

PENGUMUMAN BERHUBUNG DRAF KETETAPAN UMUM DIMUATNAIK KE LAMAN SESAWANG HASIL UNTUK MAKLUM BALAS ORANG AWAM (PUBLIC CONSULTATION)

Lembaga Hasil Dalam Negeri Malaysia (LHDNM) dalam usaha untuk menambah baik proses pengeluaran Ketetapan Umum (KU) dengan memuat naik draf KU di dalam laman sesawang LHDNM untuk mendapatkan maklum balas orang ramai berkaitan topik-topik terpilih sebelum KU tersebut dimuktamadkan.

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2nd DRAFT [20.8.2019]



INLAND REVENUE BOARD OF MALAYSIA

**TAXATION OF
FOREIGN FUND MANAGEMENT
COMPANY**

PUBLIC RULING NO. /2019

Translation from the original Bahasa Malaysia text

DATE OF PUBLICATION:

2019



Published by

Inland Revenue Board of Malaysia

Second edition

First edition on 4.9.2014

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DIRECTOR GENERAL'S PUBLIC RULING

Section 138A of the Income Tax Act 1967 (ITA) provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

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

1. Objective

The objective of this Public Ruling (PR) is to explain the tax treatment of income received by a foreign fund management company that provides fund management services to foreign and local investors. This PR is not applicable to a foreign fund management company that issues, offers or makes an invitation to subscribe or purchase units of conventional unit trust funds.

2. Relevant Provisions of the Law

2.1 This PR takes into account laws which are in force as at the date this PR is published.

2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are section 2, paragraph 6(1)(h), section 60G and Part I of Schedule 1 and Part IX of Schedule 1.

2.3 The relevant subsidiary laws referred to in this PR are:

- (a) [Income Tax \(Exemption\) \(No. 15\) Order 2007 \[P.U.\(A\) 199/2007\]](#);
- (b) [Income Tax \(Exemption\) \(No. 6\) Order 2008 \[P.U.\(A\) 255/2008\]](#);
- (c) [Income Tax \(Exemption\) \(Amendment\) Order 2016 \[P.U.\(A\) 104/2016\]](#);
and
- (d) [Income Tax \(Exemption\) \(Amendment\) \(No. 2\) Order 2016 \[P.U.\(A\) 105/2016\]](#).

3. Interpretation

The words used in this PR have the following meaning:

3.1 “Individual” means a natural person.

3.2 “Person” includes a company, a body of persons, a limited liability partnership and a corporation sole;

3.3 “Foreign investors” –

- (a) in relation to an individual means individuals who are not resident and not citizens of Malaysia;
- (b) in relation to a company means companies where the entire issued share capital is beneficially owned, directly or indirectly by persons who are not resident and not citizens of Malaysia; and

(c) in relation to a trust fund means trust funds where the entire interest in the fund is beneficially held, directly or indirectly by foreign investors, where

–
(i) the fund is created outside Malaysia; and

(ii) the trustees of the fund are not resident and not citizens of Malaysia.

3.4 “Local investors” are individuals, companies or trust funds that are not foreign investors.

4. Foreign Fund Management Companies in Malaysia

4.1 A foreign fund management company is a company incorporated in Malaysia and licensed under the Capital Markets and Services Act 2007 [Act 671].

4.2 Among the conditions stipulated by the Securities Commission Malaysia (SC) for the licensing of the foreign fund management company is that more than 50% of the paid-up capital must be owned by foreign equity.

4.3 A foreign fund management company is basically a company incorporated to provide fund management services to its clients. The SC has issued the following guidelines and documents for the establishment of foreign fund management companies in Malaysia:

(a) Guidelines for the establishment of foreign fund management companies (Revised on 1.7.2000);

(b) Application for the establishment of foreign fund management companies under the special scheme (Revised on 24.12.2007); and

(c) The SC licensing handbook (as amended on 26.11.2009).

For further information on the guidelines and documents, please refer to the SC’s website at www.sc.com.my.

5. Basis of Assessment

The basis period for a year of assessment of a foreign fund management company will be its financial accounting period and this is determined in accordance with the provisions of sections 20 and 21A of the ITA.

Example 1

A foreign fund management company commenced operations on 1.11.2015 and made up its accounts up to 30.6.2016. The company makes up its subsequent accounts up to 30 June annually.

The basis periods for the following years of assessment are:

Year of Assessment	Basis Period
2016	1.11.2015 to 30.06.2016
2017	1.07.2016 to 30.06.2017
2018	1.07.2017 to 30.06.2018

6. Tax Treatment

The tax treatment of a foreign fund management company is as follows:

6.1 Income of a foreign fund management company

A foreign fund management company that carries on the business of providing fund management services to foreign and local investors derives management fees for its services. As the management fee is received in the course of carrying on a business, it is treated as business income by virtue of paragraph 4(a) of the ITA. Where a foreign fund management company provides fund management services to both foreign investors and local investors, the income derived from the provision of such services to each of these categories of investors will be treated as arising from separate and distinct business sources.

[subsection 60G(1) of the ITA]

6.2 Provision of fund management services to foreign investors - Computation of chargeable income

The chargeable income from a source consisting of the provision of fund management services to foreign investors for a year of assessment is the statutory income from that source reduced by unabsorbed losses brought forward from earlier years from the same source.

[subsection 60G(2) of the ITA]

6.3 Income of a foreign fund management company other than income from fund management services provided to foreign investors - Computation of chargeable income

The chargeable income derived from a source or sources other than the source consisting of the provision of fund management services to foreign investors for a year of assessment shall be the statutory income from that source or the aggregate of the statutory income from each of those sources, as the case may be, reduced by any deductions for brought forward losses and current year loss from other business sources (other than losses from the provision of fund management services to foreign investors).

In other words, the brought forward losses and the current year business loss from the provision of fund management services to foreign investors are not deductible against the income from the provision of fund management services to local investors and other sources of income of the fund. Similarly, brought forward losses and the current year business loss from the provision of fund management services to local investors and other business sources are not deductible against the income from the provision of fund management services to foreign investors.

