CHAPTER THREE

DEVELOPMENT AND STRUCTURE OF PERSONAL INCOME TAX POLICY

3.1 Definition of Income

Income Tax Act 1967 defines income to be used in ordinary sense. Receipts such as gifts, legacies, lottery wins and capital gains are not considered as income. Income chargeable to tax under the Income Tax Act 1967 is:

- Employment income (gains or profits from employment)
- Business income (gains or profits from a business for whatever period of time carried on)
- Dividends, interests, and discounts
- Rents, royalties, and premiums
- Pensions, annuities, and other periodical payments
- Special classes of income (income from non of the above)

Government of Malaysia differentiates three concepts of income in the income tax ordinance. The three different kinds of income are statutory income,
assessable income, and chargeable income. Statutory income is defined as the total of all income sources that not only covers the monetary receipts but the non-monetary receipts as well.

The second category of income known as the assessable income is the statutory income less all outflows incurred in the time the income is produced. The examples of outflows are compensations to employees, donations and contributions to activities approved by the government, rents, and interests borrowed, capital depreciation, losses and bad debts. The chargeable income as its name implies is the income being considered for the payment of income tax. They are assessable income minus the personal and family deductions.

As this paper focuses on personal income tax policy, the main concern of this paper is to look upon the employment income. Employment income as its name implies is the income derived from a period of employment. The income from employment can be classified as wages, salary, leave pay, remuneration, fee, commission, or allowance regardless of whether the income is in the form of money or something else. The scope of income as defined in the Income Tax Act 1967 is very broad that includes all types of remuneration. The income Tax Act 1967 enacts that all types of allowances such as travelling allowances and entertainment allowances be included as gross income. This
enactment voids if one could prove that the allowances are not received while practising any kind of employment.

3.2 Basic Structure

The income tax levied on individuals is based on 'world scope basis', with effect from year assessment 1968. World scope assessment states that resident who is ordinarily a resident in Malaysia is liable to tax on income wherever the income is derived. Meanwhile non-resident is liable to tax on income earned in Malaysia. But with effect from the year assessment 1974 tax is levied on 'derivation basis'. Derivation basis states that an individual who is a resident in Malaysia is now liable to tax on income accrued from Malaysia or income received in Malaysia from outside Malaysia. Tax liability of non-residents remains on the world scope basis.

The length of stay in Malaysia determines residence status. According to the Inland Revenue Board, residents are people who have stayed in Malaysia for at least 182 days in a basis year. An individual is still considered a resident although the days of stay are less than 182 days. This condition applies if and only if the 182 days are in the period by which it forms part of a period of more than 182 days throughout which the individual is in Malaysia. The period the
individual is in Malaysia should be in the basis year of assessment either immediately preceding or immediately following that particular year of assessment.

Individuals are also considered as residents if the period of stay in Malaysia is 90 days or more in basis year provided that the individuals be either residents or reside in Malaysia for 90 days or more in three of the immediate five preceding years.

Individuals who have been out of Malaysia for the whole of a basis year could still be considered as residents. The status of residents will be granted if the individuals reside in Malaysia for the three immediate preceding years and will be resident for the basis year immediately following the year of absenteeism from Malaysia.

Temporary absenteeism of non-residents is considered to be one of the following:

i. attending seminar / study abroad / in connection with service matter

ii. ill-health involving the individual or a member of the immediate family

iii. social visit of no more than fourteen days
3.2.1 Basis Year

Malaysia is practising the preceding year assessment until the year 1998. Preceding year assessment means that income tax charged for a particular year is based on the income derived in that year. The calendar year immediately proceeds a year of assessment is considered as the basis year for that year of assessment. With effect from the new millennium, Malaysia is switching to the 'current year assessment' system. Under this new system, income derived in the year 2000 will be assessed to tax in year 2000 instead of year 2001 under the preceding year assessment.

Changes are not made for the sole purpose of having a different policy for the new millennium. The current year assessment does bring about some benefits. As pointed out by IRB, the benefit from the current year assessment system is that tax will be assessed and collected on income derived from that particular year. This simply means that tax will be collected based on the ability to pay and the current cash flow position of the taxpayers. Compared to the preceding year assessment where taxes are collected a year later, resulted in cash tight for the taxpayers in the following years to settle the taxes and incur different kinds of current expenses that could increase due to economic downturn or even a recession.
The mentioning benefit however does not apply for the year 2000. In the year 2000, taxpayers will have to settle tax payments for two years that are 1999 and 2000. This is because the assessment in year 1999 is still based on the preceding year basis and will be assessable to tax in the year 2000.

