INLAND REVENUE BOARD OF MALAYSIA

UNIT TRUST FUNDS
PART II - TAXATION OF UNIT TRUSTS

PUBLIC RULING NO. 7/2014

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DIRECTOR GENERAL'S PUBLIC RULING

Section 138A of the Income Tax Act 1967 [ITA] provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is issued as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw either wholly or in part, by notice of withdrawal or by publication of a new ruling.

Director General of Inland Revenue,
Inland Revenue Board of Malaysia.

1. Objective

The objective of this Public Ruling (PR) is to explain the taxation of unit trust funds and property trusts other than a real estate investment trust or property trust fund (REIT / PTF) regulated by the Securities Commission (SC).

2. Relevant Provisions Of The Law

2.1 This PR takes into account laws which are in force as at the date this PR is published.

2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are sections 2, 8, 21A, 33, 43, 44, 61, 63A, 63B, 63D, 110, paragraphs 4(*a*) and 4(*d*), Part I of Schedule 1, paragraphs 28, 35 and 35A of Schedule 6.

3. Interpretation

The words used in this PR have the following meaning:

3.1 "Individual" means a natural person.

3.2 "Director General" (DG) means the Director General of Inland Revenue Board of Malaysia referred to in section 134 of the ITA.

3.3 "Person" includes a company, a body of persons, a limited liability partnership and a corporation sole.

3.4 "Securities Commission" means the Securities Commission established under section 3 of the Securities Commission Act 1993 [*Act 498*].

4. Basis Of Assessment Of Unit Trusts

Under section 21A of the ITA, the basis year for a year of assessment of a unit trust will be either the basis year for a year of assessment or the financial accounting period (for a period of 12 months not ending on 31 December). All the subsections of section 21A are applicable except for subsection 21A(5) of the ITA.

Example 1

ABC Unit Trust commenced operations on 1.11.2010 and made up its 1st set of accounts to 30.6.2011 and subsequent accounts to 30 June every year.

The basis periods for the years of assessment are as follows:

Year Of Assessment	Basis Period
2010	1.11.2010 to 31.12.2010
2011	1.01.2011 to 31.12.2011
2012	1.07.2011 to 30.06.2012
2013	1.07.2012 to 30.06.2013

5. Residence Status

A unit trust is a trust body. Pursuant to subsection 61(3) of the ITA, a trust body is resident in Malaysia for the basis year for a year of assessment if any trustee member of the trust body is resident in Malaysia for that basis year.

6. Deductibility Of Expenses

6.1 Pursuant to subsection 33(1) of the ITA, deductions for expenses wholly and exclusively incurred in the production of gross income are allowable against each source of the fund. Examples of deductions for expenses wholly and exclusively incurred in the production of gross income include –

(a) interest on monies borrowed by the unit trust to finance the purchase of investments; and

(b) direct expenses incurred in the letting of real property by unit trusts other than REIT / PTF where the income from the letting of property is charged to tax under paragraph 4(*d*) of the ITA.

6.2 The following expenses incurred by a unit trust are not allowable as they are regarded as not being wholly and exclusively incurred in the production of the investment income:

(a) manager's remuneration;

(b) maintenance of register of unit holders;

(c) share registration expenses; and

(d) secretarial, audit and accounting fees, telephone charges, printing and stationery costs; and

(e) postage.

However, pursuant to section 63B of the ITA, in ascertaining the total income of a unit trust for the basis period for a year of assessment, a special deduction is allowed in respect of the above expenses which are referred to as permitted expenses. The special deduction is determined in accordance with the formula:

$$A \quad X \quad \frac{B}{4C}$$

where

A - is the total permitted expenses incurred for that basis period;

B - is the gross income consisting of dividend, interest and rent chargeable to tax for that basis period;

C - is the aggregate gross income consisting of **dividend and interest (whether such dividend or interest is exempt or not),** and rent and gains made from the realisation of investments (whether chargeable to tax or not) for that basis period.

This special deduction of expenses is subject to a minimum of 10% of the total permitted expenses incurred for the basis period. The allowable portion of the permitted expenses will be deducted from the aggregate income. If the aggregate income is insufficient or there is no aggregate income, the unabsorbed portion of the special deduction is not allowed to be carried forward to subsequent years of assessment.

6.3 Prior to the year of assessment 2014 the special deduction for the permitted expenses was determined in accordance with the formula:

$$A \quad X \quad \frac{B}{4C}$$

where

A - is the total permitted expenses incurred for that basis period;

B - is the gross income consisting of dividend, interest and rent chargeable to tax for that basis period;

C - is the aggregate gross income consisting of **dividend (whether exempt or not),** interest, rent and gains made from the realization of investments (whether chargeable to tax or not) for that basis period.

This special deduction of expenses was also subject to a minimum of 10% of the total permitted expenses incurred for the basis period. The allowable portion of the permitted expenses was to be deducted from the aggregate income. If the aggregate income was insufficient or there was no aggregate income, the unabsorbed portion of the special deduction was not allowed to be carried forward to subsequent years of assessment.