[subsection 60G(3) of the ITA]

6.4 Funds of foreign investors managed according to *Syariah* principles

Foreign fund management companies which manage funds of foreign investors according to *Syariah* principles are exempted from the payment of income tax in respect of statutory income derived from a business of providing fund management services to foreign investors in Malaysia. The *Syariah* funds shall be certified by the SC for each year of assessment during the exempt period. The exemption applies for the year of assessment 2007 until the year of assessment 2020.

[Income Tax (Exemption) (No.15) Order 2007 [P.U.(A) 199/2007] and [Income Tax \(Exemption\) \(Amendment\) Order 2016 \[P.U.\(A\) 104/2016\]](#)].

6.5 Funds of local investors managed according to *Syariah* principles

Foreign fund management companies which manage funds of local investors according to *Syariah* principles are exempted from the payment of income tax in respect of statutory income derived from a business of providing fund management services to local investors in Malaysia. The *Syariah* funds shall be certified by the SC for each year of assessment during the exempt period. The exemption applies for the year of assessment 2008 until the year of assessment 2020.

[Income Tax (Exemption) (No. 6) Order 2008 [P.U.(A) 255/2008] and [Income Tax \(Exemption\) \(Amendment\) \(No. 2\) Order 2016 \[P.U.\(A\) 105/2016\]](#)].

6.6 Tax rates

The tax rates applicable to a foreign fund management company are as follows:

Shareholding of a Foreign Fund Management Company	Type of Investors	Tax Rate (%)	
		Year of Assessment	
		2020 and prior	2021 onwards
100% foreign equity	Foreign	10	24
At least 30% local equity	Foreign	10	24
At least 30% local equity	Local	Prevailing domestic tax rates applicable to the Foreign Fund Management Company resident in Malaysia	

[Part I and Part IX of Schedule I to the ITA]

- 6.7 A summary of tax treatment accorded to a foreign fund management company is shown in the Appendix.
- 6.8 Determination of chargeable income of a foreign fund management company

Example 2

ABC International Asset Management Group, one of the world's largest asset managers incorporated a wholly owned subsidiary in Malaysia, ABC International Asset Management Malaysia Sdn Bhd in 2008. ABC International Asset Management Malaysia Sdn Bhd was established as a foreign fund management company and had received the SC's approval to provide fund management services to both foreign and local investors.

The service and other charges which can be specifically identified are allocated entirely to the respective funds. Common charges of the group are allocated to individual sub-funds in the ratio of their net asset values at the end of each quarter.

As ABC International Asset Management Malaysia Sdn Bhd provides fund management services to both foreign and local investors, the income from the provision of such fund management services to foreign investors shall be treated as a separate and distinct business source of income from the provision of fund management services to local investors.

Example 3

The facts are the same as in Example 2 and the following incomes were reported in the Profit and Loss Account of ABC International Asset Management Malaysia Sdn Bhd for the years ended 31.12.2020 and 31.12.2021.

Provision of Fund Management Services to Foreign Investors

Year Ended	31.12.2020 RM	31.12.2021 RM
Management fees	200,000	500,000
Allowable expenses	210,000	100,000
Capital allowances	20,000	10,000

Provision of Fund Management Services to Local Investors

Year Ended	31.12.2020 RM	31.12.2021 RM
Management fees	250,000	100,000
Allowable expenses	100,000	120,000
Capital allowances	10,000	5,000

The computation of chargeable income for the year of assessment 2020 for the provision of fund management services to foreign and local investors are as follows:

Year of Assessment 2020 – Foreign Investors

	RM
Management fees	200,000
Less: allowable expenses - RM210,000 restricted to	200,000
Adjusted income	Nil
(Adjusted loss – RM10,000)	

Current year unabsorbed losses c/f - 10,000¹

Current year unabsorbed capital allowances c/f - 20,000²

The chargeable income for the provision of fund management services to foreign investors for the year of assessment 2020 is Nil.

Year of Assessment 2020 – Local Investors

	RM
Management fees	250,000
Less: allowable expenses	<u>100,000</u>
Adjusted income	150,000
Less: Capital allowance	<u>10,000</u>
Statutory income / Chargeable income	<u>140,000</u>

The chargeable income for the provision of fund management services to local investors for the year of assessment 2020 is RM140,000. The tax payable for the provision of fund management services to local investors is as follows:

Chargeable income	-	RM140,000
Tax payable	-	RM33,600.00 (RM140,000 @ 24%)

The computation of chargeable income for the year of assessment 2021 for the provision of fund management services to foreign and local investors are as follows:

Year of Assessment 2021 – Foreign Investors

		RM
Management fees		500,000
Less: allowable expenses		<u>100,000</u>
Adjusted income		400,000
Less: unabsorbed capital allowances b/f	20,000 ²	
Capital allowance (current year)	<u>10,000</u>	<u>30,000</u>
Statutory income		370,000
Less: Unabsorbed loss b/f		<u>10,000¹</u>
Chargeable income		<u>360,000</u>

The chargeable income for the provision of fund management services to foreign investors for the year of assessment 2021 is RM360,000. The tax payable for the provision of fund management services to foreign investors would be as follows:

Chargeable income	-	RM360,000
Tax payable	-	RM86,400.00 (RM360,000 @ 24%)

Year of Assessment 2021 – Local Investors

	RM
Management fees	100,000
Less: allowable expenses – RM120,000 restricted to	100,000
Adjusted income	<u>Nil</u>

	RM
Current year unabsorbed loss c/f	- 20,000
Current year unabsorbed capital allowance c/f	- 5,000

The chargeable income for the provision of fund management services to local investors for the year of assessment 2021 is Nil.

