B26 SINGLE TIER SYSTEM AND THE TRANSITIONAL PROVISIONS

Single Tier System

Under the single tier system, income tax payable on the chargeable income of a company is a final tax in Malaysia. Any dividends distributed by the company will be exempt from tax in the hands of the shareholders. There is no further need to deduct tax when paying dividends. Dividends can be freely distributed without having to keep track of a dividend franking account. Expenses incurred in the production of the dividend income will not be deductible.

Limited Transitional Imputation System (LTIS)

Companies with a credit balance in their dividend franking accounts at 31 December 2007 are allowed to utilise these credits to pay franked dividends to shareholders up to and including 31 December 2013. Any balance remaining in the dividend franking account after this date will be disregarded. However, a company may at any time make an irrevocable election to forego the right to distribute franked dividends by filing a Form R50.

In addition, the Inland Revenue Board (IRB) has confirmed that the single tier system may exist alongside the imputation system up to 31 December 2013.

Companies can continue to pay out LTIS dividends until the dividend franking account is reduced to nil or the company exercises its irrevocable option. The amount in the dividend franking account will be reduced either by the payment of LTIS dividend or due to tax on prior years assessments being discharged, remitted or refunded.

Under the LTIS, only dividends that are paid in cash and in respect of ordinary shares are capable of being franked. An “ordinary share” is defined to mean a share other than one that carries a dividend right of a fixed amount or at a fixed percentage of the nominal value of the share, or a fixed percentage of the profits of the company.

When a dividend payment is made to an ordinary shareholder, an amount equal to the tax due on the dividend is drawn from the dividend franking account and imputed to the shareholder. Every company shall upon paying a LTIS dividend furnish the shareholder with a certificate stating the gross dividend, tax deducted or deemed deducted from the dividend and net dividend paid out.

Accordingly, as long as the company does not “overdraw” its dividend franking account, no payment will be due from the company to the government as a result of paying a dividend. However, if the company has insufficient balance in the dividend franking account, the company will be required to make an actual payment of the shortfall in tax credit to the IRB if it makes a distribution to its shareholders. This payment must be made by the last day of the 7th month from the date following the close of the accounting period. Failure to pay by this due date will result in a penalty of 10% being imposed on the amount unpaid to the IRB.

Where in relation to a year of assessment (Y/A) from Y/A 2008 to 2013 or 2014 (if applicable), a company fails to furnish the Director General a statement in the prescribed form, the Director General may compute the amount of tax credit shortfall and shall serve on the company a written requisition on the prescribed form calling upon the company to pay the tax credit shortfall and the penalty thereon upon service of the requisition. It is proposed that in addition to the present conditions for shareholders to claim tax credits, the dividend received must be paid in cash.

Shareholders whose effective rate of tax is lower than the corporate income tax rate or those who are exempt, however, are entitled to a tax refund of the tax withheld.
Anti-abuse provisions have been introduced to prevent shareholders from taking advantage of the potential refund on excess tax paid. The provisions are as follows:

- Companies, whose dividend income is treated as a passive source, will have their statutory income from that source deemed as total income. As a result, the company will not be allowed to deduct current year business loss, losses surrendered under group relief scheme or donations from their dividend source. This provision appears to be a measure to prevent other companies being purchased purely for their dividend franking account balances.

- Resident or non-resident shareholders would not be entitled to a credit for the tax withheld at source from dividends if the shares in respect of which dividends were received, were held by the shareholder for less than 90 days. An exception to this rule is made for shares listed in the Bursa Malaysia.

Where a company is not entitled to deduct tax on a dividend and issues shareholders certificates which purport to show that an amount of tax has been deducted, then an amount equal to the tax deducted or deemed deducted shall be the amount due from the company to the Government. Further, as a penalty, this amount would be increased by 10% of the amount due to the Government. The IRB will serve on the company a written requisition, calling for the company to pay the amount due and the increase on the amount due. The amount unpaid and the penalty shall be a debt due and payable to the Government.

**Filing of prescribed forms**

Pursuant to S. 45 of the Finance Act 2007 a company has to furnish to the Director General a statement in the prescribed form within 30 days from the date a LTIS dividend is paid. In this regard, IRB has given a concession via its letter dated 18 January 2008 that for dividends paid during the period between 1 January 2008 to 31 December 2013, companies are exempted from filing a statement.

Companies will still have to continue to file their Form R, by the last day of the 7th month from the date following the close of the accounting period. Failure to comply with the filing of this form is an offence under S. 120(1)(a) of the Income Tax Act 1967, whereby any person upon conviction, be liable to a fine ranging from RM200 to RM2,000\(^1\) or to imprisonment for a term not exceeding 6 months or both. However, companies which commence operations after 31 December 2007 are not required to submit Form R with effect from Y/A 2010 and subsequent years of assessment.

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\(^1\) Section 120(1) of the Income Tax Act 1967 has been amended by Act 764 of 2014 with effect from 31 December 2014 by changing the maximum fine from RM2,000 to RM20,000.