



**KALYX ACADEMY**  
WHERE KALYXIAN GROW TOGETHER

## **SECTION 3 – COMPANY TAX**

### **3.1 INTEREST RESTRICTION**

**FACILITATOR : HADDEN LIM**  
**VENUE : KALYX BOARDROOM**  
**TIME : 6:15PM**

# AGENDA

**1. Interest Restriction**

**2. Q & A**

**3. HOMEWORK**





**WHOLLY  
EXCLUSIVELY  
INCURRED**



**IN THE PRODUCTION OF THE GROSS INCOME**





**INLAND REVENUE BOARD MALAYSIA**

**INTEREST EXPENSE AND  
INTEREST RESTRICTION**

**PUBLIC RULING NO. 2/2011**

*Translation from the original Bahasa Malaysia text*

**DATE OF ISSUE: 7 FEBRUARY 2011**

# Tax treatment of interest expense

Deductibility of interest expense under paragraph 33(1)(a) In ascertaining the adjusted income of a person from a source for the basis period for a year of assessment, interest incurred and payable on money borrowed by that person and –

- (i) employed in that period in the production of gross income from that source; or
- (i) laid out on assets used or held in that period for the production of gross income from that source is an allowable expense.

Example 1: Abadi Sdn Bhd borrowed RM1 million from CIMB Bank in January 2009 for use as working capital in its manufacturing business. The company incurred interest of RM100,000 in the year 2009. It has no other investments (as reflected in the company's balance sheet).

*The interest expense of RM100,000 is allowed as a deduction from the gross business income of the company as it was incurred in the production of that income.*

Example 2: Ahmad bought a machine for use in his printing business by taking a loan of RM50,000 from Bank Industri.

*Interest expense which Ahmad has to pay to the bank is allowed as a deduction from his gross business income as the loan was laid out on asset used for the production of income.*



Example 3: Bangi Sdn Bhd which closes its account on 31 December every year borrowed RM10 million from Maybank in March 2008 to build a new factory for its own use in Bandar Baru Bangi. The building is expected to be completed in January 2010.

*Although the building has not yet been completed in the years 2008 and 2009, the interest expense incurred by the company in those years are allowed a deduction from its gross business income for the years of assessment 2008 and 2009 respectively since the loan was laid out on asset held for the production of income.*

# Pre-commencement Interest Expenses

A person would not be given any deduction on the interest expense which he has incurred on borrowed money to construct a building or plant prior to commencement of his business.

The person would not be able to claim industrial building or capital allowance (if applicable) as well on the amount of interest incurred even though such interest expense may have been capitalized as part of the cost of the building or plant. This is so because the interest expense is not part of the cost of construction of building or provision of plant.

Example 4: IPP Sdn Bhd was incorporated on 8.3.2006. The company was given a concession by the state government to supply electricity to the rural areas in the state. Before commencement of its business of power supply on 1.7.2008, the company has incurred interest expense of RM3 million on a syndicated loan of RM30 million used to build a power plant.

*The company would not be able to claim RM3 million in its tax computation for the year ending 30.6.2009 as the amount is a pre-commencement expense nor would it be eligible to claim capital allowance on the RM3 million if the amount has been capitalized as part of the cost of the power plant.*

Borrowed money not  
wholly and exclusively used  
in business

Subsection 33(2) of the ITA provides that if a person has borrowed money for purposes of business as well as for non-business purposes, the interest expense charged to the profit and loss account may not be allowed a full deduction. This is so, if in the opinion of the Director General of Inland Revenue (DGIR), a part or whole of the money has either directly or indirectly been used for non-business purposes.

Money used for non-business purposes includes:

- (i) investments in landed properties, shares, securities and Islamic securities, placement in fixed deposits; and
- (ii) loans (including interest-free loans) given to some other persons.

If a person is able to prove to the satisfaction of the DGR that investments and loans have not been made directly or indirectly out of the borrowed money, there will be no restriction on the interest expense allowable in calculating the adjusted income from the business source.

On the other hand, if a person fails to prove that the investments and loans have not been financed partly or wholly, directly or indirectly out of the borrowed money, then the amount of interest expense allowable will be restricted.

