Tax Flash

August 2012

PR No. 5/2012 – Clubs, Associations or Similar Institutions

The Inland Revenue Board ["IRB"] has recently issued the Public Ruling ["PR"] No. 5/2012 – Clubs, Associations, or Similar Institutions. This PR provides guidance on the taxability of clubs, associations or similar institutions ["CASI"] which are established and controlled by its members.

Salient points of the abovementioned PR include:-

i. Ownership and Membership of CASI

- If the ownership of a body of persons is different from its membership, the club is likely to be a trading enterprise. On the other hand, if a CASI is established and owned by its members for the benefits of its member, this would mean that all assets belong to the membership which controls the club and its dealings.

- Transactions with members are not considered as trade dealings. Any surplus of receipts over expenditure in respect of income from transactions with member must be used for the benefit of all members of the CASI.

ii. Taxability of CASI

- Prior to year of assessment ["YA"] 2009, there was no specific provision on the tax treatment for CASI. Based on the general taxation principles, members fee and income from transactions with members are not subject to tax based on the principle of mutuality whereas the income derived from transactions with non-members is subject to tax.

- Effective YA 2009, Section 53A of the Income Tax Act 1967 ["the Act"] was introduced to enhance the transparency in the tax treatment of CASI.

Hyperlinks

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References

PR No. 5/2012

iii. Tax Treatment of CASI

- Income from Transactions with Members
    - Income arising from mutual dealings with the members is not subject to tax. Examples of mutual receipts from members of CASI include:-
        - entrance fees and member subscriptions;
        - drinks and food sold at the CASI's bar / restaurants to its members;
        - amounts paid by members to attend dinners or social functions organised by CASI; and
        - amounts paid by members to attend a talk, presentation or workshop organised by the CASI.
- Income from Transactions with Non-members
    - Income from activities or transactions with non-members (such as drinks sold to non-members visiting the clubs) will be subject to tax.
    - Income derived from transactions with spouse / parents of members of CASI who are considered as non-members is also subject to tax.
- Income from Investment and External Sources
    - Income from investment of CASI such as interest, rent and dividend being non-mutual receipts is taxable.
    - Income arising from arrangement with external parties under which the external party conducts or provides particular operations on the premises of the CASI will also be taxable. For example, where a golf club made arrangements with external parties to operate a restaurant, income received by the club from the restaurant is considered to be derived from an external source and is taxable.
- Expenses Incurred and Qualifying Expenditure for Claiming Capital Allowances.
    - Outgoing or expenses which are wholly incurred in deriving the CASI's taxable income from non-members can be allowed as deductions in determining the adjusted income of the CASI from transactions with non-members.
    - Capital expenditure incurred on assets used in business transactions with non-members to derive income from non-members only will qualify for capital allowances.

- Outgoing or expenses incurred by CASI in deriving income from transactions with members are to be disregarded pursuant to Section 53A(2) of the Act. Likewise, capital expenditure incurred on assets used in transactions with members to derive income from members only will not qualify for capital allowances.

- The outgoings or expenses and capital allowances common to the income from transactions with members and non-members need to be apportioned into the respective amounts attributable to:

  - income from transactions with members; and
  - income from transactions with non-members.

***Note**: The Income Tax (Deduction Relating to Transaction with Non-members for Club, Association or Similar Institution) Rules 2011 has been gazetted on 28.11.2011 to prescribe the formula to be used in determining the amount of deduction for allowable common expenses, capital allowances on common assets and gift of money in arriving at the adjusted income, statutory income and total income respectively of a CASI relating to transactions with non-members. For further information, kindly refer to our Tax Flash – November 2011 issue.*

iv. Tax Rates

- The taxable income of CASI is taxed at scale rates applicable to resident individuals as prescribed in Paragraph 1, Part I, Schedule 1 of the Act. However, CASI are not eligible for personal reliefs when computing their chargeable income.

v. Record Keeping

- CASI are required to keep separate accounts in respect of income derived from transactions with members and with non-members.

vi. Filing of Income Tax Return Form

- CASI are required to file the Income Tax Return Form (Form TF) for each year of assessment on or before 30th June of the following year.

Guidelines on Tax Treatment of Charges for Maintenance and Joint Property Management Received by a Developer, Joint Management Body and Management Corporation

The IRB has recently issued the Guidelines on Tax Treatment of Charges for Maintenance and Joint Property Management Received by a Developer, Joint Management Body and Management Corporation ["Guidelines"] which provides clarification on the functions and tax treatments of developer, Joint Management Body ["JMB"] and Management Corporation ["MC"].