7. Taxation Of Unit Trusts

7.1 The fund is treated as a trust body and the taxation of the fund is governed principally by sections 61 and 63B of the ITA.

7.2 The tax rate applicable to a unit trust is as specified in paragraph 2, Part I of Schedule 1 of the ITA.

7.3 The following examples illustrate the determination of a unit trust's chargeable income and tax payable.

Example 2

XYZ Unit Trust Fund, established in 2001 invests in shares and bonds. The profit and loss account for the year ended 31.12.2014 is as follows:

Income		RM
Malaysian dividend (single-tier)		400,000
Dividend (pioneer company - tax exempt)		100,000
Dividend from overseas (tax exempt)		100,000
Interest		30,000
Interest (tax exempt)		5,000
Gains on disposal of investments		300,000
Gross income		935,000
Less: Expenses		
Trustee's fee	24,000	
Manager's remuneration	24,000	
Share registration expenses	20,000	
Audit, accounting and secretarial fees	12,000	
Telephone and stationary expenses	6,000	
Printing and postage	5,000	91,000
Net profit		844,000

Computation of Tax Payable For The Year of Assessment 2014

Income	**RM**
Interest	30,000
Gross income	30,000
Less: Special deduction for permitted expenses[1]	
Formula:	
$A \times \frac{B}{4C}$	
$67{,}000 \times \frac{30{,}000}{4 \times 935{,}000} = 537$	
Or 10% of 67,000 = 6,700 Whichever is the greater	6,700
Chargeable income	23,300
Tax on RM23,300 @ 25%	5,825.00
Tax payable	5,825.00

[1]Note	
Permitted expenses Total permitted expenses incurred for the basis period **(A)**:	
Manager's remuneration	24,000
Share registration expenses	20,000
Audit, accounting and secretarial fees	12,000
Telephone and stationery	6,000
Printing and postage	5,000
	67,000
Gross income consisting of interest chargeable to tax (**B**):	
Interest	30,000

Aggregate of the gross income (whether chargeable to tax or not)(**C**)	
Malaysian dividend (single-tier)	400,000
Dividend (pioneer company)	100,000
Dividend from overseas	100,000
Interest	35,000
Gains on disposal of investments	300,000
	935,000

Example 3

ABC Unit Trust Fund was established to invest in shares, bonds and fixed deposits. The profit and loss account of ABC Unit Trust for the year ended 31.12.2014 is as follows:

Income		RM
Malaysian dividend (single-tier)		200,000
Exempt dividend		50,000
Interest (tax exempt)		100,000
Gains from disposal of shares		500,000
Gross income		850,000
Less: Expenses		
Manager’s remuneration	30,000	
Share registration expenses	10,000	
Telephone and stationery	6,000	
Trustee’s fee	24,000	
Secretarial and accounting fee	12,000	
Interest on loan to purchase shares	6,000	88,000
Net profit		762,000

Computation of Tax Payable For The Year of Assessment 2014

Income	RM	RM
Dividend	200,000	
Less: interest on loan	6,000	
Tax exempt	194,000	NIL
Dividend (tax exempt)		NIL
Interest (tax exempt)		NIL
Gains from disposal of shares		NIL
Aggregate income		NIL
Less: Special deduction for permitted expenses[2] Formula: $A \times \frac{B}{4C}$ $58,000 \times \frac{0}{4 \times 850,000} = 0$ or 10% of 58,000 = 5,800 whichever is the greater	5,800	NIL
Chargeable income		NIL

Tax payable	NIL

[2]Note **Permitted expenses** Total permitted expenses incurred for the basis period **(A)**:	
Manager’s remuneration	30,000
Share registration expenses	10,000
Telephone and stationery	6,000
Secretarial and accounting fee	12,000
	58,000

Gross income chargeable to tax (**B**): NIL	NIL
Aggregate of the gross income (whether chargeable or not)(**C**)	
Malaysian dividend Exempt dividend Interest (tax exempt) Gains from disposal of shares	200,000 50,000 100,000 500,000 850,000

Example 4

DEF Islamic Unit Trust Fund is an Islamic fixed income fund that invests in Islamic money market instruments, short term bonds (*sukuk*) and government bonds (*sukuk*) in Malaysia and other foreign countries approved for investments by the SC and *Syariah* Advisory Council. The profit and loss account of DEF Islamic Unit Trust Fund for the year ended 30.9.2014 is as follows:

Income		RM
Gross dividend income (date of payment 28.12.2013)		900,000
Profits from short term deposits, bank balances and government *sukuks*		3,000,000
Net realized gain on sale of investments		1,100,000
Gross income		5,000,000
Less: Expenses		
Manager's remuneration	300,000	
Trustee's fee	24,000	
Auditors' remuneration	6,000	
Tax agent's fee	5,000	
Administration expenses	20,000	355,000
Net profit		4,645,000

