TAX MANAGEMENT for SMALL MEDIUM ENTERPRISE (SME)

The income tax payable for an SME for a particular year of assessment (tax year) is based on entity chargeable (taxable) income. The chargeable income is generally determined by the difference between total taxable income and total allowable deduction for the tax year.

According to the Income Tax Act, 1967 (the Act), a SME will be taxed on income derived in Malaysia. However, SME will not be liable on “foreign source” income ie income derived from outside Malaysia except if the SME is a resident company carrying on the business of banking, insurance, sea or air transport for the basis year for the year of assessment.

In addition certain income or receipts are not liable to income tax include -

- Capital gains (e.g. from sale of fixed assets or investments not held for trading purposes);
- Gains on foreign exchange arising from non-trade transactions (e.g. repayment of long term loans or advances, purchase of fixed assets);
- Unrealized gains on foreign exchange arising from trade transactions;
- Compensation received from compulsory acquisition of land by Government or State Government where the land is held for long term investment purposes;
- Income specifically exempted under the Act or by way of Ministerial Order such as grants or subsidy from Government.

SME Corp allocates grant and subsidy to SME. A detail explanation on the tax implications is discussed under “Garis Panduan berkaitan dengan Pengecualian Cukai ke atas Pemberian atau Subsidi dan pendapatan Pihak Berkuasa Berkanun” issued by Inland Revenue Board Malaysia.

1. Definition of SME

In fact, there is no definition of SME under the Income Tax Act, 1967 (the Act). The definition of SME used by SME Corporation and Bank Negara Malaysia for purposes of granting financial assistance is not found in the Act for income tax purposes.

However, the Act gives special preferential treatment to ‘certain’ SME companies as defined below. For the purposes our discussion I refer them as “Special Classes of SME”.


Prior to the year of assessment 2009, Special Classes of SME refers to companies resident in Malaysia which has a paid-up capital in respect of ordinary shares of RM2.5mil and less at the beginning of the basis period for a year of assessment is given preferential tax treatment as spelt out in the relevant provisions of the Act.

From year of assessment 2009 onwards, the definition of the “Special Classes of SME” is amended to refer to resident companies that has a paid-up capital in respect of ordinary shares of RM2.5mil and less at the beginning of the basis period for a year of assessment but exclude companies if more than:

a. Fifty per cent of the paid up capital in respect of ordinary shares of the company is directly or indirectly owned by a related company
b. Fifty percent of the paid up capital in respect of ordinary shares of the related company is directly or indirectly owned by the first mentioned company; or
c. Fifty percent of the paid up capital in respect of ordinary shares of the first mentioned company and the related company is directly or indirectly owned by another company

Related company means a company which has a paid up capital in respect of ordinary shares of more than two million and five hundred thousand ringgit at the beginning of the basis period for a year of assessment.

As such, currently resident SME companies with a paid up ordinary share capital not exceeding RM 2.5million which form part of a group where there is direct or indirect control of/by a related company is not eligible for preferential tax treatment or considered as “Special Classes of SME”.

“Special Classes of SME” for tax purposes enjoy three preferential tax treatments such as:

1) Tax rates
2) The estimate of tax payable
3) Accelerated capital allowance
1.1 Tax Rates

For Special Classes of SME, the corporate tax rate with effect from year of assessment 2009 is as follows:-

- First 500,000 chargeable Income is taxed at 20%
- In excess of RM500,000 chargeable income is to taxed at 25%

However, for companies that do not fall under the definition of Special Classes of SME, the corporate tax rate is 25% (flat rate). Only the Special Classes of SME has a two tier tax rate (20%/25%). The rest of the companies will be taxed on a one flat rate of 25%.

The two tier tax rate would allow a maximum tax savings of RM25,000.

1.2 Estimate tax payable

According to section 107C(2) of the Act, a company is required to submit an estimate of their tax payable (using form CP204) for a year of assessment to the Director General of Inland Revenue Board not less than 30 days before the 1st day of the basis period for a year of assessment.

Under section 107C(4) of the Act, where a company first commences operation in a year of assessment and the basis period for that year is not less than six months, the estimate of tax payable is required to be submitted within 3 months from the commencement of operations.

However, for a newly setup Special Classes of SME, the SME is not required to submit the estimate of tax payable for the first two years of assessment under section 107(4A) of the Act.
1.3 Accelerated Capital Allowance (ACA)

As a rule, ACA permits a quicker write off (higher rates) for a qualifying investment as compared to the normal initial/annual allowance rate for capital allowance purposes. As such, ACA would help the company to save paying income tax up front.

For Special Classes of SME, according to paragraph 19A Schedule 3 of the Act, ACA apply to small value assets (the value of each asset being not more than one thousand ringgit) in use for the purposes of the business, where the total qualifying plant expenditure in respect of such asset for each year of assessment exceeds the amount of ten thousand ringgit.

