from RPGT and the balance would be subject to the normal RPGT rates.

The *Real Property Gains Tax (Exemption) Order 2009* (which was effective from 1 January 2010) essentially provided for an effective rate of 5% to be applied on chargeable gains. A formula is used to arrive at the portion of the chargeable gain which is exempt from tax:

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

A = Chargeable gain x applicable tax rate* – (Chargeable gain × 5%)
B = Chargeable gain x applicable tax rate*
C = Chargeable gain
(*based on period of ownership of the asset as per Sch. 5, RPGT Act 1976)

Example:
Company A disposes of a piece of land on 1 February 2010 which was acquired on 1 July 2008. The land was acquired for RM1 million and is disposed of for RM1.4 million. The computation would be as follows:

	RM
Disposal proceeds	1,400,000
Acquisition cost	1,000,000
Chargeable gain	400,000
Exempt portion: $\frac{(400{,}000 \times 30\%^*) - (400{,}000 \times 5\%)}{(400{,}000 \times 30\%^*)} \times 400{,}000$	(333,333)
Chargeable gain subject to RPGT	66,667
RPGT Payable: 66,667 × 30%	20,000

The RPGT payable of RM20,000 would also be arrived at by multiplying the RM400,000 gain by 5%.

*[*30% being the applicable tax rate for a disposal within 2 years]*

The *Real Property Gains Tax (Exemption) (No. 2) Order 2009* which took effect from 1 January 2010 replaced the order above. It was basically the same as the revoked order except that it also provided for the exemption of RPGT in respect of a chargeable asset which is disposed of after five years from its date of acquisition.

For disposal of properties commencing from 1 January 2012, the RPGT rates on the gains from the disposal of real property were reviewed as follows:

Holding period	Tax Rates		
	Companies	Individual (Citizen & Permanent Resident)	Individual (Non-citizen)
Up to 2 years	10%	10%	10%
Exceeding 2 until 5 years	5%	5%	5%
Exceeding 5 years	0%	0%	0%

The *Real Property Gains Tax (Exemption) (No 2) Order 2009* was revoked by the *Real Property Gains Tax (Exemption) Order 2011*. The formula specified is similar to what was stated above (per the 2009 Order) except that there is now a 5% and a 10% tax rate depending on the holding period. Therefore, item A in the formula refers to "the amount of tax charged on the chargeable gain at the appropriate tax rate reduced by the amount of tax charged at the rate of 10%" where the chargeable asset is disposed within 2 years after acquisition. For a disposal within the third to the fifth year after acquisition, item A refers to "the amount of tax charged on the chargeable gain at the appropriate tax rate reduced by the amount of tax charged at the rate of 5%".

As a measure to further curb real estate speculation activities, the rates were increased for disposal of real property and shares in real property companies from 1 January 2013 as shown in the table below:

Date of Disposal	Tax Rates		
	Companies	Individual (Citizen and Permanent Resident)	Individual (Non-Citizen)
Within 2 years from date of acquisition	15%	15%	15%
Between 2–5 years from date of acquisition	10%	10%	10%
Disposal after 5 years from date of acquisition	0%	0%	0%

The *Real Property Gains Tax (Exemption) Order 2012*, which came into operation on 1 January 2013 revoked the previous *Real Property Gains Tax (Exemption) Order 2011*. The formula specified is similar to what was stated above (per the 2009 and 2011 Orders) except that there is now a 15% and a 10% tax rate depending on the holding period.

From 1 January 2014, the RPGT rates (in Schedule 5 of the RPGT Act) on the gains from disposal of real property and shares in real property companies were amended as follows:

Date of Disposal	Real Property Gains Tax Rates		
	Companies	Individual (Citizen & Permanent Resident)	Individual (Non-Citizen)
Within 3 years from date of acquisition	30%	30%	30%
In the 4th year	20%	20%	30%
In the 5th year	15%	15%	30%
In the 6th year and subsequent years	5%	0%	5%

This change was introduced to further curb real estate speculation activities which have exerted pressure on property prices and is effective for disposal of real property and shares in real property companies from 1 January 2014.

The Real Property Gains Tax (Exemption) Order 2012 which had stipulated the rates of tax applicable for disposals made on and after 1 January 2013 was revoked from 1 January 2014 under the Real Property Gains Tax (Exemption) (Revocation) Order 2013. As such, the new rates stipulated in Schedule 5 of the RPGT Act apply from 1 January 2014.

15.3 DISPOSAL PRICE

The computation of disposal price is set out in Para. 5 of Sch. 2 and is arrived at as follows:

Consideration in money or money's worth for the disposal of the asset.

Less: "permitted expenses"

Para. 5(1)(a) – all expenses wholly and exclusively incurred on the asset at any time after its acquisition by or on behalf of the disposer for the purposes of enhancing or preserving the value of the asset, being expenditure reflected in the state or nature of the asset at the time of the disposal;

Para. 5(1)(b) – all expenses wholly and exclusively incurred, after acquiring the asset, in establishing, preserving or defending the title to, or to a right over the asset;

Less: Para. 5(1)(c) – the "incidental costs" to the disposer of making the disposal.

