

▶▶ Tax Flash



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PR No. 3/2011 - Investment Holding Company

The Inland Revenue Board ["IRB"] has recently issued the Public Ruling ["PR"] No.3/2011 – Investment Holding Company. This PR provides guidance on the tax treatment in respect of an Investment Holding Company ["IHC"] resident in Malaysia.

Salient points of the abovementioned PR include:-

i. Definition of an IHC

- An IHC means a company whose activities consist mainly in the holding of investments and not less than 80% of its gross income (whether exempt or not) other than gross income from a source consisting of a business of holding of an investment is derived from the holding of those investments.

ii. Definition of a Business of Holding an Investment

- A business of holding of an investment means a business of letting of real property where a company in any year of assessment ["YA"] provides any maintenance services or support services in respect of the real property comprehensively and actively.
- Maintenance services or support services comprehensively provided include:-
 - doing generally all things necessary (e.g. cleaning services or repairs) for the maintenance and management of the real property such as the structural elements of the building, stairways, fire escapes, entrances and exits, lobbies, corridors, lifts/escalators, compounds, drains, water tanks, sewers, pipes, wires, cables or other fixtures and fittings; and
 - doing generally all things necessary for the maintenance and management of the exterior parts of the real property such as playing fields, recreational areas, driveways, car parks, open spaces, landscape areas, walls and fences, exterior lighting or other external fixtures and fittings.

If a person only provides security services or other facilities, it is not considered as providing maintenance services or support services comprehensively.

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- Services must be provided by the person who owns or lets out the real property or by another person/firm hired by such person.
- iii. Determination of an IHC
- A company is an IHC if the following two criteria are met:-
 - its main activity is the holding of investments; and
 - not less than 80% of the company's gross income (whether exempt or not) is derived from the holding of those investments.
 - The amount of gross income from a "business of holding of an investment" is not included as part of the gross income from the holding of investments (i.e. only income from interest, dividend and rental under Section 4(d) of the Income Tax Act 1967 ["the Act"] are to be included as part of the gross income from the holding of investments).
 - A company which has been determined to be an IHC in the basis period for a YA will be deemed to be an IHC in the subsequent YA until it is proven otherwise.
 - A company carrying on the business of holding investments i.e. a non-IHC in a YA will still be deemed as a non-IHC for the subsequent YA even though the income from the holding of investment is not less than 80% of its gross income if the gross income from rental (i.e. business of holding of investment) decreases in the subsequent YA due to temporary cessation of tenancy because of the following circumstances:-
 - repair and renovation of the building;
 - absence of tenants for a period of 2 years or less after termination of tenancy;
 - legal injunction or other official sanction; or
 - other circumstances beyond the control of the company.
- iv. Tax Treatment for IHC not Listed on the Bursa Malaysia – Section 60F
- Any income derived from holding of investments [i.e. interest, dividend, rental (non-business) and rental (business of holding of an investment)] is treated as a non-business source. Income other than this (such as management services fees) is treated as other gains or profits subject to tax under Section 4(f) of the Act.
 - An amount of permitted expenses determined in accordance with the prescribed formula is allowed as a deduction against the aggregate income in arriving at the total income of an IHC for a YA.

- The prescribed formula for the computation of the amount of allowable permitted expenses is:-

$$A \times \frac{B}{4C}$$

or 5% of B, whichever is lower

where:

- A is the total of the permitted expenses incurred for a basis period reduced by any receipts of a similar kind;
- B is the gross income consisting of dividend, interest and rent chargeable to tax for a basis period;
- C is the aggregate of the gross income consisting of dividend (whether exempt or not), interest and rent, and gains from realization of investments for a basis period.

Note : “dividend” is deemed to include income distributed by a unit trust (effective YA 2011).

With effect from the YA 2008, any expenses related to the derivation of single-tier dividend are to be disregarded. As such, permitted expenses attributable to the single-tier dividend are to be disregarded in determining the permitted expenses that can be deducted from the aggregate income of the IHC.