Observation

- (1) The unabsorbed capital allowance of RM20,000² and unabsorbed adjusted loss of RM10,000¹ from the provision of fund management services to foreign investors for the year of assessment 2020 are to be carried forward to the year of assessment 2021 and subsequent years and to be set-off only against the same source of income i.e. from the provision of fund management services to foreign investors. It is to be noted that the unabsorbed loss and capital allowance from the provision of fund management services to foreign investors in the year of assessment 2020 are not allowed to be set-off against the income from the provision of fund management services to local investors.
- (2) Similarly, in the year of assessment 2021 the unabsorbed loss and capital allowances from the provision of fund management services to local investors are to be carried forward to the year of assessment 2022 and subsequent years to be set-off only against the same source of income i.e. from the provision of fund management services to local investors. The unabsorbed loss and capital allowances are not allowed to be set-off against the income from the provision of fund management services to foreign investors.

Example 4

Good Fund Management Sdn Bhd was incorporated in Malaysia on 1.1.2005 with a local equity of 30%. The Fund was approved by the SC to provide fund management services to both foreign and local investors. The income of Good Fund Management Sdn Bhd for the year ended 31.12.2020 and 31.12.2021 are as follows:

	Fund Management Services To Foreign Investors	Fund Management Services To Local Investors & Other Sources
	RM	RM
Year of Assessment 2020		
Adjusted income	570,000	2,830,000
Capital allowance	10,000	30,000
Rental		35,000
Year of Assessment 2021		
Adjusted income	(250,000)	3,332,000
Capital allowance	9,000	32,000
Rental		8,000

Donations made to approved institutions for the basis years 2020 and 2021 are RM2,000 and RM3,000 respectively. The loss brought forward from the year of assessment 2019 for fund management services to foreign investors was RM60,000.

Computation of Chargeable Income

	Fund Management Services to Foreign Investors	Fund Management Services to Local Investors & Other Sources
	RM	RM
Year of Assessment 2020		
Adjusted income	570,000	2,830,000
Capital allowance	10,000	30,000
Statutory income	560,000	2,800,000
Less: Loss b/f	60,000	Nil
Rental	500,000	2,800,000
	Nil	35,000
Aggregate income	500,000	2,835,000
Less: Donation	Nil	2,000
Total income/Chargeable income	500,000	2,833,000
Tax rate	10%	24%
Tax payable	50,000	679,920

	Fund Management Services to Foreign Investors RM	Fund Management Services to Local Investors & Other Sources RM
Year of Assessment 2021		
Adjusted income	Nil	3,332,000
Capital allowance	Nil	32,000
Statutory income	Nil	3,300,000
Rental	Nil	38,000
Aggregate income	Nil	3,338,000
Less: Donation	Nil	3,000
Total income/Chargeable income	Nil	3,335,000
Tax rate	24%	24%
Tax payable	Nil	800,400
Loss c/f	(RM250,000)	Nil
Capital allowance c/f	RM9,000	Nil

Example 5

Sturdy Investments (Malaysia) Sdn Bhd is a company incorporated in Malaysia as a fund management company and approved by the SC. The business commenced on 1.1.2008. The Profit and Loss Account and the Balance Sheet for the year ended 30.9.2021 are as follows:

Profit and loss account for the year ended 30.9.2021

Income	RM	RM
Management fee – Foreign investors fund		2,685,579
Expenses		
Professional fee	40,000	
Wages and salary	1,500,000	
Rental	120,000	
Maintenance and repairs	1,000	
Advertising	1,000	
Travelling and accommodation	60,000	
Other expenses	583,929	2,305,929
Net profit		379,650

Balance Sheet as at 30.9.2021

Liability	RM	RM	RM
Current liabilities			
Other creditors			16,000
Other current liabilities			<u>851,670</u>
Total current liabilities			867,670
Shareholder's equity			
Paid-up capital		1,500,000	
Appropriation account			
Opening balance at 1.10.2020	3,196,485		
Net profit	<u>379,650</u>		
Closing balance at 30.9.2021		<u>3,576,135</u>	
Total equity			<u>5,076,135</u>
Total liabilities and equity			<u>5,943,805</u>
Assets			
Current assets			
Other debtors			250,000
Bank and cash balance			50,000
Other current assets			<u>5,643,805</u>
Total assets			<u>5,943,805</u>

The disallowable expenses and capital allowances are RM18,637 and RM2,000 respectively.

Computation of Income Tax - Year of Assessment 2021

Fund management services to foreign investors

Net profit	RM 379,650
Add: expenses disallowed	<u>18,637</u>
Adjusted income	398,287
Less: Capital allowance	<u>2,000</u>
Statutory income / Chargeable income	<u>396,287</u>
Tax on 396,287 @ 24%	95,108.88
Tax payable	95,108.88

Example 6

The facts are the same as in Example 5 except that Sturdy Investments (Malaysia) Sdn Bhd provides fund management services of a *Syariah* compliant fund (certified by the SC) to both foreign and local investors. The Profit and Loss Account and the Balance Sheet are prepared for the year ended 30.9.2019. The statutory income derived from a business of providing fund management services of *Syariah* compliant funds to foreign and local investors was RM396,287 and RM85,000 respectively.

Computation of Income Tax - Year of Assessment 2019

Fund management services to foreign investors

The statutory income amounting to RM396,287 derived by Sturdy Investments (Malaysia) Sdn Bhd from a business of providing fund management services of *Syariah* compliant funds to foreign investors in Malaysia in the year of assessment 2019 is tax exempt.

Fund management services to local investors

The statutory income amounting to RM85,000 derived by Sturdy Investments (Malaysia) Sdn Bhd from a business of providing fund management services of *Syariah* compliant funds to local investors in Malaysia in the year of assessment 2019 is tax exempt.

Example 7

Smart Fund Investment (Malaysia) Sdn Bhd (SFIMSB) was established as a foreign fund management company and had received the SC's approval to provide fund management services to both foreign and local investors.

The fund management services to local investors are managed in accordance with *Syariah* principle certified by the SC. For the year of assessment 2019, the statutory income derived from a business of providing fund management services of *Syariah* compliant funds to local investors was RM250,000.

Meanwhile, the fund management services to foreign investors are not managed in accordance with *Syariah* principles. The statutory income derived from a business of providing fund management services funds to foreign investors was RM450,000 in the year of assessment 2019.

