



INLAND REVENUE BOARD MALAYSIA

**PROFESSIONAL INDEMNITY
INSURANCE**

PUBLIC RULING NO. 3/2009

Translation from the original Bahasa Malaysia text

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DIRECTOR GENERAL'S PUBLIC RULING

A Public Ruling as provided for under section 138A of the Income Tax Act 1967 is issued for the purpose of providing guidance for the public and officers of the Inland Revenue Board Malaysia. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied.

A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which is inconsistent with it.

**Director General of Inland Revenue,
Inland Revenue Board Malaysia.**



1. This Ruling explains the new tax treatment on:
 - (i) the deductibility of premium expense paid for a professional indemnity insurance policy; and
 - (ii) the taxability of insurance proceeds received in relation to a professional indemnity insurance.
2. The provisions of the Income Tax Act 1967 (ITA) related to this Ruling are section 22 and subsection 33(1).
3. The words used in this Ruling have the following meanings:
 - 3.1 "Person" includes an individual, a partnership and a company.
 - 3.2 "Profession" includes the profession of lawyers, accountants, architects, doctors, pharmacists, engineers, surveyors or any other profession where its profession status is recognised by a written law or statute in Malaysia.
 - 3.3 "Professional" means a person who belongs to a profession and is a member of a professional body which represents the profession or registered with a body which governs the profession.
4. **Prerequisite for a professional to carry on or to practise a profession**
 - 4.1 Some professions require a person to be members of a professional body which represents the profession to enable that person to practise and maintain his profession. Examples of these professions are accountants, lawyers and engineers.

Example 1:

Nathan is a lawyer who has membership with the Malaysian Bar Council. He practises his profession through a legal firm, Nathan & Ali. Nathan falls under the meaning of professional in this Ruling.

- 4.2 However, there are also some professions which require a person to be registered with a body corporate which governs the profession and which is recognized by the Malaysian Government for purposes of practising and maintaining his profession. The person is not required to be a member of the relevant professional body. Examples of these professions are medical doctors, dentists and architects.

Example 2:

Dr. Maira is a doctor who is registered with the Malaysian Medical Council (MMC) which is a body corporate incorporated under the Ministry of Health. She is not a member of the Malaysian Medical Association (MMA), the professional body which represents her profession. In the year 2008, she practises her profession as a doctor in her own clinic. Dr. Maira can practise her profession as she is registered with MMC. Accordingly, Dr. Maira falls under the meaning of professional in this Ruling.

5. Requirement to purchase a professional indemnity insurance

- 5.1 A professional, due to the nature of his work, may be exposed to the likelihood of lawsuits for professional negligence for what he had done or what he had said in the course of his work.

Example 3:

Voon, an accountant may have given advice carelessly on a financial transaction of a client who subsequently lost money after acting on that advice. The client may sue Voon for the money lost in the transaction and may claim compensation from him.

- 5.2 Professional indemnity insurance (PII) is an insurance policy taken to protect the insured against liability that would otherwise be borne by him for his negligence. The insurance may cover the cost of defending the suit and the cost of the award.
- 5.3 Some professions require its members to purchase PII as provided under the profession's by-laws or rules. Examples of these professions are accountants and lawyers.
- 5.4 Whereas other professionals generally purchase PII on grounds of prudence and not because it is a requirement under the profession's by-laws or rules. Examples of these professions are medical doctors and architects.

6. Tax treatment of professional indemnity insurance premium expense

- 6.1 Premium paid on PII is an expense that is not deductible as the policy is taken to cover a personal liability or risk. It is an expense to cover a claim made against the personal assets of a person and is not wholly

and exclusively incurred in the production of income under subsection 33(1) of the ITA.

- 6.2 However, as a concession, premium expense paid for PII is allowed a deduction from the year of assessment 2006 for a practising professional who is a member of a professional body which represents his profession if the following conditions are fulfilled:
- (i) the professional has to be carrying on the business of his profession; and
 - (ii) the purchase of the PII is a requirement regulated by the profession's by-laws or statute.
- 6.3 In line with the Budget 2008 announcement, this concession is extended to all professionals within the meaning of this Ruling regardless of whether or not the purchase of a PII policy is a requirement under the profession's by-laws or statute. Thus, from the year of assessment 2008, a practising professional is allowed a deduction for PII premium expense if the professional carries on the business of his profession.

Example 4:

Dr. Steven, a partner in a business of dental practice, operates from a clinic together with his partners. He is registered with the Malaysian Dental Council and holds an Annual Practising Certificate. In the year 2008, he purchased a PII policy to cover himself in the event of lawsuits arising out of his profession as a dentist.

The premium paid for PII qualifies as a deduction against the gross income from the partnership business since Dr. Steven who is registered with a body governing his profession carries on the business of his profession.

Example 5:

Ir. Lee is a sole-proprietor of an engineering business, Excellent Engineering Consultancy. In the years 2007 and 2008, he purchased a PII policy and paid a premium of RM10,000 for each year. He is a member of the Institution of Engineers Malaysia (IEM). The statute or by-laws of IEM does not impose a requirement for their members to purchase a PII policy in order to practise as a professional.



