TAX FLASH

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In this Issue

PR No. 4/2019 – Tax Treatment of Wholly & Partly Irrecoverable Debts and Debt Recoveries

The Inland Revenue Board ["IRB"] has recently issued the *Public Ruling ["PR"] No. 4/2019 – Tax Treatment of Wholly & Partly Irrecoverable Debts and Debt Recoveries* to provide guidance on the tax treatment in respect of:-

- wholly and partly irrecoverable debts as a deduction against gross income incurred by a person from a business for the basis year of a year of assessment; and
- recoveries of wholly and partly irrecoverable debts where a deduction has been made in ascertaining the adjusted income in prior year of assessment.

- Moore Malaysia
- Moore Global
- Inland Revenue Board

Salient points of the abovementioned PR include:-

i. Irrecoverable Debts

- 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, the following conditions must be fulfilled:-
  - the bad debt shall be an amount that has been included in the gross income of a person for the basis period for a year of assessment prior to the relevant year of assessment; and
  - the debt is a debt which is irrecoverable.
- All reasonable steps based on sound commercial considerations should be taken to recover the debt. To support a claim for deduction of a bad debt written off for tax purposes, there should be sufficient evidence of such reasonable steps have been taken, including one or more of the following:-
  - issuing reminder notices;
  - debt restructuring scheme;
  - rescheduling of debt settlement;
  - negotiation or arbitration of a disputed debt; or
  - legal action (such as filing of civil suit, obtaining of judgement from the court and execution of the judgement).
- The steps that should be taken depends on the amount of the irrecoverable debt and to be written off and/or the anticipated cost effectiveness of each action. If the amount of the debt and the anticipated cost hinders any action to pursue the debt, the reasons should be documented. 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.
- A debt can be considered as wholly irrecoverable or bad on the occurrence of any one of the following:-
  - the debtor has died without leaving any assets from which the debt can be recovered;
  - the debtor is a bankrupt or under liquidation and there are no assets from which the debt can be recovered;
  - the debt is statute-barred;
  - the debtor cannot be traced despite various attempts and there are no known assets from which the debt can be recovered;
  - attempts at negotiation or arbitration of a disputed debt have failed and the anticipated cost of litigation is prohibitive; or
  - any other circumstances where there is no likelihood of cost effective recovery.
- 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 brought to tax as gross income for the basis period the amount is received [Section 22(2)(a) of the Income Tax Act 1967 ["ITA 1967"].
- In the case where the nature of a business is giving loans and advancement, e.g. a moneylender company, a bank or a person giving loans in the course of its business, the interest (which has been included in the gross income) and the loan given are considered as a debt pursuant to the Section 34(3) of the ITA 1967 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.

ii. Doubtful Debts

- A provision is an expense which is not allowable since it does not fulfill the meaning of 'incurred'. However, Section 34(2) of the ITA 1967 allows a provision made for trade debts which are reasonably estimated to be irrecoverable and becoming bad (i.e. provision for doubtful debts) is allowable as a deduction in ascertaining the adjusted income of a business.
- The doubtful debt allowable has to be 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 year of assessment prior to the relevant year of assessment [Section 34(3)(a) of the ITA 1967].
- Specific provision for doubtful debts
    - A specific provision made at the end of the accounting period for the amount of the debt which is expected to be irrecoverable, which is determined with reasonable grounds to be irrecoverable can be allowed as a deduction against the gross income for the relevant basis period.
    - 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 year of assessment, and there is a change in the amount of the specific provision in a subsequent year:-
        - a deduction should be made against the gross income for the subsequent year for the amount of the increase in the specific provision; or
        - an addition should be made to the gross income for the subsequent year for the amount of the decrease in the specific provision.
- General provision for doubtful debts
    - 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.

iii. Circumstances Where Irrecoverable Debts Are Not Allowed as Deductions

- Forgiving or waiving 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.
- 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 nontrade debts written off earlier are not taxable.
- Debt due from related or connected person written off which is not made at an arm's length basis and without valid business or commercial reasons would not qualify for a tax deduction.

iv. Settlement of Trade Debt with Assets

- A debt may be settled by the foreclosure of an assets 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 this 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.

The above PR replaces the PR No. 1/2002 issued on 2nd April 2002.

Guidelines for Approval of DGIR under Section 44(6) of the ITA 1967

The IRB has, on 5th September 2019, issued the updated *Guidelines for Approval of Director General of Inland Revenue ["DGIR"] under Section 44(6) of the ITA 1967* to replace the previous Guidelines issued on 15th May 2019 with the following amendment:-

- Paragraph 6.1 (iv) of the Updated Guidelines
  - An annual audited financial statement audited by an accredited Public Auditor shall be sent by or on 30th April of each year to the IRB's Tax Policy Department together with the list of donors who donated RM10,000 (previously RM1,000) and above.

Note: *For further information on the previous Guidelines for Approval of DGIR under Section 44(6) of the ITA 1967, kindly refer to our Tax Flash – June 2019 issue.*

Guidelines on Imposition of Penalty under Section 112(3) of the ITA 1967, Section 51(3) of the PITA 1967 and Section 29(3) of the RPGT Act 1976

The IRB has recently issued the *Operational Guidelines No. 5/2019* (revised) dated 16th October 2019 to replace the previous Guidelines issued on 5th March 2015. The revised Operational Guidelines clarify on the imposition of penalty under:-

- Section 113(2) of the ITA 1967 for late submission of tax returns in accordance with Section 77(1) or 77(A) of the ITA 1967;
- Section 51(3) of the Petroleum (Income Tax) Act 1967 ["PITA 1967"] for late submission of tax returns in accordance with Section 30 or 30A of the PITA 1967; and
- Section 29(3) of the Real Property Gains Tax Act 1976 ["RPGT Act 1976"] for late submission of Real Property Gains Tax ["RPGT"] returns in accordance Section 13 of the RPGT Act 1976.