**The tax treatment of income received by SFIMSB
- Year of Assessment 2019**

	Fund Management Services to Foreign Investors	Fund Management Services to Local Investors
	RM	RM
Statutory income (RM)	<u>450,000</u>	<u>250,000</u>
Total income/Chargeable income	<u>450,000</u>	<u>250,000</u>
Tax rate	10%	-
Tax payable	45,000	-
Exemption account	-	<u>250,000</u>

7. Updates and Amendments

<p>This PR replaces the PR No. 6/2014 dated 4.9.2014.</p>	Amendment	
	Paragraph	Explanation
	2	Paragraph 2.3 is amended.
	5	Example 1 is amended.
	6	<p>Previous paragraph 6(a) and 6(h) are deleted.</p> <p>Previous paragraphs 6(b) to 6(g) and 6(i) to 6(j) are renumbered to 6.1 to 6.8.</p> <p>Previous paragraphs 6(e) to 6(g) are amended.</p> <p>Examples 3 to 6 are amended.</p> <p>New Example 7 is inserted.</p>
Appendix	Appendix is amended.	

8. Disclaimer

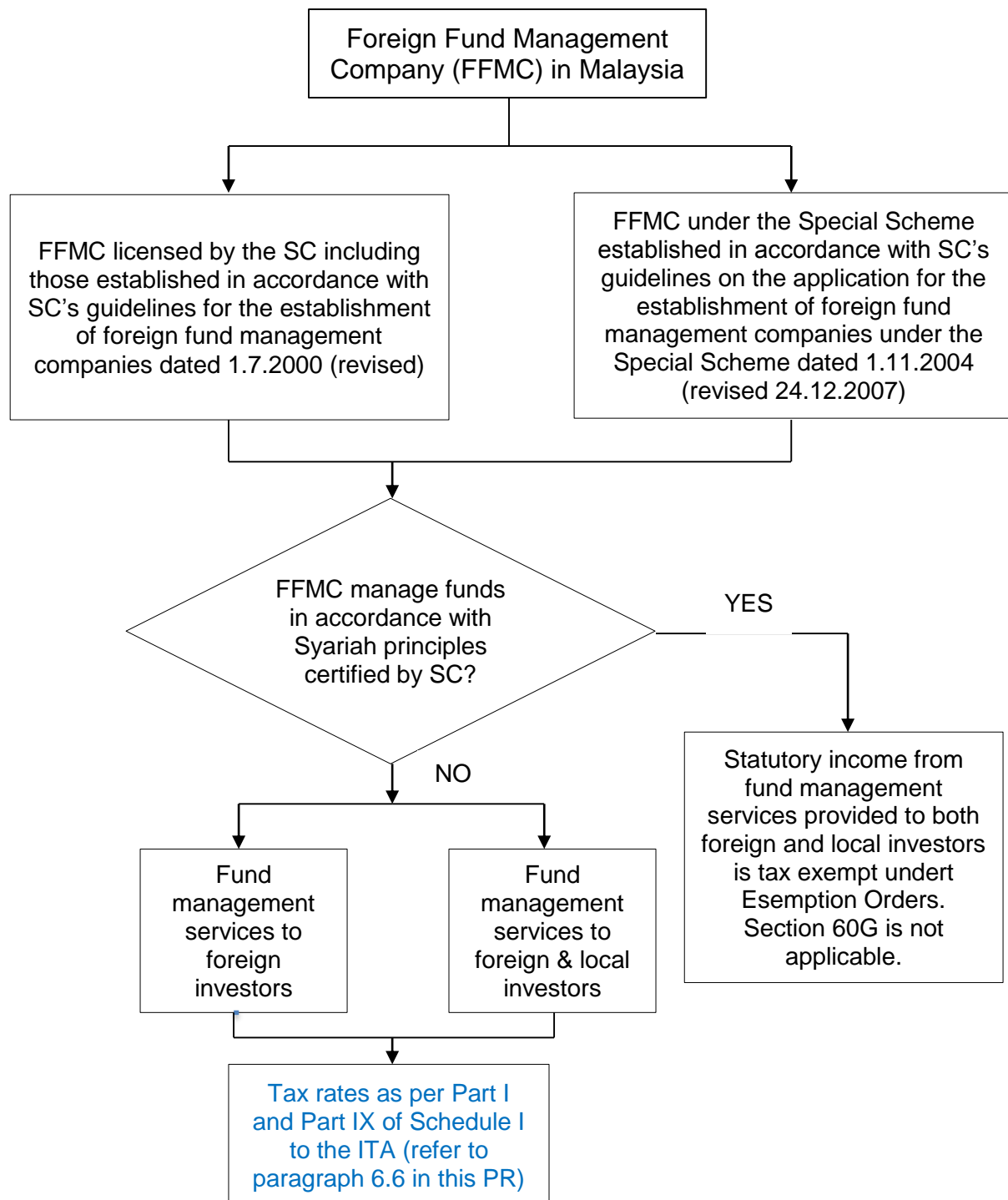
The examples in this PR are for illustration purposes only and are not exhaustive.

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

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Appendix

Summary Of Tax Treatment Accorded To A Foreign Fund Management Company





INLAND REVENUE BOARD OF MALAYSIA

**TAX TREATMENT OF WHOLLY & PARTLY
IRRECOVERABLE DEBTS AND DEBT
RECOVERIES**

PUBLIC RULING NO. /2019

Translation from the original Bahasa Malaysia text

DATE OF PUBLICATION: 2019



**TAX TREATMENT OF WHOLLY &
PARTLY IRRECOVERABLE DEBTS AND
DEBT RECOVERIES**

INLAND REVENUE BOARD OF MALAYSIA

**Public Ruling No. /2019
Date of Publication: 2019**

Published by
Inland Revenue Board of Malaysia

Second edition

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**TAX TREATMENT OF WHOLLY &
PARTLY IRRECOVERABLE DEBTS AND
DEBT RECOVERIES**

INLAND REVENUE BOARD OF MALAYSIA

**Public Ruling No. /2019
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The Director General of Inland Revenue may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new ruling.