Realising this matter, government has proposed a solution to lessen the burden of the taxpayers. In the year 2000, tax will not be charged on income for the basis period 1999. In year 2000, taxes paid are only based on the income derived in the year 2000 only. Taxpayers will be happy to know that taxes for the year 1999 will be waived. Regardless of the waive, taxpayers still need to declare their income for 1999. The income waive however, does not cover dividend income, income derived by foreign employees and non-residents who commence or terminate their employment in Malaysia in 1999, and taxpayers subject to withholding tax or final tax.

The current year assessment system is of a least importance in this paper because the year of analysis for the study ends in the year 1997. Year 1997 is still under the preceding year assessment.

3.2.2 Assessment

Assessment of tax is made only after the period of submitting the return form expires. Until now there is no fixed date for issuing an assessment. It is the
obligation of the citizens to declare the income derived in that particular year to any branches of IRB.

Advanced assessment is allowed for individuals who plan to leave the city permanently if the income derived prior to the departure is categorised under the chargeable Malaysian personal income tax for the following year of assessment. There is still no specific date for the advanced assessment. It is stated in the Income Tax Act 1967 that the advanced assessment could be made in any year after a subsequent year of assessment.

In general, IRB has listed down four different types of assessment. They are separate assessment, combined assessment, separation / divorce cases, and tax treatment on income of a deceased individual / wife.

Separate assessment states that a married woman's income is assessed separately from that of the husband's. The wife will be issued a notice of assessment but she will still have to declare her income in her husband’s tax return form. Separate assessment is not made compulsory as husband and wife are allowed to combine their total income to be assessed as one. The combined assessment notice will be issued under the husband's name. The norm is to have combined assessment if the total income is considered small.
If a marriage comes under fire and divorce is the only solution, the wife will revert to her former tax status prior to the marriage. The wife will have her own tax return (reopening of previous tax file or opening of a new one). The husband will continue filing his tax return using his own tax reference number and will be assessed as an individual.

Another assessment is the tax treatment on income of a deceased individual / wife. Since the assessed person has died, the tax return will be issued in the name of the legal representative. The assessment of income for the deceased individual / wife for that year up to the date of death will be assessed separately. Any income accumulated after the date of death constitutes the income of the estate of the deceased and is assessed in the name of the executor or administrator of the estate.

3.2.3 **Tax Payment**

Income Tax Act 1967 states that full amount of tax must be paid within 30 days from the date of service of the notice of assessment unless the person is permitted to pay by instalments. Failure to pay within the specified period will cause the taxpayers to incur a ten- percent penalty. The balance of the remaining unpaid taxes (upon expiration of the 30 days) has been increased to ten percent of the unpaid balance with effect from the year 1981. The increase
will continue for the remaining balances for no more than five periods. The percent of penalty has been increased to fifteen percent of the remaining unpaid balance with effect from the year 1982.

Monthly deductions to settle the payment of tax due on all salary taxpayers are allowed starting from the year 1977. Other kinds of earners have no choice but to pay the tax in full amount. In Peninsular Malaysia, employers in accordance with specific direction given by the department made monthly deductions. Employees are also allowed to make some kind of arrangements with their employers to deduct tax from their monthly salary in advance of the assessment. For Sabah and Sarawak, the monthly deductions for the payment of tax are made based on the tax deduction tables provided.

The compulsory deduction scheme for employees is introduced with effect from the year 1987. This scheme is introduced for employees whose tax liability is in excess of RM 500 for any year of assessment can settle their taxes by instalments. Monthly tax deductions are also allowed but only by specific direction from IRB. The number of instalments depends on the amount of tax payable by the individuals.

A scheme for compulsory payment of tax by instalments is practised with effect from January 1st 1989. IRB will issue a direction to pay tax that is based
on the previous year's tax. Upon receiving this direction taxpayers are
obligated to pay the tax in five bimonthly instalments as directed by the
collection's branch. If the taxpayers can't seem to pay in five bimonthly
payments, they can request for variation in payments.

