Chapter 6
Non – Business Income

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Dividend

- Dividend can be defined as a distribution or payment out of profits.
Dividend

- Dividend is considered an income because the payment is made from the company capital fund. Therefore, when the payment of dividend is made, it will directly reduce the company’s asset.
- Shareholders who received dividend from the company, will have extra income and this income will be chargeable to tax.
Other types of dividend received by shareholders, for example, **bonus shares is exempted from tax** because they are not classified as an income but merely as a returns on capital.
Dividend

- Distribution of assets due to liquidation of a company is also not an income to the shareholders. This is because they are getting back their capital/investment from the company. Therefore it does not contribute to the shareholders’ income.
Dividend

- The right issues to shareholders at a premium which is lower than market value will not be chargeable to tax.
Income Classification

• If dividend received is from the **business main activities**, therefore it is classified as an income under **section 4(a)** of the Income Tax Act 1967, which is known as the **business income**.

• However, if the dividend is **not from the business main activities**, it falls under **Section 4(c)** of the Income Tax Act 1967 as a **dividend income**.
Derivation of Income

- The dividend is considered derived from Malaysia if it was paid, credited or distributed by a resident company. According to Section 8(b) and (c) of the Income Tax Act 1967, a company is considered a Malaysian resident company when its management and control are based on Malaysia.
Deduction of Tax on Dividend Received

- A major tax proposal in Budget 2008 is the introduction of the single-tier income tax system, replacing the imputation system previously in place.
Deduction of Tax on Dividend Received

- Under the **single-tier system**, companies are **no longer** required to deduct tax on dividends paid to shareholders. The **corporate tax paid on a company’s profits will be a final tax** and dividends distributed to **shareholders will be exempted from tax**.
Basis of Assessment

There are three important aspects that we need to know in this.

- Basis Period
- Assessment Year
- Date of Payment
Basis of Assessment

- **Basis Period**

- When the dividend is paid, credited or distributed to shareholders in a basis year, it will be assessed in that year (the relevant year).
Basis of Assessment

- **Assessment Year**

  From the year of assessment 2000, the basis to assess dividend income is a **calendar year**. This is applied to all taxpayers except for **company, trust body, and co-operative society**. For these groups of taxpayers, the assessment year is according to their **financial year end**.
Basis of Assessment

- **Date of Payment**

According to Section 23 (b) of the Income Tax Act 1967, the date of payment of dividend is when the receiver has the right and control over the cash or fund which represents the dividend income.
Allowable Expenses

- The allowable expenses include interest expense, management charge and others if loan is taken to finance the investment.
Allowable Expenses

- Expenses like *commission for agent, brokerage fees or legal fees* are not allowed to be deducted from *dividend income*. This is due to the fact that these expenses relate to capital transaction activity and not revenue activity.
Foreign Dividend

- Foreign dividends received by person chargeable to tax is exempted from the tax except for company in a specialised industry (i.e. banking, insurance and air and sea transportation). This type of company is subjected to the world income scope, meaning that all income received in Malaysia or received from outside Malaysia is taxable.
Exempted Dividend

(a) Dividend paid, credited or distributed by cooperative society.

(b) Dividend paid from exempt income from unit trust and unit trust property.

(c) Dividend paid from exempt income from venture capital company.

(d) Dividend paid from exempt income from account which enjoyed the tax incentives for resident company under Investment Promotion Act 1986.

(e) Dividend paid from account which enjoyed tax incentive for resident company under Income Tax act 1967, such as Reinvestment allowance, Shipping incentives, and offshore insurance Incentives.

(f) Dividend paid from exempt tax for foreign income received in Malaysia by resident company.

(g) Dividend paid out of tax exempt account arising from foreign income received in Malaysia by a resident company (except banking, insurance and air and sea transportation) or unit trust.

(h) Dividend paid using exempt income from chargeable income existed in the year of assessment 2000 (Prior Year Assessment).
Interest

- Merriam Webster Online Dictionary, “interest” could be defined as the profit in goods or money that is made on invested capital.
Classification of Interest Income

Investment income + Business income → Interest income
Classification of Interest Income

- Interest is chargeable under Section 4(c), Income Tax Act 1967 if the interest income is recognised as an investment income and not a business income. Interest income for company, unit trust and society will be assessed according to financial year end respectively.
For **other chargeable person** such as individual taxpayer, interest income will be assessed according to the **calendar year**.
Classification of Interest Income

However, the interest income will be assessed as the business income under Section 4(a) if:

Section 4(a):
(a) It is received from trading debts;
(b) It is received from the ordinary course of business activity; and
(c) It is enjoyed by company in specialised industry such as bank and insurance company.
Derivation of Interest Income

- Any interest income received by any person is subjected to the Malaysian taxation if:

(a) Interest income is received in Malaysia; or
(b) Interest income is received in Malaysia from outside Malaysia.
Derivation of Interest Income

Section 15 of the Act states that the interest income is deemed derived from Malaysia if:

Section 15 of the Act:

(a) The responsibility for payment lies with Government or state government;
(b) The responsibility for payment lies with a person who is resident in Malaysia; and
(c) The interest is charged as an outgoing or expense against any income accruing in or derived from Malaysia.
Basis of Assessment

- The basis period of interest income for non-business, unit trust or social body is based on a calendar year. For a company, the basis year is the financial year end.
Allowable Expenses to be Deducted

- Interest expense relates to the loan is allowable to be deducted from gross interest income in determining the adjusted income from interest.
Exemption of Interest Income

Para 35, Schedule 6 of ITA 1967:

Schedule 6 of ITA, 1967 deals with exemptions of income tax. Paragraph 35 of Schedule 6 is regarding the exemption of interest paid or credited to any individual, unit trust and listed closed-end fund. It includes:

(a) Securities or bonds issued or guaranteed by the Government; or

(b) Debentures, other than convertible loan stock approved by Securities Commission; or

(c) Bon Simpanan Malaysia issued by Bank Negara Malaysia.

This order was effective from the year of assessment 2003 and subsequent year of assessment.
Exemption of Interest Income

Exemption Order

Resident individual are subjected to 5% withholding tax on gross interest income from deposits with licensed banks and finance companies and this is a ‘final tax’. Thus, resident individual will not be taxed again on the interest income. However, the following interest income will be exempted from tax by the Minister of Finance:

(a) Any bank or financed company licensed under Banking and Financial Institution Act 1989 (BAFIA) or Islamic banking Act 1983 on saving or fixed deposit (less than one year) not exceeding RM100,000;
(b) Any registered cooperative society;
(c) Bank Simpanan Nasional;
(d) Bank Pertanian Malaysia;
(e) Lembaga Urusan Tabung Haji;
(f) Malaysia Building Society Berhad; and
(g) Any other institutions approved by the Minister.

In the case of savings that exceed RM100,000, withholding tax of 5% will only applied to interest income earned in excess of RM100,000.
Exemption of Interest Income

Other exemptions on the interest income are as the following:

(a) Interest paid or credited on Certificates issued by Government.

(b) Premium from investment in Premium Saving Certificate under Bank Simpanan Nasional’s scheme.

(c) Interest received from bond and securities issued by Pengurusan Danaharta Nasional Berhad within or outside Malaysia.

(d) Interest received from non-convertible bond by any listed company in MESDAQ.

(e) Interest received from Merdeka Bond issued by Bank Negara Malaysia.

(f) Interest received by non-resident company from securities issued by the government and from non-convertible Islamic Securities or debenture issued in Ringgit Malaysia and approved by Securities Commission.
Section 2 of the Income Tax Act 1967, rental income can be defined to include any sum received for the use or occupation of any premises or for the hiring of any things. Rental income includes rent from moveable and immovable properties.
Rental Income

- Rent income fall under two sections:
  - Section 4(d) as an investment income
  - Section 4(a) as a business income
Rental Income

According to the Public Ruling PR 1/2004, rental income can be assessed as business income when a person owns a minimum unit of properties as the following:

<table>
<thead>
<tr>
<th>Types of Properties</th>
<th>Minimum Units Owned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factory</td>
<td>1</td>
</tr>
<tr>
<td>Warehouse</td>
<td>1</td>
</tr>
<tr>
<td>Office/shopping complex</td>
<td></td>
</tr>
<tr>
<td>The whole complex</td>
<td>1</td>
</tr>
<tr>
<td>Standard lot</td>
<td>4</td>
</tr>
<tr>
<td>Shop house</td>
<td>4</td>
</tr>
<tr>
<td>Residential properties</td>
<td>4</td>
</tr>
<tr>
<td>Mixture of properties</td>
<td>4</td>
</tr>
</tbody>
</table>
Derivation of Rental Income

**Immoveable Properties**
Rental income is deemed derived from Malaysia when the location of the landed properties is in Malaysia although:

(a) The owner is outside Malaysia; or
(b) The rental agreement is signed outside Malaysia.
Derivation of Rental Income

Movable Properties
Usually, movable properties relates to the leasing of factory and machine. The derivation of rental income depends on the place where the properties are used.

(a) **Place of where the business of lessor is carried on in Malaysia**
- If the place where the business of lessor is carried on in Malaysia, therefore the rental income accrued in Malaysia or received by the lessor is taxable under Section 4(a) as a business income.

(b) **Place of where the business of lessor is carried on outside Malaysia**
- Income received by foreign lessor is subject to withholding tax and it is derived from Malaysia.
Basis of Assessment

- Rental income received by a company, a trust body and a club will be assessed according to the financial year end.
- Individual taxpayers will be assessed using the current calendar year.
Basis of Assessment

- Two important aspects in the basis of assessment.

Advance Rental Income
According to Sec. 27(2) of the Income Tax Act 1967, is assessable in the year of receipt, although it is subject to refund.