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

1. Objective

The objective of this Public Ruling (PR) is to explain the tax treatment of –

- i) wholly and partly irrecoverable debts as a deduction against gross income of a person from a business for the basis year for a year of assessment (YA); and
- ii) recoveries of wholly and partly irrecoverable debts where a deduction has been made in ascertaining the adjusted income for an earlier YA.

2. Relevant Provisions of the Law

- 2.1 This PR takes into account laws which are in force as at the date this PR is published.
- 2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are section 2, subsection 22(2), 24(5), sections 30 and 34.

3. Interpretation

The words used in this PR have the following meaning:

- 3.1 "Bad debt" is a debt arising from trade in which the debt has been included in the gross income of a business of a person for the basis period for a YA prior to the relevant YA that it is reasonably estimated to be irrecoverable after appropriate steps have been taken to recover it.
- 3.2 "Recoveries" are money or assets received in connection with a trade debt that has been written off as bad in an earlier period.
- 3.3 "Gross income" of a person from a source for the basis period for a YA is the gross income as ascertained in accordance with section 22 of the ITA.
- 3.4 "Adjusted income" in relation to a business source and a basis period, means adjusted income ascertained in accordance with sections 33 and 34 of the ITA.
- 3.5 "Person" includes a company, a body of persons, a limited liability partnership and a corporation sole;

- 3.6 "Basis period" in relation to a person, each source of his and a YA, means such basis period, if any, as is ascertained in accordance with section 21 or 21A of the ITA.
- 3.7 "Year of assessment", subject to subsection 2(5) of the ITA, means calendar year.
- 3.8 "Related or connected person" means any person who is in a position to influence or be influenced by the other person in any significant way or to any substantial degree, or to control or be controlled by the other person, and includes:
- a) In the case of an individual: a spouse, relative, an associate or a person controlled by a relative or associate;
 - b) In the case of a company: a director, a related company or its directors, a relative of a director, or a person who controls or is controlled by the company;
 - c) In the case of a partnership: a partner, a relative of a partner, or a person who controls or is controlled by a partner;
 - d) In the case of a co-operative society: a member of the board, committee or other governing body of the co-operative society, or a person who controls or is controlled by the co-operative society;
 - e) In the case of any other body, association or group of persons: a person having the direction or control of the management of its business or affairs, including an administrator; a beneficiary; a karta; a member of the board, committee, council or other governing body; a trustee; or a person who controls or is controlled by that body, association or group of persons.
- 3.9 "Relative", in relation to a person, includes
- a) a parent;
 - b) a child (including a stepchild and a child adopted in accordance with any law);

- c) a brother or a sister;
- d) an uncle or an aunt;
- e) a nephew or a niece;
- f) a cousin;
- g) an ancestor; or
- h) a lineal descendant.

3.10 "Associate", in relation to a person, means:

- a) a person in any of the following relationships to that person, that is to say, husband or wife, parent, child, brother, sister and partner;
- b) the trustee of a settlement in relation to which that person is, or any such relative of his (living or dead) as is mentioned in paragraph a) above or a settlor;
- c) where that person is interested in any shares or obligations of a company which are subject to any trust or are part of the estate of a deceased person, any other person interested therein.

3.11 "Director" in relation to a company, includes any person occupying the position of director (by whatever name called), any person in accordance with whose directions the directors are accustomed to act and any person who –

- a) is a manager of the company or otherwise concerned in the management of the company's business;
- b) is remunerated out of the funds of that business; and
- c) is, either on his own or with one or more associates (as interpreted in paragraph 3.10), the beneficial owner of (or able directly or through the

medium of other companies or by any other indirect means to control) twenty percent or more of the ordinary share capital of the company.

3.12 "Related company" has the same meaning as in subsection 2(4) of the ITA and controlled in the same manner described by section 139 of the ITA, by not more than 5 persons.

3.13 "Arm's length basis" refers to the circumstances, decisions or outcomes that would have been arrived at if unrelated or unconnected persons were to deal with each other wholly independently and out of reach of personal influence.

4. Introduction

Debts which are allowed as a deduction in ascertaining the adjusted income of a business is a trade debt which is irrecoverable either wholly or partly. Such debt is written off as bad. Trade debt is a debt that arises from the sales of goods or services and has been included in the gross income of the business.

Reasonable steps should be taken before writing off a trade debt as bad and then allowed as a deduction in ascertaining the adjusted income of a business. Steps to recover the debt should be taken before any decision is made to write off debt.

Subsection 34(2) of the ITA allows a trade debt which is reasonably estimated to be irrecoverable either wholly or partly, to be deducted from gross income in computing the adjusted income of the business.

Where a trade debt is written off as bad or an amount of debt which is estimated to be irrecoverable has been subsequently received, the total debt which is recovered shall be regarded as a gross income of the business since deductions have been made in relation to the debt and such estimates (provision).

5. Irrecoverable Debts

5.1 Trade debts exist when sales are made but payments are not received. For example, a seller supplied its stock-in-trade to a buyer and for some reason, the buyer cannot make payment on the stocks that has been sold to him. The amount which is unpaid is a trade debt or a business debt and is a loss to the seller's business because the sale has been included in the gross income of the seller. Trade debts which have long not been paid and have been identified as wholly irrecoverable are known as bad debts. Typically bad debts will be written off and claimed as deductions in ascertaining the adjusted income of the business.

5.2 In order for a trade debt to be written off as bad and allowed as a deduction against the gross income in ascertaining the adjusted income of the business, generally two conditions are to be fulfilled. The first condition is that the debt shall be an amount that has been included in the gross income of a person for the basis period for a YA or the prior YAs. The second condition is such debt is a debt which is irrecoverable.

5.3 Sound considerations should be taken by the person carrying the business before a trade debt can be written off. All circumstances of the debt such as the likelihood and cost of its recovery should be considered before a decision is made to write off the debt.