The current policy to ease the burden of paying a large amount of tax in one
lump sum or instalments is the 'Scheduler Tax Deduction' (STD). IRB defines
STD as a collection scheme whereby it is obligatory for each employer to
deduct from the salary following a schedule determined by IRB. Currently,
there are three categories of employees who are subjected to STD. First are the
employees who started employment before January 1st 1995. This category of
employees will face a tax deduction in respect of income derived from the
preceding year. Second and third categories are the employees who start
working after January 1st 1995 and employees in Sabah and Sarawak. This
category of employees will face a tax deduction from income derived in the
current year.
3.3 Tax Rates

The income tax rates differ from that of residents and non-residents. The only common experience is the seven different tax rates for the year 1977 – 1997. For residents, starting from taxing the first RM 2,500 for six percent in 1977, the rate is reduced to zero percent for the first RM 2,500 starting from the year 1995. The highest earner of income also experiences a lower tax rate of thirty two percent in 1997 and thirty percent in 1999 from a high of fifty five percent in 1977.

Non-residents also experience lower tax rates as the nation progresses towards further development. Tax rates for non-residents do not change as much as those of the residents do. In 1977, non-residents were charged forty percent on every ringgit of chargeable income and fifteen percent of gross income on income consisting of interest and loyalty. Non-residents enjoy a one-percent reduction on the tax rate on every ringgit of chargeable income for the year 1990 and 1993. Tax rates for 1990 and 1993 were reduced to thirty five percent and forty percent respectively. Currently, in the year 1999, the tax rate on chargeable income is thirty percent.

\[1\] Refer to Appendix B for details of the income tax rates
3.4 Deductions

Income Tax Act 1967 allows for several deductions in the computation of income. The allowable deductions fall into two broad categories. They are general expenditure and specific deductions.

3.4.1 General Expenditure

General expenditure focuses on the expenses incurred wholly and exclusively in the production of income. Allowable deductions do not include capital expenditure either on private or domestic nature. Any payment made to a person other than the State Government for the purpose of extracting timber from Malaysian forest or in respect of interest paid to a non-resident is not categorised under the allowable deductions.

3.4.2 Specific Deductions

The deductions accounted under the allowable deductions listed down in the Income Tax Act 1967 are as follows:

i. obligatory contributions by employers to approved pension and provident funds

ii. payroll tax paid in the basis period
iii. expenditure wholly expended in the business of working of
    mines, estates, timber, or forestry in Malaysia

iv. expenditure on replanting

v. expenditure on scientific research

vi. losses incurred in business, trade, or profession

vii. expenditure on abortive prospecting

viii. gifts or money to the government or to approved institutions

3.4.3 Personal Relieves

For resident individuals, the Income Tax Act 1967 allows a RM 2,000 and one-
ten of earned income up to a maximum of RM 1,000. Wife will be subjected

to a relief of RM 1,000. Children relieves are allowable for children who are

unmarried and under 16 years of age at any time in the basis period. Children

above 16 years old must have been receiving full time studies at higher

institutions. Allowable deductions for the first child is RM 800, second child

is RM 700, third child is RM 600, fourth child RM 500, and fifth child is RM

400. Handicapped children above 16 years old are allowed for deductions up

to the amount of RM 400.
Relieves for individuals have been increased to RM 5,000 and RM 2,000 for wife with effect from the year 1980. Deductions for children are also increased to four times the normal deduction.

Children relieves are once again amended to RM 650 for the first child, RM 750 for the second child, RM 800 for the third, fourth, and fifth children with effect from the year 1985. In the year 1991, children relieves are once again revised to RM 800 each for the first five qualifying children and RM 1,000 for handicapped children. In the same year too, an additional RM 1,000 has increased wife's relief.

Children relief for children with disabilities has been increased to RM 1,600 with effect from the year 1992. The same year also states that increased relief for a child educated abroad in a college or similar institution can only be granted to those who are above eighteen years old.

Currently, children who commence studies abroad before January 1\textsuperscript{st} 1994, will continue to receive RM 800 x 4 = RM 3,200 deductible allowance until the completion of the studies. Those who commence studies after January 1\textsuperscript{st} 1994, will only be entitled for deductible allowance of RM 800 x 2 = RM 1,600 until the completion of studies.
Other personal relieves as stated in the current Income Tax Act are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Disabled individual (further deduction)</td>
<td>RM 5,000</td>
</tr>
<tr>
<td>2</td>
<td>Disabled wife (further deduction)</td>
<td>RM 5,000</td>
</tr>
<tr>
<td>3</td>
<td>Fees for the purpose of acquiring technical skills (Maximum)</td>
<td>RM 2,500</td>
</tr>
<tr>
<td>4</td>
<td>Medical expenses for parents (Maximum)</td>
<td>RM 5,000</td>
</tr>
<tr>
<td>5</td>
<td>Medical expenses for serious diseases on individual, spouse or children</td>
<td>RM 5,000</td>
</tr>
<tr>
<td>6</td>
<td>Purchases of necessary disability equipment for wife, children, or parents</td>
<td>RM 5,000</td>
</tr>
<tr>
<td>7</td>
<td>Life insurance premium</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Self (Maximum)</td>
<td>RM 5,000</td>
</tr>
<tr>
<td></td>
<td>Wife (Maximum)</td>
<td>RM 5,000</td>
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<tr>
<td>8</td>
<td>Insurance scheme for education or medical benefit</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Self (Maximum)</td>
<td>RM 2,000</td>
</tr>
<tr>
<td></td>
<td>Wife (Maximum)</td>
<td>RM 2,000</td>
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</tbody>
</table>