However, where an asset which is disposed of was acquired by the disposer prior to 1 January 1970, the amount of the expenditure under Para. 5(1)(a) and (b) above which relates to the period prior to 1 January 1970 is to be disregarded.

"Incidental costs" of disposal is described by Para. 6 of Sch. 2 to consist of:

(a) fees, commission or remuneration paid for the professional services of any surveyor, valuer, accountant, agent, or legal adviser;
(b) cost of transfer (including stamp duty); and
(c) the cost of advertising to find a buyer and cost reasonably incurred in making any valuation or in ascertaining market value.

Example 15.1

Encik Azam disposed of his house with land in 2016 for RM600,000. His disposal price is arrived at as follows:

	RM	RM
Consideration		600,000
Less: Permitted expenses:		
Cost of extension to building [Para. 5(1)(a)]	90,000	
Legal expenses to defend title to land [Para. 5(1)(b)]	10,000	
		(100,000)
Less: Incidental costs of disposal:		
Agents fees	5,000	
Legal expenses	11,000	
Advertisement to find buyer	1,000	
		(17,000)
Disposal price		483,000

In computing the disposal price, any outgoings or expenses allowable or which would have been allowable for income tax purposes (but for an exemption or insufficiency of gross income) are not to be taken into account for RPGT purposes. It does not matter if the expenses were not actually deducted from income; so long as it qualifies as allowable expenses in arriving at the adjusted income or loss, it would not be considered again for RPGT purposes (Para. 7 of Sch. 2). As such, capital expenditure which qualifies for capital allowances, such as industrial building allowance or agriculture allowance for income tax purposes, would constitute part of permitted expenses. This is due to the fact that capital allowances are deducted from adjusted income and not in ascertaining or arriving at adjusted income or loss.

Any amount paid or to be paid in respect of Goods and Service Tax (GST) as input tax by the disposer cannot be deducted in computing the disposal price if the disposer is:

(a) liable to be registered under the GST Act and has failed to do so; or
(b) entitled under the GST Act to credit that amount as input tax. This applies even if the disposer did not actually made a claim under the GST Act.

Further, no deduction is available in respect of output tax borne by the disposer if he is GST registered or liable to be GST registered.

Expenditure in respect of which a disposer has been or is to be directly or indirectly reimbursed by any other person or by any government or other authority is not to be taken into account for the purposes of Para. 5(1)(a) or (b) in computing the disposal price (Para. 30, Sch. 2).

Where an asset is disposed of subject to a subsisting charge or incumbrance, the full amount of the liability assumed by the acquirer is deemed to form part of the disposal price [Para. 20(2), Sch. 2].

Further, in arriving at the disposal price, a deduction will not be allowed for contingent liabilities. Paragraph 26, Sch. 2 states that a deduction will not be allowed:

(a) for any liability remaining with or assumed by the disposer which is contingent on a default in respect of liabilities assumed by the acquirer under the terms and conditions of the lease (in the case of a disposal by way of transferring a lease); or
(b) for any contingent liability of the disposer in respect of any covenant for quiet enjoyment or other obligation assumed by the transferor of the asset; or
(c) for any contingent liability in respect of a warranty or representation made on disposal of the asset.

However, if it is shown to the satisfaction of the DG that the contingent liability (as stated above) has become enforceable and is being or has been enforced, the DG will make the necessary adjustments to the RPGT liability which may involve a repayment of the RPGT.

From 2 September 2006, a chargeable asset is deemed to be disposed of if an asset acquired or held by a person is taken into trading stock. The disposal price of the chargeable asset is equal to the market value at the date the asset is taken into stock. This amendment is via Para. 17A of Sch. 2 of the RPGT Act.

This new provision clarifies the valuation and the treatment on the transfer of a chargeable asset from fixed assets to trading stock. This change does appear to confirm that the IRB will apply the decision in *DGIR v LCW* for income tax cases i.e. the "cost" of the asset to a property developer will be the market value at the date the asset is transferred to trading stock.

In *BGH Sdn Bhd v KPHDN* [(2011) MSTC ¶10-020], RPGT was imposed on the price stated in the sale and purchase agreement. A rebate in the form of a deduction from the sale price was disregarded since it was not reflected in the agreement.

15.4 ACQUISITION PRICE

The computation of acquisition price is set out in Para. 4 of Sch. 2 and is arrived at as follows:

Consideration in money or money's worth paid by the acquirer

Add: incidental costs of acquisition

Less: Para. 4(1)(a) – Compensation received for damage to the asset, destruction or depreciation of the asset.

Para. 4(1)(b) – Money received under insurance policy for damage, loss, destruction or depreciation of the asset; and

Para. 4(1)(c) – Deposit forfeited to him in connection with an intended transfer of the asset.

With regard to incidental costs of acquisition, it is similar to that for disposal, i.e. those stated in Para. 6(1)(a) and (b). In addition to these, the cost of advertising to find a seller and any interest paid on capital employed to acquire the asset is also treated as incidental cost.