# Interest restriction under subsection 33(2) of the ITA



The deduction of interest expense payable on borrowed money used for purposes of business, investments and loans is determined as follows:

- (i) if the total amount of investments and loans is the same with or exceeds the amount of borrowed money, the whole amount of interest expense is disallowed; or
- (ii) if the total amount of investments and loans is less than the amount of borrowed money, then only a portion of the interest expense is disallowed.

## Effective date

This Ruling is effective for the year of assessment 2011 and subsequent years of assessment.

The portion of interest expense to be restricted against the gross business income is computed by using the following formula:

Cost of investments and loans financed by interest-bearing borrowed money	
_____	X Average interest payable, monthly or annually
Outstanding balance of interest-bearing borrowed money at month or year end	

# Application of the formula

## **1. Borrowed money does not exceed RM500,000**

Where the total cost of investments and loans which are financed directly or indirectly from the borrowed money does not exceed RM500,000, subsection 33(2) interest restriction will be computed based on the **end-of-year balance**.

## **2. Borrowed money exceed RM500,000**

- i. the total cost of investments and loans which are financed directly or indirectly from the borrowed money exceeds RM500,000; or
- ii. there are no investments and loans at the end of the financial year because the investments and loans which are financed directly or indirectly by the borrowed money have been sold, transferred or repaid during the year.

Subsection 33(2) interest restriction will be applied strictly based on monthly balances and the relevant information should be kept by the taxpayer for tax audit purposes.

The interest expense incurred is deemed to have been accrued evenly every month if monthly balances are used in computing interest restriction under subsection 33(2) of the ITA.

Example 5: Alamanda Sdn Bhd closes its account on 31 December every year. It had obtained an overdraft facility of RM400,000 from Maybank for use in its business in December 2008. It bought 1,000 units of TNB shares and 5,000 units of Telekom shares on 5 January 2009. It also purchased a terrace house and a shophouse in January 2009. It received income from the investments in 2009 as follows:

Shares	Units	Cost (RM)	Dividend (RM)
TNB	1,000	10,000	2,000
Telekom Bhd	<u>5,000</u>	<u>30,000</u>	<u>Nil</u>
<b>Total</b>	<b><u>6,000</u></b>	<b><u>40,000</u></b>	<b><u>2,000</u></b>

Property	Cost (RM)	Rental received (RM)	Revenue expenses (RM)
Terrace house	100,000	12,000	1,000
Shop house	<u>160,000</u>	<u>24,000</u>	<u>2,500</u>
<b>Total</b>	<b><u>260,000</u></b>	<b><u>36,000</u></b>	<b><u>3,500</u></b>



The company claimed an interest expense of RM40,000 in its profit and loss account for the year of assessment 2009. As the company could not substantiate the purchase of investments were not financed from the overdraft, the amount of interest expense deductible against the gross income from its business has to be restricted.

The interest restriction is computed using the formula in paragraph 6.2 of this Ruling as follows:

$$\begin{aligned} \text{Interest restricted} &= \frac{\text{RM300,000}}{\text{RM400,000}} \times \text{RM40,000} \\ &= \text{RM30,000} \end{aligned}$$

<i><b>Dividend income (RM)</b></i>	<i><b>Rental income (RM)</b></i>
$\frac{40,000}{300,000} \times 30,000 = 4,000$	$\frac{260,000}{300,000} \times 30,000 = 26,000$
<div> <i>Gross income</i> <div>2,000</div> </div> <div> <i>Less: Interest allowable</i> <div></div> </div> <div> <i>(RM4,000 restricted)</i> <div><u>2,000</u></div> </div> <div> <i>Statutory income</i> <div><u>NIL</u></div> </div>	<div> <i>Gross income</i> <div>36,000</div> </div> <div> <i>Less: Interest allowable</i> <div>26,000</div> </div> <div> <i>Other expenses</i> <div><u>3,500</u></div> </div> <div> <i>Statutory income</i> <div><u>6,500</u></div> </div>

Example 6: Same facts as in Example 5 except that the shares were financed by an interest-free loan from one of the directors. The interest restriction is computed as follows:

$$\begin{aligned} \text{Interest restricted} &= \frac{\text{RM260,000}}{\text{RM400,000}} \times \text{RM40,000} \\ &= \text{RM26,000} \end{aligned}$$

# Interest expense incurred on investments

For purposes of deducting interest expense against dividends, interest or rental income, all investments in portfolio shares, loans or properties of the respective sources should be aggregated regardless of whether they are income producing or non-income producing.