Based on the abovementioned Guidelines, the tax treatment accorded to the developer, JMB and MC are as follows:-

i. Developer

- The mutuality principle among owners of unit is extended to the developer / subsidiary company that administers the property on behalf of the owners of unit.
- Any surplus of maintenance charges received (after deduction of maintenance expenses) belonging to the owners of unit as reflected under the accounts of developer / subsidiary company is not taxable.
- Interest income received from excess fund and rental income received from properties (such as multipurpose hall, swimming pool deck, etc) jointly owned by the owners of unit is subject to income tax on the developer / subsidiary companies at corporate tax rate.
- Separate Building Maintenance Account and accounts for business have to be maintained by the developer / subsidiary company.

ii. JMB

- The mutuality principle applies to JMB / Joint Management Committee ["JMC"].
- Any surplus / deficit arising from the Building Maintenance Fund is not subject to tax / disregarded.
- Interest, rental, dividend and other gains derived from the utilisation of Building Maintenance Fund is subject to income tax.
- JMB / JMC is to be taxed at scale rates applicable to resident individuals as prescribed in Paragraph 1, Part I, Schedule 1 of the Act.
- JMB / JMC is required to file an Income Tax Return Form (Form TF) under Section 77 of the Act.

Guidelines on Tax Treatment of Charges for Maintenance and Joint Property Management Received by a Developer, Joint Management Body and Management Corporation

iii. MC

- The mutuality principle applies to MC.
- The MC is treated as the continuous entity of JMC for the purpose of tax. The same income tax reference number registered by JMC shall continue to be used by the MC.
- The same tax treatment accorded to JMB / JMC will apply to MC.
- If the building maintenance is managed by a company / professional body / person who provides maintenance services as his business, fees received for such services will be subject to income tax on the company / professional body / person concerned.

All relevant records and documents in relation to the maintenance of building must be kept by the developer / JMB / JMC / MC and made available to the IRB during tax audit.

The above Guidelines apply to JMB established upon enforcement of the Building and Common Property (Maintenance and Management) Act 2007 (Act 663) on 12 April 2007 in Peninsular Malaysia and the Federal Territory of Labuan.

Transfer Pricing Guidelines 2012

Transfer Pricing Guidelines 2012

Following the gazette of the Income Tax (Transfer Pricing) Rules 2012 recently, the IRB has issued the new Transfer Pricing Guidelines ["the TP Guidelines"] to replace the old Transfer Pricing Guidelines issued in 2003. The TP Guidelines provide guidance for persons involved in transfer pricing ["TP"] arrangements to operate in accordance with the methods and manner in line with Section 140A of the Act, as well as compliance with the administrative requirements on the types of records and documentations to be maintained in accordance to the said Rules.

Pertinent points of the abovementioned TP Guidelines which are noteworthy include:-

i. Scope

- The TP Guidelines apply to controlled transactions for the acquisition or supply of property or services between associated persons, where at least one person is assessable or chargeable to tax in Malaysia and the TP documentation requirements will only apply to a person carrying on a business :-
  - o with gross income exceeding RM25 million, and the total amount of related party transaction exceeds RM25 million;
  - o in relation to financial assistance, where such financial assistance exceeds RM50 million. The TP Guidelines do not apply to transactions involving financial institution.

- Any person falling outside the above scope of TP Guidelines may opt for either :-

  - to comply fully with the guidance and TP documentation requirements in the TP Guidelines; or

  - to comply with TP documentation requirements consisting of organisational structure, controlled transactions and pricing policies only.

- The TP Guidelines need not apply to transactions between persons who are both assessable and chargeable to tax in Malaysia, where it can be proven that any adjustments made will not alter the total tax payable or suffered by both persons.

ii. Losses

- Where an associated enterprise is continuously suffering losses, it may be an indication that it is not being compensated fairly.

- In determining whether the losses are acceptable, it is important to ensure that the controlled transaction entered into is commercially realistic and make economic sense. Thus, a taxpayer is expected to maintain contemporaneous documentation which outlines the non-TP factors that have contributed to the losses.

iii. TP Documentation

- Taxpayers are required to prepare and keep contemporaneous TP documentation in addition to the records required to be maintained for a period of 7 years as required under Section 82 of the Act.

- The list of documentation that taxpayers need to prepare is provided in the TP Guidelines.

- A taxpayer engaged in the provision or acquisition of intragroup services, transfer of intangible property or participate in cost sharing arrangement is also required to prepare documentation that contain specific information as listed in the TP Guidelines.

- TP documentation is not required to be submitted with the annual tax return forms but should be made available to the IRB within 30 days upon request.

***Note**: The Income Tax (Transfer Pricing) Rules 2012 which are deemed to have come into operation on 1st January 2009 defines the meaning of "Contemporaneous TP documentation". For further information, kindly refer to our Tax Flash – June 2012 issue.*

iv. Penalty

- Tax adjustments as a result of a TP audit are subject to penalty under Section 113(2) of the Act at the following penalty rates:-

	Penalty
No contemporaneous TP documentation	35%
TP documentation prepared not according to requirements in the TP Guidelines	25%

- Taxpayers falling outside the scope of the TP Guidelines and have not prepared a contemporaneous TP documentation may be subject to 25% penalty on tax adjustments in respect of transactions not conducted at arm's length.