5.3.1 Actions taken to recover the debt

All reasonable steps based on sound commercial considerations should be taken to recover the debt. There should be evidence to support the claim that recovery action has been taken before the debt is written off as bad. The steps that should be taken include one or more of the following:

- a) issuing reminder notices;
- b) debt restructuring scheme;
- c) rescheduling of debt settlement;
- d) negotiation or arbitration of a disputed debt; or
- e) legal action (filing of civil suit, obtaining of judgement from the court and execution of the judgement).

The steps that should be taken depends on the size of the irrecoverable debt and to be written off and/or the anticipated cost effectiveness of each action. If the size of the debt and the anticipated cost hinders any action to pursue the debt, the reasons should be documented.

To support a claim for deduction for tax purposes, the decision made should be based upon valid commercial considerations and not

personal, private or other reasons. It should be considered a reasonable basis if it can be shown that the anticipated cost of any legal action is prohibitive in relation to the amount of debt.

The evidence showing the followings must also be made available in the event of a tax audit to qualify for a deduction for tax purposes:

- a) that each debt has been evaluated separately;
- b) when and by whom this was done; and
- c) the specific information used in arriving at that evaluation.

5.3.2 Circumstances when a debt can be considered as irrecoverable

Debts which are irrecoverable become bad (either wholly or partly) when the creditors lose all hope to recover such debt. As long as there are any additional steps for recovery that can be taken to recover the debt, such debt cannot be written off as bad.

After reasonable steps for recovery as in paragraph 5.3.1 have been taken, a debt can be considered as wholly irrecoverable or bad on the occurrence of any one of the following:

- a) the debtor has died without leaving any assets from which the debt can be recovered;
- b) the debtor is a bankrupt or under liquidation and there are no assets from which the debt can be recovered;
- c) the debt is statute-barred;
- d) the debtor cannot be traced despite various attempts and there are no known assets from which the debt can be recovered;
- e) attempts at negotiation or arbitration of a disputed debt have failed and the anticipated cost of litigation is prohibitive; or

- f) any other circumstances where there is no likelihood of cost effective recovery.

Example 1

Abadi Sdn. Bhd., a wholesaler, supplied goods worth a total of RM10,000 on various dates in 2015 to Bersatu Mini Market. Various payments totalling RM6,500 were received. However, it was later discovered that the mini market had closed down and the sole proprietor could not be contacted. Reasonable steps had been taken to recover the debt including tracing the debtor at his last known business and residential addresses, but failed. The company decided to write off this debt in its Income Statement for the year ended 31.12.2017.

Debt of RM3,500 (RM10,000 - RM6,500) is a bad debt which is allowed as a deduction in computing the statutory income of a business as the debt has arisen from transactions that have been included in the gross income of the business and all reasonable steps have been taken to recover the debt but it cannot be recovered.

Example 2

Chanteq Sdn. Bhd. took over the retail business of an existing partnership. Among the assets taken over included trade debts amounting to RM30,000. During its first two years of operation, the company managed to collect all the debts that had been taken over from the partnership, except for a debt of RM2,000 as the debtor could not be traced.

The company decided to write off this debt in the Income Statement in the second year of business. Although the debt was originally a trade debt in the accounts of the partnership, the amount constituted a non-trade debt of Chanteq Sdn. Bhd. as it had arisen from taking over of the assets of the partnership and not from a transaction that was included as gross income of the company. Therefore, the amount of RM2,000 written off as a bad debt **cannot** be allowed as a deduction in computing the adjusted income. Conversely, the recoveries amounting to RM28,000 should not be regarded as taxable.

If the amount of bad debts written off and allowed as a deduction in ascertaining the adjusted income is recoverable, the amount recovered must be included in the gross income for the basis period the amount is received - paragraph 22(2)(a) of the ITA. Therefore, any trade debt recovered which was previously written off as bad should be reflected in the Income Statement in the period in which it was received. If the recovery is not included in the Income Statement but is otherwise included in the reserve or other accounts, an adjustment is required in the tax computation.

Example 3

Purnama Sdn. Bhd. wrote off RM2,700 which was a trade debt of Qalif (who had passed away) for the year ended 30.9.2017. In the same financial year, the company received RM2,000 from Rayyan, whose trade debt was written off and allowed as a deduction for tax purposes three years ago because he could not be contacted.

The amount of RM2,700 being Qalif's trade debt which was written off as a bad debt was allowed as a deduction and the recovery of RM2,000 received from Rayyan is taxable. If both of these amounts are shown in the Income Statement for the year ending 30.9.2017, no adjustment is required in the tax computation.

If the recovery of RM2,000 is not entered into the Income Statement, an adjustment for that amount should be made in the tax computation .

5.3.4 Giving Loans or Advancement is the Ordinary Course of Business

Paragraph 5.2 specifies that one of the conditions to enable a trade debt to be written off as a bad debt and be allowed as a deduction in ascertaining the adjusted income of a business is that the amount of debt has been included in the gross income for the basis period for a YA prior to the relevant YA. However, this term shall not apply in a case where the nature of a business is giving loans and advancement, for example a moneylender company, a bank or a person giving loans in the course of its business.

For such a business, subsection 34(3) of the ITA provides that the interest (which has been included in the gross income) and the loan are considered as a debt. Where such debt is irrecoverable partly or wholly and is written off as a bad debt (after all reasonable steps are

taken and all circumstances are considered), both the interest and the loan that are written off shall be allowed as a deduction in arriving at the adjusted income of the business.

6. Doubtful debts

- 6.1 For a debt which is doubtful to be recovered, a reasonable estimation for such debt as a provision has to be prepared. A provision is an expense which is not allowable since it does not fulfill the meaning of 'incurred'. However, subsection 34(2) of the ITA allows a provision made for trade debts which are reasonably estimated to be irrecoverable as a deduction in ascertaining the adjusted income of a business. The provision for doubtful debts is an estimation made for debt which are irrecoverable or debts becoming bad.