In addition, other ACA incentive on Natural Gas-Powered Buses and Natural Gas Refuelling Equipment, Control Equipment, Plant used in Building and Construction, Timber or Mining Industries, Computer Software, Computers and Information Technology Equipment, Plant and Machinery for Recycling of Wastes, Plant and Machinery for Conservation of Energy also apply to Special Classes of SME.

1.4 Group Relief Losses for SME

Under s44A of the Act, group relief losses permits a ‘surrendering company’ (loss co) to transfer part of its untilised current year loss to one or more related claimant companies (profit co) provided the certain conditions are met. One of the conditions for group relief losses is that both surrendering company and claimant company must have ordinary paid up share capital of more than RM2.5 million at the beginning of the basis period. As such, special classes of SME would not be eligible for group relief losses incentive.
1.5 Corporate Tax System for SME

Currently (2013) whether SME or non SME, companies in Malaysia are either adopting the imputation corporate system or the single tier corporate system. However by 1 January 2014 all companies must adopt the single tier corporate system.

Under the single tier system, the taxable income of the company is taxed at the company’s level but when the profits are distributed to the shareholders as dividends, the dividends are exempted in the hands of the shareholders.

2. SME Companies Tax Responsibilities

The common responsibilities in respect of companies for tax purposes are as follows:

1) Furnish tax return (Form C & R)
2) Furnish the estimate of tax payable
3) Furnish Form E
4) Record keeping

2.1 Furnish Tax Returns (Form C & R)

A company must fill up Form C and R (Tax return) and submit the return either by e-filing or manual filing. The basic requirements as to Form C and R are as follows:-

- Every return must be made in a prescribed form, Form C and R.
- If filed manually, the offices which returns are to be furnished to:-

  Information Processing Department  
  Inland Revenue Board of Malaysia  
  Level 10-18, Tower C  
  Persiaran MPAJ  
  Jalan Pandan Utama  
  Pandan Indah  
  55100 Kuala Lumpur

- The return must be signed to declare that this returns contains information that is true, correct and complete pertaining to the income tax of the company. Failure to sign the return is considered as an incomplete form and an offence under the Act.
• Every company must lodge the Form C and R within 7 months from the following close of the accounting period which constitute the basis period for the year of assessment. (Refer to s77A of the Act)

• Any default to furnish Form C or R, without reasonable excuse, would be liable to a fine of not less than RM 200 and not more than RM2,000 or to imprisonment for a term not exceeding 6 months or both.

• Where no prosecution action has been initiated and there is a default in not furnishing Form C, the Director General (DG) may require that person to pay a penalty equal to 300% the amount of tax which before any set off, repayment or relief under the Act.

• On submission of the Form C within the due date, the return form C is deemed an assessment made on the company.

2.2 Submission of the Estimate of Tax Payable (Form CP204)

Basic rules on tax estimate are:

• Generally, a company is required to submit an estimate of tax payable for the year of assessment to the Director General of Inland Revenue Board not less than 30 days before the 1st day of the basis period for a year of assessment.

• The estimate is paid by monthly installments. The number of installments depends on the number of months in the basis period for a year of assessment.

• New SME companies are exempted from filing the tax estimates for the first two year of assessments. For new non SME companies, tax estimate is exempted only for the 1st year of assessment if the number of months of basis period for the 1st year of assessment is 6 months or less.
• For existing companies, payment of tax estimate is by equal monthly installments beginning from the second month of the company’s basis period (Financial year). Each subsequent installment must be paid by the 10th day of the relevant month.

• For the 1st year of assessment in respect of CP 204 submitted for new companies, the payment of tax estimate must be made by equal installments beginning for the 6th month of the basis period. Each subsequent installment must be paid by the 10th day of the relevant month.

• A penalty is imposed on late payment or no payment is made in respect of the installment on due date. The amount of penalty for each installment delay or unpaid is 10% of the amount of installment unpaid on due date.

• A company shall make an estimate of tax payable for a year of assessment which is not less than 85% of the revised tax estimate or tax estimate if there is no revised tax estimate for the immediate preceding year of assessment.

• A company can make a revised tax estimation in the 6th or the 9th month or in both months in the basis period for a year of assessment. This estimation may be submitted to Director General of Inland Revenue Malaysia (DGIRM) by using Form CP204A.

• Companies are authorized to revise their estimate of tax payable by way or a form CP204A. They are allowed to do so in the sixth month or ninth month or both months of the basis period. If estimate of tax payable(CP204) is submitted after date due, no revision of estimate is allowed.