- The rate of penalty shall be increased by 20% as compared to the last penalty rate imposed for the previous offence but limited to a sum not exceeding 100% of the amount of tax undercharged, where:-

  - o the taxpayer obstructs or interferes with a TP audit; or

  - o the taxpayer fails to comply with the arm's length principle after previous TP audit.

Tax Exemption on Gains or Profit Falling under Section 4(f) Received by a Non-Resident from a Labuan Entity

Income Tax (Exemption) (No. 4) Order 2012

Pursuant to Income Tax (Exemption) (No. 4) Order 2012, any gains or profit falling under Section 4(f) of the Act received by a non-resident from a Labuan entity is exempted from tax. The withholding tax provision under Section 109F is also not applicable to the gains or profit.

The above Order is deemed to come into operation on 11th February 2010 and the Income Tax Exemption (No. 4) Order 2009 is therefore revoked.

Double Deduction for Sponsorship of Scholarship to Student of Higher Educational Institution

Income Tax (Deduction for the Sponsorship of Scholarship to Student of Higher Educational Institution) Rules 2012

Following the 2012 Budget announcement, the Income Tax (Deduction for the Sponsorship of Scholarship to Student of Higher Educational Institution) Rules 2012 have been gazetted to allow for double deduction for expenses incurred and paid by a company for sponsoring scholarship to student.

Among others, the conditions for claiming of the above double deduction for sponsorship of scholarship are:-

- Claimant Company
  - incorporated under the Companies Act 1965 and resident in Malaysia;
  - sponsoring scholarship to students of higher educational institution; and
  - the scholarship agreement with a student must be executed from 8th October 2011 to 31st December 2016.

- Student
  - must be a citizen and resident in Malaysia;
  - receives full-time course of study in diploma or bachelor's degree at higher educational institution;
  - has no means of his own; and
  - whose parents or guardians have total monthly income not exceeding RM5,000.

"Higher educational institution" means any institution established under the Universities and University Colleges Act 1971, Universiti Technologi MARA Act 1976 or the Private Higher Educational Institutions Act 1996.

The expenses qualify for deduction are payment required by higher educational institution relating to course of study and educational aid and reasonable cost of living expenses throughout the student's period of study.

The above Rules shall not apply to a company that has made a claim for deduction of scholarship under Section 34(6)(l) of the Act in the basis period for the relevant year of assessment.

The above Rules shall have effect from the YA 2011 to YA 2016.

Revocation of Deductions for Freight Charges for Export of Rattan and Wood-based Products

Income Tax (Deductions for Freight Charges) (Revocation) Rules 2012

The Income Tax (Deductions for Freight Charges) (Revocation) Rules 2012 has been gazetted to revoke the Income Tax (Deductions for Freight Charges) Rules 1990 which allows double deduction on freight charges incurred by the manufacturer of rattan and wood-based products for export of such products.

The above Rules shall take effect from the YA 2016.

Revocation of Deductions for Insurance Premiums for Exporters

The Income Tax (Deductions of Insurance Premiums for Exporters) (Revocation) Rules 2012 has been gazetted to revoke the Income Tax (Deductions of Insurance Premiums for Exporters) Rules 1995 which allows double deduction on insurance premiums paid to any insurance company incorporated in Malaysia for export of cargo.

The above Rules shall take effect from the YA 2016.

Income Tax (Deductions of Insurance Premiums for Exporters) (Revocation) Rules 2012

Revocation of Deductions of Insurance Premiums for Importers

The Income Tax (Deductions of Insurance Premiums for Importers) (Revocation) Rules 2012 has been gazetted to revoke the Income Tax (Deductions of Insurance Premiums for Importers) Rules 1982 which allows double deduction on insurance premiums paid to any insurance company incorporated in Malaysia for importation of cargo.

The above Rules shall take effect from the YA 2016.

Income Tax (Deductions of Insurance Premiums for Importers) (Revocation) Rules 2012

Protocol to Amend the Article on Exchange of Information - Double Tax Agreement between Malaysia and Indonesia

The protocol signed between Malaysia and Indonesia pertaining to the article on Exchange of Information ["EOI"] has recently been gazetted. The new article on EOI is in line with the EOI provision of Article 26 of the Organisation for Economic Co-operation and Development Model Convention with regard to secrecy and disclosure of information received and obligation to supply information by the authorities of one contracting state to the other contracting state.

Double Taxation Relief (The Government of the Republic of Indonesia) (Amendment) Order 2012

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