However, this tax treatment does not apply to investments which produce income that is exempted from tax and interest-free loans to related parties, which are financed by the borrowed money.

Example 8: Badrul Sdn Bhd obtained a loan facility from Ambank for use in its sundry shop business. The company invested in unit trusts and purchased some shares using part of the proceeds from the loan facility. Interest restriction computed by using the formula in paragraph 6.2 of this Ruling is RM8,000. Badrul Sdn Bhd received the following investment income:

Unit trust	Units	Cost (RM)	Distribution of income (RM)
SBS Growth Fund	20,000	20,000	2,000
Makmur Fund	<u>10,000</u>	<u>10,000</u>	<u>1,000</u>
<b>Total</b>	<b><u>30,000</u></b>	<b><u>30,000</u></b>	<b><u>3,000</u></b>

Portfolio shares	Units	Cost (RM)	Dividend income (RM)
MAS Bhd	2,000	10,000	Nil
XYZ Bhd (pioneer co.)	10,000	50,000	(tax-exempt) 5,000
ABC Ltd (foreign co.)	5,000	20,000	(tax-exempt) 2,000
Malakof Bhd	<u>10,000</u>	<u>40,000</u>	<u>10,000</u>
<b>Total</b>	<b><u>27,000</u></b>	<b><u>120,000</u></b>	<b><u>17,000</u></b>

### *Tax treatment*

*(a) Interest expense applicable to the investments in unit trusts:*

$$\frac{RM30,000}{RM150,000} \times RM8,000 = RM1,600$$

*(b) Interest expense applicable to the portfolio shares:*

$$\frac{RM50,000}{RM150,000} \times RM8,000 = RM2,667$$

**Computation of statutory income**

(i) <i>Distribution of income</i>	<i>RM3,000</i>
<i>Less : Interest expense</i>	<u><i>RM1,600</i></u>
<b><i>Statutory income</i></b>	<u><b><i>RM1,400</i></b></u>
 (ii) <i>Gross dividend income</i>	<i>RM10,000</i>
<i>Less : Interest expense</i>	<u><i>RM 2,667</i></u>
<b><i>Statutory income</i></b>	<u><b><i>RM7,333</i></b></u>



# Refinancing loan

- Any interest incurred on a second loan taken to refinance an existing loan would be deductible for tax purposes if the earlier loan was taken for the purpose of producing the business income.
- However, if the second loan is taken to finance the earlier loan which was used for business as well as non-business purposes, then interest restriction under subsection 33(2) of the ITA applies.

# Non-application of subsection 33(2) interest restriction

- Subsection 33(2) interest restriction is not applicable where interest on borrowed money charged to the business accounts does not exceed RM10,000 in the case of companies and RM6,000 in the case of individuals and others.
- Where interest on borrowed money charged to the business accounts exceeds RM10,000 in the case of companies and RM6,000 in the case of individuals and others, subsection 33(2) interest restriction should be applied.
- However, the interest disallowed for business purposes as a result of applying subsection 33(2) can be set-off against income from investments or loans, whichever is applicable.

**Source :**

**1. Public Ruling No. 2/2011 – Interest Expenses and Interest Restriction**

[http://www.hasil.gov.my/pdf/pdfam/PR2\\_2011.pdf](http://www.hasil.gov.my/pdf/pdfam/PR2_2011.pdf)

**2. Public Ruling No. 8/2015 – Loan or Advances to Director by a Company**

[http://lampiran1.hasil.gov.my/pdf/pdfam/LOAN\\_OR\\_ADVANCES\\_TO\\_DIRECTOR.pdf](http://lampiran1.hasil.gov.my/pdf/pdfam/LOAN_OR_ADVANCES_TO_DIRECTOR.pdf)