- With effect from the YA 2008, statutory dividend income (franked dividend) received by a company (except an IHC listed on the Bursa Malaysia) will be deemed to be the total income or part of the total income of the company. In the case where the IHC derives only franked dividends, permitted expenses will not be allowed.
- v. Tax Treatment for IHC Listed on the Bursa Malaysia – Section 60FA
- Any income derived from holding of investments [i.e. interest, dividend, rental (non business and business of holding of an investment)] is treated as a business source under Section 4(a) of the Act. Each source of income has to be assessed as a separate business source.
 - In ascertaining the adjusted income of each business source for a YA:-
 - no deduction on expenses is allowed if that source does not produce any income.
 - the amount of allowable deduction for direct expenses is restricted to the amount of gross income from that source for that YA. Any excess of that expenses is to be disregarded (cannot be absorbed by any other source of income or carried forward to subsequent YA); and

- the amount of allowable deduction for common expenses which is determined based on the gross income is restricted to the amount of gross income from that source for that YA. Any excess expenses are also to be disregarded.
- In ascertaining the statutory income from each business source for a YA, the allowances under Schedule 3 of the Act can be allowed but restricted to the amount of adjusted income from that source. If there is no adjusted income or the adjusted income is not sufficient to absorb those allowances, any excess of allowances cannot be carried forward to subsequent YA.
- If in a YA, an IHC also carries on a business activity (such as provision of management services) (not as the main activity), any adjusted loss from that business source will be given the normal treatment under Sections 43(2) and 44(2) of the Act (i.e. any adjusted loss from that business source for a YA can be deducted against the aggregate income for that YA and any unabsorbed loss can be carried forward to set-off against aggregate statutory business income for the subsequent YA).
- Special Provision
 - Any unabsorbed business loss and unabsorbed capital allowances ["CA"] brought forward from the YA prior to the introduction of the Section 60FA of the Act (effective YA 2006) can be set-off against the business sources for the YA 2006 and subsequent YA.
 - For the purpose of computing the statutory income from each business source, CA for the current year shall be utilised to set-off against the adjusted business income first followed by the unabsorbed CA brought forward from the previous YA.
- If an IHC is listed on the Bursa Malaysia for any period in the basis period for a YA, the tax treatment under Section 60FA of the Act shall apply for that YA.

The above PR takes effect from the YA 2006.

PR No. 4/2011 – Income from Letting of Real Property

The IRB has recently issued the PR No. 4/2011 – Income from Letting of Real Property. This PR provides guidance on the tax treatment on income derived from letting of real property as business source and non-business source under Section 4(a) and Section 4(d) of the Act respectively.

Salient points of the abovementioned PR include:-

- i. Letting of Real Property as a Business Source
 - Rental income received from letting of real property is deemed as business source and subject to tax under Section 4(a) of the Act if maintenance services or support services are comprehensively and actively provided in relation to the real property.
 - Maintenance services or support services comprehensively provided include:-
 - doing generally all things necessary (e.g. cleaning services or repairs) for the maintenance and management of the real property such as structural elements of the building, stairways, fire escapes, entrances and exits, lobbies, corridors, lifts/escalators, compounds, drains, water tanks, sewers, pipes, wires, cables or other fixtures and fittings; and
 - doing generally all things necessary for the maintenance and management exterior parts of the real property such as playing fields, recreational areas, driveways, car parks, open spaces, landscape areas, walls and fences, exterior lighting or other external fixtures and fittings.

If a person only provides security services or other facilities, it is not considered as providing maintenance services or support services comprehensively.

- Services must be provided by the person who owns or lets out the real property or by another person/firm hired by such person.
- The income from letting of real property to related parties can be treated as a business source under Section 4(a) of the Act provided that the rental charged is at arm's length basis. Otherwise, the IRB may adjust the rental payment accordingly.

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- ii. Special Treatment for Letting of Building to an Approved Multimedia Super Corridor ["MSC"] Status Company
 - Effective YA 2006, the letting of building in Cyberjaya Flagship Zone to an approved MSC status company is treated as carrying on a business and the income received is subject to tax under Section 4(a) of the Act in accordance to the Income Tax (Industrial Building Allowance) (Approved MSC Status Company) Rules 2006.
- iii. Letting of Real Property as a Non-Business Source
 - Rental income received from letting of real property is treated as non-business source and subject to tax under Section 4(d) of the Act if a person lets out the real property:-
 - without providing maintenance services or support services comprehensively and actively; or
 - maintenance services or support services are passively derived from the ownership of the real property (e.g. maintenance services provided by management corporation of an apartment let out).
- iv. Commencement Date of Letting of Real Property
 - The commencement date of letting of real property is determined as follows:-
 - Section 4(a) source – the date the real property is made available for letting (i.e. ready to be occupied by tenants and actions have been taken to facilitate the letting)
 - Section 4(d) source – the date the real property is rented out for the first time.
- v. All Real Properties Grouped as a Single Source
 - Rental income derived from letting of several properties can be grouped as a single source as follows:-
 - where all real properties is a business source – grouped as one business source and assessed under Section 4(a) of the Act;
 - where all real properties is a non-business source – grouped as one non-business source and assessed under Section 4(d) of the Act;
 - where some of the real properties is a business source and some is a non-business source – assessed under Section 4(a) and Section 4(d) of the Act respectively.