Subsection 34(2) of the ITA is a special provision which allows a trade/business debt which is reasonably estimated to be irrecoverable either wholly or partly as a deduction in ascertaining the adjusted income from a business of a person for the basis period for a relevant YA. The debt is a debt arising from the sale of stock-in-trade or provision of services which is estimated to be irrecoverable and that amount of debt has been included as the gross income of a person for the basis period for a YA prior to the relevant YA - paragraph 34(3)(a) of the ITA.

- 6.2 Bad debts are trade/business debts which are reasonably estimated to be wholly irrecoverable at the end of the relevant period - paragraph 34(2)(a) of the ITA. Doubtful debts are trade/business debts which are reasonably estimated to be partly irrecoverable in which the debt is doubtful to be fully recoverable - paragraph 34(2)(b) of the ITA. It is a trade debt that has not yet been paid off but has the hope to be partly recovered.

There are two types of provisions for doubtful debts, i.e. specific and general provision for doubtful debts.

6.2.1 Specific provision for doubtful debts

Trade doubtful debt is a long unpaid debt but there is still hope to be recovered either wholly or partly. Where there is some reasonable basis that recovery of a trade debt is doubtful (based on valid commercial considerations but not personal, private or other reasons), a specific provision can be made at the end of the accounting period for the amount of the debt which is expected to be irrecoverable. That

provision which is determined with reasonable grounds to be irrecoverable is a provision which can be allowed as a deduction against the gross income for the relevant basis period.

6.2.1.1 The preparation of specific provision for doubtful debts

To make an estimation or a specific provision for doubtful debts, the likelihood of recovery of each debt has to be determined. This should be done at the end of the relevant accounting period (i.e. at or immediately after the time of closing the accounts).

The evidence regarding the following matters must be provided in preparing the specific provision for doubtful debts:

- a) that each debt has been evaluated separately;
- b) how the extent of its doubtfulness was evaluated;
- c) when and by whom this was done; and
- d) what specific information was used in arriving at that evaluation.

In addition to the items in the paragraph above, the circumstances below must also be considered for the purpose of evaluating a debt as doubtful:

- a) the period over which the debt has been outstanding;
- b) the current financial status of the debtor; and
- c) the credit record of the debtor.

For each doubtful debt, the specific proportion of the debt that is regarded as doubtful should be determined after taking into consideration the following:

- a) the person's history of bad debts,
- b) the experience for the particular trade/industry; and/or
- c) the age-analysis of the debts.

Subject to paragraph 6.2.1.2, the aggregate of the specific provision for each debt constitutes the specific provision for doubtful debts of the business which qualifies for deduction in that year.

6.2.1.2 Increase or decrease in the specific provision

Where a specific provision for doubtful debts has been made for a particular accounting period and the amount has been allowed in the relevant basis period for a particular YA, and there is a change in the amount of the specific provision in a subsequent year:

- a) a deduction should be made against the gross income for the subsequent year for the amount of the increase in the specific provision; or
- b) an addition should be made to the gross income for the subsequent year for the amount of the decrease in the specific provision.

Example 4

Delima Sdn. Bhd. made a specific provision for doubtful debts of RM3,500 for the financial year ended 30.6.2016. For the financial year ended 30.6.2017, the specific provision for doubtful debts was RM4,300. In its Income Statement, the company showed the specific provision of RM3,500 for the year ended 30.6.2016 and the increase in specific provision of RM800 (RM4,300 - RM3,500) for the year ended 30.6.2017.

Provided that the conditions mentioned in paragraphs 6.2.1.1 has been met, the specific provisions made in the account are

allowable for the relevant years and no adjustment is required in the tax computation.

Example 5

Elektra Sdn. Bhd. made a specific provision for doubtful debt of RM3,500 for the financial year ended 30.6.2016. For the financial year ended 30.6.2017, the specific provision was reduced to RM2,000 because some payments had been received.

The decrease in the specific provision of RM1,500 (RM3,500 - RM2,000) is shown as 'specific provision written back' in the Income Statement. No adjustment is required in the tax computation since the decrease in the specific provision of RM1,500 should be taxed.

6.2.2 General provision for doubtful debts

The general provision for doubtful debts is made without any separate evaluation for each debtor and is generally made based on a specific percentage of debtor balances, sales or any other general grounds. The general provision for doubtful debts is not allowed as a deduction since the provision is made based on general information, even if there is a legal requirement or an accounting convention for the particular trade or industry to make such a provision.

Any increase in the general provision is not allowable and any decrease, on the other hand, is not taxable.

An adjustment shall be made in the tax computation for any such general provision shown in the Income Statement.

- 6.3 Specific and general provisions do not alter the amount owing in the debtors accounts. On the other hand, a bad debt written off reduces the balance in relevant debtor's account.

Where a deduction has been made under subsection 34(2) of the ITA in ascertaining the adjusted income of a business, any sum which is recovered in

a basis period shall be treated as gross income from the business for the relevant period – subsection 30(1) of the ITA.

7. Circumstances Where Irrecoverable Debts Are Not Allowed as Deductions

7.1 Forgiving or waiving payment of debt

A decision to forgive or to waive payment of a trade debt (either wholly or in part) should not be regarded as a valid business or commercial consideration for tax purposes. The amount written off for the above reasons shall not be allowed as a deduction against the gross income since the decision to write off such debt is not based on the possibility of recovery of the debt.

Example 6

Fuchsia Holdings Sdn. Bhd. is negotiating the take-over of one of its subsidiaries, Garnet Sdn. Bhd. by a consortium of businessmen. At the request of the consortium and in order to facilitate the deal, the directors of Fuchsia Holdings Sdn. Bhd. decide to forgive an accumulated debt on account of goods and services supplied to Garnet Sdn. Bhd. amounting to RM100,000. A letter to that effect (enclosing a copy of the directors' resolution) is issued to Garnet Sdn. Bhd. which then proceeds to extinguish the debt in its balance sheet as at 30.9.2017. In its accounts for the year ended 30.9.2017, Fuchsia Sdn. Bhd. writes off the amount as a bad debt.