• An underestimate of estimate of tax payable occurs if the revised estimated ( in the absence of the revised estimate, the original estimate of tax payable) is less than 70% of the actual tax payable. Underestimation is penalized to deter willful reduction of estimate of tax payable. This penalty is 10% on the difference between 70% of the actual tax payable and the revised estimate of tax payable ( in the absence of the revised estimate, the original estimate of tax payable).
• In the absence of estimate of tax payable furnish to the IRB for a year of assessment, the DG may direct any company to make payment by installments of such time and such account as the DG directs. This is usually done by way of a form CP205. Where the CP205 is issued before the 9th month of the basis period, the amount shall be deemed the estimate of tax payable.

• Where there is prosecution action initiated, no CP205 issued, no CP204 has been submitted and the company has tax payable for the year of assessment, the company would be penalized with a penalty of 10% of the tax payable for failure to submit the tax estimate.

• A company, trust body or co-operative society fails to furnish the estimated tax payable (CP204) in the prescribed period of 30 days before the beginning of the basis period of a year of assessment or has furnished the estimate tax payable that is less than 85% of the previous year estimate, IRB may at any time direct instalment payments for estimates of tax payable by way of CP205.

2.3 Companies responsible as an Employer

1. Submission of Income tax Return (Form E)
2. Prepare and render to his employee a statement of remuneration (Form EA/EC)
3. Deduction from remuneration (Monthly Tax Deduction)
4. Provide information about new employees commencing employment
5. Provide information about employees ceasing employment
6. Provide information about leaving Malaysia

2.3.1 Submission of Income Tax Return (Form E)

Every employer must furnish to the Director General in the prescribed form (Form E) not later than 31st March in the year following the first-mentioned year. For example, the employer must furnish Form E for the year of assessment 2012 by 31 March 2013.
Any failure to furnish Form E, without reasonable excuse, would be liable to a fine of not less than RM 200 and not more than RM2,000 or to imprisonment for a term not exceeding 6 months or both.

2.3.2 Prepare and render to his employees Form EA/EC

Every employer must prepare and render to his employee a statement of remuneration (Form EA/EC) for that employee on or before the last day of February in the year immediately following the first mentioned year.

Any failure to furnish Form E, without reasonable excuse, would be liable to a fine of not less than RM 200 and not more than RM2,000 or to imprisonment for a term not exceeding 6 months or both.

2.3.3 Monthly Tax Deduction (MTD)

Every employer is required to deduct tax from their employee’s remuneration in accordance using the MTD table or the computerization method.

Once tax is deducted, the amount of tax deducted must be remitted to the DG by 10th day of every month together with form CP39.

Any failure to comply with Monthly Tax Deduction, without any reasonable reason, is liable to prosecution and upon conviction, can be fined up not less than RM200 and not more than RM2,000 or to imprisonment for a term not exceeding six months or to both.

2.3.4 Provide information about new employees commencing employment

According to section 83(2), employers must inform the Director-General within one month of new employees likely to be chargeable to tax in respect of employment income (use form CP22).

Any failure to furnish, without reasonable excuse, would be liable to a fine of not less than RM 200 and not more than RM2,000 or to imprisonment for a term not exceeding 6 months or both.
In addition, the employer shall be liable, in the case of a failure to comply with section 83 (2), to pay the full amount of tax due from the employee.

2.3.5 Provide information about employees ceasing employment/ leave Malaysia

Employers must inform the Director-General:-

a) by a form CP22 a written notice of those employees who are or are likely to be chargeable to income tax in respect of employment income who are about to cease in their employment provided that the employee is subject to Monthly Tax Deduction (MTD) or not eligible for MTD and known to the employer that he is not retiring from employment.

b) by a form CP21 or a written notice of those employees who are about to leave Malaysia for a period in excess of three months.

Employers must inform the Director-General by notice in writing of those employees within one month before the cessation of employment or date of departure from Malaysia. The Director-General may reduce the time of one month in certain cases. Where the Director-General is satisfied that an employee is required to leave Malaysia at frequent intervals in the course of his employment, he may waive the requirement of this section.

Any failure to furnish, without reasonable excuse, would be liable to a fine of not less than RM 200 and not more than RM2,000 or to imprisonment for a term not exceeding 6 months or both.
In addition, the employer shall be liable, in the case of a failure to comply, to pay the full amount of tax due from the employee.

2.3.6 Record Keeping Responsibilities

- A company is required to keep and retain in safe custody sufficient record to enable the income or loss of the company to be readily ascertained.
• A company must keep records and books of accounts including cash book, sales ledger, purchases ledger and a general ledger. Appropriate entries for each transaction should be recorded as soon as possible (in any case not later than 60 days after the transaction).

• Supporting documents such as invoices, bank statement, pay-in slips, cheque butts, receipts of payments, payroll records and copies of receipts issued should be retained.

• Where gross takings for a year exceed RM150,000 from the sale of goods or RM100,000 from the performance of services, receipts issued must be serially numbered.

• A valuation of stock in trade should be made the end of the accounting period and appropriate records maintained.

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