Salient points of the above revised Operational Guidelines include:-

i. Rate of Penalty for Late Submission of Tax Returns
   - Pursuant to Section 112(3) of the ITA 1967 and Section 51(3) of the PITA 1967, where a person fails to furnish a return to the IRB for a year of assessment within the stipulated period, the rate of penalty for late submission of tax returns will be imposed based on the length of delay the tax return is submitted. Details of penalties imposable are as follows:-

Length of Delay (from Due Date of Submission)	Penalty Rate on Tax Payable
Within 12 months	15%
> 12 months to 24 months	30%
> 24 months	45%

   - Pursuant to Section 29(3) of the RPGT Act 1976, where a person fails to furnish a RPGT return to the IRB within the stipulated period, the rate of penalty for late submission of RPGT returns will be imposed based on the length of delay the RPGT return is submitted. Details of penalties imposable are as follows:-

Length of Delay (from Due Date of Submission)	Penalty Rate on Tax Payable
Within 12 months	15%
> 12 months to 24 months	20%
> 24 months	25%

- Effective year of assessment ["YA"] 2019, where a company, limited liability partnership, trust body or co-operative society fails to notify the IRB of the change of accounting period in accordance with Section 21A(3A) of the ITA 1967, the penalty imposed under Section 112(3) of the ITA 1967 for late submission of tax returns will remain even if the return form is received within the stipulated period.

ii. Rate of Penalty for Failure to Furnish Returns

- Where a person has failed to submit his return by the stipulated deadline, the DGIR may raise an assessment according to his best judgement together with penalty for failure to furnish returns as follows:-

Related Act	Section Involved for Best Judgement Assessment	Section for Imposition of Penalty	Penalty Rate on Tax Payable
ITA 1967	Section 90(3)	Section 112(3)	45%
PITA 1967	Section 38(3)	Section 51(3)	45%
RPGT Act	Section 14(2)	Section 29(3)	45%

- The above revised Operational Guidelines come into effect on 1st October 2019.

***Note**: For further information on the previous Guidelines on the Imposition of Penalty under Section 112(3) of the ITA 1967 issued on 5th March 2015, please refer to our Tax Flash – April 2015 issues.*

Accelerated Capital Allowance for Development Cost of Customised Computer Software

Following the 2018 Budget announcement, the *Income Tax (Capital Allowance) (Development Cost for Customised Computer Software) Rules 2019* has been gazetted to allow the claim of Accelerated Capital Allowance on the development cost for customized computer software.

For the purpose of the above Rules, "development cost for customised computer software" means consultation fee, payment for rights of software ownership and incidental fee relating to the development of customised computer software.

The Rules apply to a resident person who incurred development cost for customised computer software in the basis period for the year of assessment 2018 onwards. It is noteworthy that the development cost for customised computer software shall be deemed to be incurred by the person in the basis period for a year of assessment in which the customized computer software is capable of being used for the purpose of his business.

The above Rules shall have effect from YA 2018 and the Income Tax (Deduction for Information Technology-Related Expenditure) Rules 2000 shall be revoked with effect from YA 2018.

Updated Guidelines on Application for Incentive for Green Technology

The Malaysian Investment Development Authority has issued the updated *Guidelines for Green Technology Tax Incentive* which provides the following incentives for companies involving in Green Technology:-

i. Investment tax allowance for companies which undertake Green Technology Project;
ii. Tax exemption for companies which undertake Green Technology Services; and
iii. Investment tax allowance for companies which acquire Green Technology Assets.

Following the Budget 2019 announcement, the Guidelines for Green Technology Tax Incentive has been updated to provide the list of qualifying green technology assets which expanded from the existing 9 assets to 40 assets eligible for the investment tax allowance incentive mentioned in item (iii) above. A summary of the qualifying green technology assets is provided in the *Appendix*.

Note: *For further information relating to the tax incentives available to the companies involved in green technology, please refer to our Tax Flash – April 2016 issue.*

Registration for Service Tax on Digital Services

A foreign service provider who provides digital services to consumers in Malaysia and who is liable to be registered as a foreign registered person can start to apply for registration effective 1st October 2019 via *http://mystods.customs.gov.my/landing-page/*.

Service Tax (Digital Service) Regulations 2019

The *Service Tax (Digital Service) Regulations 2019* has been gazetted on 30th September 2019.

The salient points pertaining to the Regulations are summarised below:-

i. Contents of Invoice or Document
   - Every foreign registered person who issues an invoice or a document in relation to provision of digital services to his consumer shall state the following particulars:-
     - date of invoice;
     - registration number of the foreign registered person;
     - descriptions of the digital services provided; and
     - total amount payable excluding service tax, rate of service tax and total service tax chargeable shown as a separate amount.

ii. Hours for Submission of Return and Payment
   - The ordinary hours for the purpose of receiving returns and payments of service tax or penalty payable through electronic banking shall be from 7.30 a.m. to 11.30 p.m. Malaysian standard time (UTC/GMT + 8 hours) on any day of the week.
   - Where any return and payment of service tax or penalty payable is made beyond the ordinary hours, it shall be deemed to be received on the next day.

Note: *For further information, kindly refer to our Tax Flash – August 2019 issue.*

Service Tax (Rate of Digital Services Tax) Order 2019

The *Service Tax (Rate of Digital Services Tax) Order 2019* has been gazetted on 30th September 2019 and is in force effective 1st January 2020. Based on the Order, service tax shall be charged and levied on digital services at the rate of 6% of the value of the digital services charged by a foreign registered person.