In its tax computation for the relevant YA, Fuchsia Holdings Sdn. Bhd. should not be allowed a deduction for the amount written off as the decision is made for reasons other than in the ordinary course of business and on the basis of considerations other than the likelihood of recovery.

For Garnet Sdn. Bhd. the amount of debt forgiven should be reflected in its Income Statement where that amount which has been added back is taxable. The amount, being a reduction in the cost of goods and services previously charged in full in the Income Statement.

7.2 Non-trade debts

Non-trade debts that are written off as bad, or provisions made in respect of non-trade debts that are doubtful, either specific or general, are not deductible in the computation of adjusted income. Similarly, recoveries relating to non-

trade debts written off earlier are not taxable. Suitable adjustments should be made in the tax computation if such amounts are included in the Income Statement.

7.3 Debt due from related or connected person

7.3.1 A stringent examination should be made before making a decision to write off (or to extinguish by any other means) a trade debt arising from a related or connected person as bad debts that can be considered for deduction for tax purposes. Similarly when making a specific provision for a trade debt due from a related or connected person, a stringent examination has to be conducted.

7.3.2 There should also be evidence to prove that the decision made to write off a trade debt is made at an arm's length basis and for valid business or commercial reasons. Strong evidence must show that the decision is not made based on private, personal or other non-commercial reasons.

Example 7

Herriot Holdings Sdn. Bhd. provides colour separation and other ancillary services to one of its subsidiaries, Jaya Printers Sdn. Bhd. Based on the draft accounts for the financial year ended 31.10.2017, Jaya Printers Sdn. Bhd. is expected to incur a substantial loss in respect of its printing business. To avert adverse publicity, the directors of Herriot Holdings Sdn. Bhd. (who are also directors of Jaya Printers Sdn. Bhd.) decided to waive payment of an amount of RM20,000 from the total amount owing by the subsidiary company on account of services rendered. Jaya Printers Sdn. Bhd. is informed of this by way of a letter and it proceeds to reflect this in its final accounts which show a small net profit. In the Income Statement of Herriot Holdings Sdn. Bhd. for the financial year ended 31.10.2017, the amount is written off as a 'trade discount'.

The amount written off should be disallowed in computing the adjusted business income of Herriot Holdings Sdn. Bhd. for the relevant YA since there is no commercial basis for the 'discount' and the decision cannot in any way be regarded as being made at arm's length in view of the relationship of the two companies and the status of the directors.

No adjustment is necessary in the tax computation of Jaya Printers Sdn. Bhd. since the discount has been correctly treated for both accounting and tax purposes.

However, if this situation is between independent persons, the trade discount will be allowed tax deduction due to commercial reasons i.e. long term sustainability or joints brand name implications.

Example 8

Kamal, a sundry goods wholesaler, has been supplying goods on a regular basis to Latiff, a sundry shopkeeper, for the past 25 years. In the course of their long business relationship, they have become good friends. In 2008, Latiff married Kamal's sister. In the year 2013, Latiff's business has been steadily declining (amongst other reasons, due to the opening of a hypermarket in the vicinity) and in 2017, Kamal decided to write off the whole amount of the accumulated debts of Latiff (who is being sued by several of his other creditors).

In view of their relationship as brothers-in-law, the decision by Kamal to write off the debt of Latiff might be regarded as more for personal rather than for valid commercial reasons. Therefore, the trade debts that are written off should **not** be allowed as a deduction for tax purposes.

However, if it could be shown that the financial position of the debtor is the criterion for the decision (for example, Latiff has already been adjudged a bankrupt at the time the decision is made to write off the debt), then a deduction should be allowed since the write off is based on a valid commercial consideration.

Example 9

Matrix Bhd. writes off RM15,000 in its Income Statement for the year ended 31.7.2017, being the trade debt of its subsidiary Newton Sdn Bhd., which has been liquidated and deregistered in the same period.

Since the trade debt is written off due entirely to the financial position of the debtor (the liquidation of Newton Sdn Bhd.), the amount written off should be allowed notwithstanding the relationship between the two companies.

8. Settlement of Trade Debt With Assets

A debt may be settled by the foreclosure of an asset held as security for the debt or by an asset (such as a property or shares in a company) given in exchange for the debt. In such a case, the net proceeds from the sale of the asset or the market value of the asset given in exchange is the value to be taken as settlement for the debt.

Any balance of the debt still outstanding can be claimed as a bad debt if one of the circumstances mentioned in paragraph 5.3.2 is satisfied.

Example 10

Tanah Development Sdn. Bhd., a property developer which has many unsold houses as its stock, owed RM300,000 to Spectrum Sdn. Bhd. a construction company. After some negotiation and in view of the severe cashflow problems of the debtor, Spectrum Sdn. Bhd. agrees to accept a completed shophouse (market value is at RM280,000) as full settlement of the debt. However, soon after the agreement is reached, the market for properties sharply weakens. On completion of the transfer, Spectrum Sdn. Bhd. decided not to sell the shophouse immediately. Instead, the shophouse is let out. In the transfer documents for the property, the consideration is shown as RM280,000 and stamp duty based upon that value is duly assessed and paid. In its Income Statement, Spectrum Sdn. Bhd. has written off RM20,000 (RM300,000 - RM280,000) as a bad debt after one of the circumstances mentioned in paragraph 5.3.2 is satisfied.

The write off amounting to RM20,000 should be allowed for tax purposes as the market value of the asset accepted in exchange for the debt is RM280,000, as evidenced by its acceptance by the Collector of Stamp Duty.

9 Updates and Amendments

This PR replaces PR No. 1/2002 dated 2 April 2002.

10. Disclaimer

The examples in this PR are for illustration purposes only and are not exhaustive.



**TAX TREATMENT OF WHOLLY &
PARTLY IRRECOVERABLE DEBTS AND
DEBT RECOVERIES**

INLAND REVENUE BOARD OF MALAYSIA

**Public Ruling No. /2019
Date of Publication: 2019**

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

DRAFT