### 3.5 Fiscal Incentives For Savings

Malaysia is known to be among the countries with the highest savings rate. Incentive scheme for savings were introduced in the Income Tax Act 1967 to induce more and more peoples to save. Interest of RM 600 in respect of savings with commercial banks, Lembaga Urusan Tabung Haji, co-operative societies, Bank Pertanian or licensed finance companies will be exempt from
tax with effect from year assessment 1979. A higher interest will be exempt from deposits with the National Savings Bank with the interest of RM 1,000.

The amount of interest being exempt from tax has been increased with effect from year assessment 1981 to further induce more people to save. Interest accruing on a deposit of RM 100,000 deposited with any licensed bank will be exempt from tax.

For depositors of the National Savings Bank, they could save up to RM 30,000 and enjoy a tax-free interest. In addition, interest equivalent to interest accruing on a deposit of RM 100,000 in any fixed deposit account for a period exceeding twelve months with any licensed bank will be exempt from tax.

The amount of interest received from deposits at any licensed bank is increased to RM 5,000 with effect from the year assessment 1988 until present. Depositors of the National Savings Bank enjoy another additional benefit of having a tax-free interest for fixed deposits up to RM 100,000 with a maturity period of six months.
3.6 Example of Tax Computation Of An Employment Income For Unmarried Individual\(^2\)

<table>
<thead>
<tr>
<th>TAX COMPUTATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>STATUTORY INCOME</strong></td>
</tr>
<tr>
<td><strong>GROSS INCOME</strong></td>
</tr>
<tr>
<td><strong>TOTAL INCOME OF ALL SOURCES</strong></td>
</tr>
<tr>
<td>Less: Donations/Gift to Government/ State Government And approved institutions</td>
</tr>
<tr>
<td><strong>TOTAL INCOME</strong></td>
</tr>
<tr>
<td>Less: ( (i) ) Personal Relief</td>
</tr>
<tr>
<td>( - ) self and dependence.</td>
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<tr>
<td>( - ) medical expenses for parents.</td>
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<tr>
<td>( - ) medical expenses for serious disease.</td>
</tr>
<tr>
<td>( - ) disabled individual</td>
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<tr>
<td>( - ) disabled wife</td>
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<tr>
<td>( - ) fees for education in scientific, technology or vocational</td>
</tr>
<tr>
<td>( - ) cost of purchase of necessary basic supporting equipment for disabled person.</td>
</tr>
<tr>
<td>( - ) wife</td>
</tr>
<tr>
<td>( - ) child/children/disabled child</td>
</tr>
<tr>
<td>( (ii) ) deductions for insurance premiums and obligatory contributions to an approved provident fund.</td>
</tr>
<tr>
<td>( - ) insurance premium on education or medical benefit.</td>
</tr>
<tr>
<td><strong>CHARGEABLE INCOME</strong></td>
</tr>
<tr>
<td><strong>INCOME TAX CHARGEABLE</strong> (as per tax rates)</td>
</tr>
<tr>
<td>Less: Rebates</td>
</tr>
<tr>
<td>( (i) ) Self</td>
</tr>
<tr>
<td>( (ii) ) Wife</td>
</tr>
<tr>
<td>( (iii) ) Zakat, Fitrah</td>
</tr>
<tr>
<td>( (iv) ) Purchase of Personal Computer /Levy on foreign workers</td>
</tr>
<tr>
<td>Less: Relief for foreign tax/tax deducted at source from dividends</td>
</tr>
<tr>
<td><strong>TOTAL TAX PAYABLE</strong></td>
</tr>
</tbody>
</table>

\(^2\) Form taken from the IRB web-site: http://www.hasilnet.org.my