Tax Planning
It is normal when we rent a house, we as the owner of the house will collect some deposit in advance as a guarantee for any damages that might happen during the tenancy period. This deposit is not assessable. However, when the deposit is used for the purpose of ‘rent’ it will be assessable at the time of conversion from deposit to rents payments. In the rental agreement, it is important to clearly define the words ‘rent’ and ‘deposit’ as deposits is not included in the rental income of the owner.
Allowable Expenses

(a) Cost of repair and maintenance;
(b) Insurance premium on fire/burglary;
(c) Cost of supervision and collection of rent;
(d) Cost of obtaining new tenant to replace the old tenant;
(e) Interest paid on loan taken to finance the property;
(f) Cost of renewing rental agreement;
(g) Assessment charge;
(h) Quit rent when rental is commenced; and
(i) Cost during temporary non-occupation.
Allowable Expenses

- **Temporary Non-occupation**

- When rental income exist, any expenses incurred in the period of temporary non-occupation of the premises are allowable to be deducted from the gross rental income.
Non – Allowable Expenses

• The cost incurred in obtaining the first tenant such as advertising expenses, commission, legal fees for rental agreement with first tenant are not allowed to be deducted. This kind of cost is regarded as capital expenditure.
Capital Allowance

- The capital allowance of the rented property cannot be claimed, when the rental income is assessed under Section 4(d) – Investment Income.
- However rental income assessed under Section 4(a) – business income is entitled to claim capital allowance.
Rental Loss

- Rental expenses incurred in one basis year exceeded the gross rental income received in that basis year, the excess cannot be offset against other source of income in the same year or carried forward to the subsequent year. In that case, it should be considered as a permanent loss. This provision is only applied to rental income which is assessed under Section 4(d).
Rental Loss

- The business income can offset its losses against other source of income in the same year or carried forward the unabsorbed losses to the subsequent year.
Sources of Income

- Shop lots and shop houses and other business premises constituted a single source. On the other hand, residential properties such as houses and flats are considered as another separate source. Last but not least, the vacant land is also considered as another source.
Royalty is a lump sum payment paid as consideration for the used of, or the right to use:

(a) Copyright, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks or tapes for radio or TV broadcasting, motion picture films, film or video tapes to be used in Malaysia.

(b) Know-how or information concerning technical, industrial, commercial or scientific knowledge, experience or skills.
Derivation of Royalty Income

(a) Royalty income is derived from Malaysia; or
(b) Received in Malaysia from outside Malaysia (applies to individual resident, companies in specialise industries, trust, cooperative societies).

- Royalty will be assessed according to the financial year end for a company, a unit trust or a cooperative society. For individual taxpayers, it will be assessed according to a calendar year.
Exemption for Royalty Income

Schedule 6 of the Income Tax Act 1967, “Para 32” discussed types of royalty received which is exempted from tax:

(a) Royalty from publication, used or right to used any artistic work and royalty from recording tapes or compact disk (CD): Such individual entitled for exemption of RM6,000 for that basis year.

(b) Payment received by individual resident in respect of translation of books or literary work on request by Ministry of Education or Attorney General’s Chambers, exempted to the amount of RM12,000 (Para 32A).

(c) Payment received by individual resident in respect of publication of, or the used of or the right to use any literary work or any original painting entitled for exemption of RM20,000 for the that basis year. (Para 32B).

(d) Total Income in respect of cultural performance approved by the Minister by resident individual for that basis year but excludes the income received by him from his formal employment (Para 32C).

(e) Musical composition up to RM20,000 (YA 2000) (Para 32D).

(f) Honorarium payment in respect of service provided for the purposes of validation, moderation or accreditation of franchised educational programmes in Higher Learning Institution is tax-exempt. (YA 2004) (Para 32E).

(g) Public Ruling 94/2004 - 50% exemption of the statutory income in relation to Scientific research which has been commercialised.
Other Sources of Non-Business Income

- Premium
- Discount
- Pension
Premium

- Premium could be defined as a **sum of money paid in addition to a regular price**, salary, or other amount.

- The premium receiver or landlord who received premium income would be assessed under Section 4(d) in addition of rental income.
Premium

- **Difference between Premium and Rental Income:**
  - **Premium will only be received once** but **rent will be continuously received** until the rental agreement ceases.
Discount

- A discount arises when the bills of exchange are purchased below their face value.
Discount

- Bill of exchange refers to a promissory note such as note payable and note receivable.
- Any profit arising from discounting transaction and any profit accrued by holding the bill until maturity or sale before maturity are assessable to tax under Section 4(c).
Pension

- Pension is a periodical payment made to individual who has permanently ceased to exercise an employment.
- Pension income is assessable under Section 4(e) of the Income Tax Act 1967.
Pension

- Pension is said to be derived from Malaysia if the payer

(i) Working for the Government or State Government; or
(ii) Resident in Malaysia.
Exemption of Pension

Paragraph 30 of Schedule 6, of the Income Tax Act 1967, states that when pension received on retirement at the age of 55 or compulsory age of retirement, the pension is exempted from tax. However there are a few conditions to be complied with:

(i) The pension must be derived from Malaysia;
(ii) The recipient has reached the age of 55 or compulsory age or retire due to ill health;
(iii) The pension is paid out from an approved fund; and
(iv) The receiver must exercise his former employment in Malaysia.
Q & A