The income derived from a business source of letting of real property under Section 4(a) of the Act shall be treated a separate business source if a person has another business source of income from other businesses in the same YA.

vi. Expenses Relating to Income of Letting of Real Property

- Generally, all expenses which are wholly and exclusively incurred in the production of income is allowed as a deduction from income of business of letting of real property subject to tax under Section 4(a) of the Act.
- Expense which is allowed a deduction from income of letting of real property subject to tax under Section 4(d) of the Act is the direct expense deductible under Section 33(1) of the Act such as assessment and quit rent, interest on loan, fire insurance premium, expense on rent collection, expense on rent renewal and expense on repair.
- Initial expense (such as costs incurred to obtain the first tenant) is not allowed for a deduction from income of letting of real property whether assessed under Section 4(a) or 4(d) of the Act as the expense is incurred to create a source of rental income and not incurred in the production of rental income.
- Expenses incurred during a period the real property is not rented out can be allowed if:-
 - the period the real property is not rented out occurs after it has been let out and it is ready to be rented out.
 - the letting ceases temporarily due to the following circumstances:-
 - repair or renovation of the building
 - absence of tenants for a period of 2 years after termination of tenancy
 - legal injunction or other official sanction; or
 - other circumstances beyond the control of the person who lets out the real property

provided that the real property is maintained in good condition and is ready to be let out.

vii. Rental Income Received in Advance

- Rental income received in advance is treated as gross income for the basis period in which it is received.
- Where there is only one real property, expense incurred in relation to the rental income received in advance after that basis period is allowable in the basis period in which the income is assessed i.e. amendment has to be done to the assessment for the YA concerned.
- Where there is more than one real property and rental income from one or several real properties is received in advance, expenses related to that source is deductible from other rental income in the basis period in which the expenses are incurred. This is only applicable to rental income from real properties which are assessed as one source.

viii. CA

- CA can be claimed on capital expenditure incurred on plant and machinery if the letting of real properties is treated as a business source.
- Where the letting of real property is treated as a business source and the letting of real property ceases temporarily due to the circumstances mentioned above, CA can still be claimed in respect of the period the real property is not let out provided the real property is maintained in good condition and is made available for letting.
- Where there is a change in tax treatment of letting of a real property from a business source under Section 4(a) to a non-business source under Section 4(d) in the basis period of a YA, the person who lets out the real property has two sources of income from the same property in that basis period i.e. rental income under Section 4(a) and Section 4(d) of the Act. CA cannot be claimed on plant and machinery since they are not used for the business purpose at the end of the basis period for that YA.
- Where there is a change in tax treatment of letting of a real property from a non-business source under Section 4(d) to a business source under Section 4(a) in the basis period of a YA, the person who lets out the real property has two sources of income from the same real property in that basis period i.e. rental income under Section 4(d) and Section 4(a) of the Act. CA can be claimed on plant and machinery in the real property since they are used for the business purpose at the end of the basis period for that YA. The qualifying expenditure for the plant and machinery is the market value on the first day they are used in the business.

ix. Industrial Building Allowance ["IBA"]

- IBA can be claimed where a person owns a building and lets out the building which is in used as an industrial building even though it is a non-business source.
- Where a building is let out to an approved MSC status company, the owner of the building is eligible to claim IBA on the qualifying building expenditure incurred.

x. Replacement Cost of Furnishings

- Where the letting of a furnished real property is treated as non-business source, the cost of replacing furnishings (e.g. furniture and air conditioner) can be claimed as a deduction from the rental income.

xi. Letting of Part of Building Used in the Business

- Where a building (owned or rented) is used for business purposes and part of the building is let out, the rent arising from the letting is treated as part of income from the existing business source.

The above PR takes effect from the YA 2011 and supersedes the PR 1/2004 issued on 30th June 2004.

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