For the year of assessment 2007, the PII premium paid is not allowable as a deduction against the gross income from Ir. Lee's business because IEM's by-laws does not impose a requirement for the purchase of the PII policy in order for Ir. Lee to practise as a professional.

However, for the year of assessment 2008, the PII premium is allowed a deduction from gross income of the business because he is a member of the relevant professional body and he carries on the business of his profession. The condition imposed in relation to the requirement for purchase of PII in accordance with the profession's by-laws or statute no longer applies.

- 6.4 In the case of a professional who is not engaged in professional practice but carries on some other business or is in employment, the premium paid for PII is not allowed as a deduction against the gross income from that other business or employment.

Example 6:

Dr. Aidil is a full-time surgeon employed by a government hospital. He is registered with the Malaysian Medical Council (MMC) and is also a member of the Malaysian Medical Association (MMA). In the years 2007 and 2008, he purchased a PII policy and paid a premium of RM2,400 each year.

The PII premium paid for the years 2007 and 2008 are not eligible for deduction against Dr. Aidil's employment income because he is not carrying on the business of his profession.

Example 7:

Felicia is an accountant who does not practise as an accountant but instead is carrying on a full-time direct-selling business. Felicia purchases a PII policy to maintain her professional status as an accountant.

As Felicia is not carrying on the business of her profession as an accountant, she does not satisfy the necessary requirement for deduction of PII premium. Accordingly, the PII premium paid is not allowed a deduction from the gross income of the direct-selling business.

6.5 Professional indemnity insurance premium expense incurred by a company

Where a particular professional body allows its members to practise the profession in the form of a company and the company purchases a PII, the PII premium paid by the company is allowed a deduction from the gross income of the company if the condition stipulated in paragraph 6.3 is satisfied.

Example 8:

Senibina Bumi Lanskap Sdn Bhd (SBLSB) is an architectural consultancy company which provides architectural services and consultancy. The company purchased a PII to cover the cost of compensation and defending lawsuits in relation to the construction project of a hotel in Putrajaya. The purchase of the PII is not a mandatory requirement for architects to maintain their professional status.

Since SBLSB which carries on an architectural consultancy business purchased a PII in relation to the profession of an architect, the PII premium paid is allowed as a deduction from the gross income of SBLSB's business.

6.6 Professional indemnity insurance premium expense for a locum

Where a professional carrying out locum duties purchases a PII, the PII premium paid is not allowed as a deduction against the income from locum or any other income. For the purposes of this Ruling, the ordinary meaning of the word locum is used i.e. a person who temporarily fulfills the duties of another person carrying on the same profession. For example, a locum doctor may stand in for another doctor in a hospital or a clinic. Income from locum is taxed as a source of employment income of the doctor.

Example 9:

Dr. Merican who carries on a business as a doctor since the year 2006 purchased a PII policy to cover himself against lawsuits in the course of carrying on his profession as a doctor. He paid an amount of RM2,500 yearly for PII premium since the year 2006. From January 2008, Dr. Merican also carries out duties as a locum in another private clinic and purchased an additional PII policy to provide protection for his duties as a locum doctor. The premium paid in respect of this PII policy is RM1,000 per year.



Dr. Merican is entitled to a deduction of the PII premium amounting to RM2,500 paid in relation to the business of his profession. However the PII premium amounting to RM1,000 paid in relation to his locum duties is not allowed a deduction against the income from locum or the business income since it is not made in relation to carrying on the business of his profession.

7. Tax treatment of insurance proceeds and compensation

7.1 Where a professional has been allowed deduction for a PII premium paid, any proceeds on the policy received in connection with the PII will be subject to tax. Proceeds are taxed regardless whether the insurance company makes payment to the professional or pays compensation directly to the claimant.

7.2 Compensation to the claimant can be paid in the following manner:

- (i) the insurance company pays the proceeds to the professional and the professional pays that amount to the claimant; or
- (ii) the insurance company pays directly to the claimant .

The compensation paid in both the above methods is not allowed under subsection 33(1) of the ITA since it is made to compensate the loss of the professional's personal assets.

Example 10:

Mohd Fahrin is an architect and practises his profession through his architectural firm. He purchased a PII to cover himself against risks. In the year 2008, his dissatisfied client sued him for damages to the client's bungalow caused by faulty design. The insurance company concerned made compensation payment of RM200,000 directly to Mohd Fahrin's client (the claimant).

The compensation amounting to RM200,000 paid directly to the claimant is deemed received in the books of the architectural firm and is subject to tax. The amount of proceeds paid as compensation to the claimant is deemed paid out from the firm's accounts but is not allowable as a deduction.

Example 11:

Bernard, a lawyer received proceeds amounting to RM150,250 from an insurance company and this amount exceeds the compensation of RM100,000 paid out to his client who made a claim against him.



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Since the PII premium paid by Bernard had been allowed as a deduction, the proceeds of RM150,250 is charged to tax. The compensation of RM100,000 paid out to his client is not allowed a deduction.

8. Effective date

This Ruling is effective from the year of assessment 2008 and it supersedes the Public Ruling No. 5/2006 issued on 31 May 2006.

**Director General of Inland Revenue,
Inland Revenue Board Malaysia.**