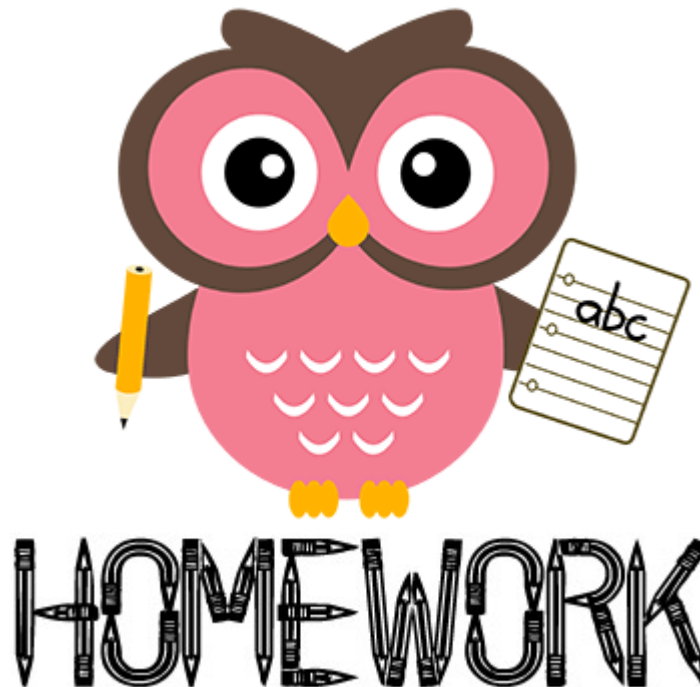
**3. Announcement regarding the application of subsection 77A(4) and section 140B of the Income Tax Act (ITA) 1967**

<http://lampiran1.hasil.gov.my/pdf/pdfam/ANNOUNCEMENT REGARDING THE APPLICATION OF SUBSECTION 77A 10042014.pdf>

**4. Public Ruling No. 2/2013 – Perquisites from Employment**

[http://lampiran1.hasil.gov.my/pdf/pdfam/PR2\\_2013.pdf](http://lampiran1.hasil.gov.my/pdf/pdfam/PR2_2013.pdf)





Example 7: Metro Bhd has obtained a loan facility from RHB Bank Bhd. Particulars of its monthly loan balances and investments financed by the borrowed money from RHB Bank Bhd are as follows:

Month ending	Loan balances (RM)	Investments (RM)	Interest expense (RM)
January	3,000,000	1,500,000	10,000
February	4,000,000	3,000,000	10,000
March	2,500,000	3,000,000	10,000
April	1,500,000	3,000,000	10,000
May	7,000,000	5,000,000	10,000
June	4,000,000	5,000,000	10,000
July	6,000,000	2,000,000	10,000
August	NIL	2,000,000	NIL
September	3,500,000	2,000,000	10,000
October	1,000,000	NIL	10,000
November	7,000,000	3,000,000	10,000
December	4,000,000	3,000,000	10,000



## SECTION 3 – COMPANY TAX

### TOPIC 3.1 INTEREST RESTRICTION

*The portion of interest expense that is restricted under subsection 33(2) of the ITA is computed as follows:*

<b>Month ending</b>	<b>Computation</b>		<b>Interest restricted (RM)</b>
January	$\frac{\text{RM1,500,000}}{\text{RM3,000,000}} \times \text{RM10,000}$	=	5,000
February	$\frac{\text{RM3,000,000}}{\text{RM4,000,000}} \times \text{RM10,000}$	=	7,500
March	The whole interest is disallowed as the invested money exceeds the borrowed money	=	10,000
April	The whole interest is disallowed as the invested money exceeds the borrowed money	=	10,000
May	$\frac{\text{RM5,000,000}}{\text{RM7,000,000}} \times \text{RM10,000}$	=	7,143
June	The whole interest is disallowed as the invested money exceeds the borrowed money	=	10,000

## SECTION 3 – COMPANY TAX

### TOPIC 3.1 INTEREST RESTRICTION

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July	$\frac{\text{RM2,000,000}}{\text{RM6,000,000}} \times \text{RM10,000}$	=	3,333
August	No interest expense was incurred for the month	=	NIL
September	$\frac{\text{RM2,000,000}}{\text{RM3,500,000}} \times \text{RM10,000}$	=	5,714
October	The whole interest is allowable as no investment was made in the month	=	NIL
November	$\frac{\text{RM3,000,000}}{\text{RM7,000,000}} \times \text{RM10,000}$	=	4,286
December	$\frac{\text{RM3,000,000}}{\text{RM4,000,000}} \times \text{RM10,000}$	=	7,500
	<b>Total interest</b>	=	<b>70,476</b>



**INLAND REVENUE BOARD OF MALAYSIA**

**LOAN OR ADVANCES TO DIRECTOR BY  
A COMPANY**

**PUBLIC RULING NO. 8/2015**

Translation from the original Bahasa Malaysia text

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