Computation of Tax Payable For Year of Assessment 2014

Income	RM
Dividend	900,000
Profits from short term deposits, bank balances and government *sukuks* (tax exempt)	NIL
Gross income	900,000
Less: Special deduction for permitted expenses[3] Formula: $A \times \dfrac{B}{4C}$ $326{,}000 \times \dfrac{900{,}000}{4 \times 5{,}000{,}000} = 14{,}670$ or 10% of 326,000 = 32,600 whichever is the greater	32,600
Chargeable income	867,400

Tax on RM867,400 @ 25%	216,850
Less: section 110 set-off (RM900,000 X 25%)	225,000
Tax repayable	(8,150)

[3]Note	
Permitted expenses Total permitted expenses incurred for the basis period **(A)**:	
Manager's remuneration	300,000
Auditors' remuneration	6,000
Administration expenses	20,000
	326,000

Gross income consisting of dividend chargeable to tax (**B**):	
Dividend	900,000
Aggregate of the gross income (whether chargeable or not)(**C**)	
Dividend income	900,000
Profits from short term deposits, bank balances and government *sukuks*	3,000,000
Net realized gain on sale of investments	1,100,000
	5,000,000

8. **Taxation Of Property Trusts Other Than Real Estate Investment Trust Or Property Trust Fund**

8.1 Property Trusts that invest primarily in income generating real estate but do not qualify as REIT / PTF under the SC guidelines will continue to have their rental income taxed under paragraph 4*(d)* of the ITA.

8.2 As rental income from the rental of properties is treated as income under paragraph 4*(d)* of the ITA, property trusts are not eligible to claim capital allowances on fixed assets pursuant to paragraph 2 of Schedule 3 of the ITA. However a property trust other than a REIT / PTF that receives rental income from its properties is entitled to claim a special deduction for qualifying capital expenditure under section 63A of the ITA apart from the special deduction for expenses under section 63B of the ITA. This special deduction for qualifying capital expenditure is deductible against the adjusted income from the rental source of the unit trust.

8.3 Qualifying capital expenditure means capital expenditure incurred on the provision of machinery or plant used for the purposes of deriving rent from the letting of property, including -

(a) expenditure incurred on the alteration of an existing building for the purpose of installing that machinery or plant and other expenditure incurred incidentally to the installation thereof provided that such expenditure does not exceed 75% of the aggregate of itself and any other qualifying capital expenditure; and

(b) expenditure incurred on preparing or levelling land in order to prepare a site for the installation of the machinery or plant provided that such expenditure does not exceed 10% of the aggregate of itself and any other qualifying capital expenditure.

8.4 The following conditions must be fulfilled in order to qualify for the special deduction:

(a) the qualifying capital expenditure must be incurred by the unit trust;

(b) the unit trust must be the owner of the asset; and

(c) the asset must be in use by the unit trust for the purposes of deriving rent from the letting of real property.

8.5 The special deduction will be in the form of an allowance equal to 10% of the qualifying capital expenditure made against the adjusted income from the source relating to the derivation of rental from the letting of real property. Any unabsorbed allowances will not be allowed to be carried forward to subsequent years of assessment.

8.6 Where at the end of the basis period for any year of assessment,

(a) the residual expenditure in relation to an asset in respect of which qualifying capital expenditure has been incurred is zero;

(b) the asset is no longer owned by the unit trust; or

(c) the asset is no longer in use by the unit trust

no allowance is to be made to the unit trust for that year of assessment or subsequent years.

8.7 The special deduction for qualifying capital expenditure of a unit trust is given in ascertaining statutory income from the rental source. It is not a capital allowance in the normal sense and there is no carry forward if the adjusted income is insufficient. Neither is there any balancing charge or balancing allowance.

8.8 This special deduction is not applicable to unit trusts which are REIT / PTF.

8.9 To ensure that only REIT / PTF enjoy the special tax treatment where rental income from the letting of property is treated as a business source, a new provision under section 63D of the ITA was introduced to state that rental income received by unit trusts (other than REIT / PTF) shall not be treated as a business source.

8.10 The following example illustrates the tax treatment of a property trust other than REIT / PTF:

Example 5

A property trust (not a REIT / PTF), established in 2001 invests primarily in real estate besides investing in shares and bonds. A building was acquired in 2014 and was rented out from 1.6.2014. Before the building was rented out, additional elevators were installed. The capital expenditure on the elevator amounted to RM900,000 and the alteration cost was RM600,000. The profit and loss account for the year ended 31.12.2014 is as follows:

Income		RM
Malaysian dividend (single-tier)		400,000
Dividend (pioneer company - tax exempt)		100,000
Dividend from overseas company		100,000
Interest (tax exempt)		5,000
Rent (gross)		700,000
Gains on disposal of investments		300,000
Gross income		1,605,000
Less: Expenses		
Trustee's fee	24,000	
Management fee for fund	24,000	
Property management fee	12,000	
Share registration expenses	20,000	
Audit, accounting and secretarial fees	12,000	
Office rent	18,000	
Telephone and stationary expenses	6,000	
Printing and postage	5,000	
Assessment and quit rent	10,000	
Fire insurance	5,000	136,000
Net profit		1,469,000

Computation of Tax Payable For The Year of Assessment 2014

Income		RM
Rent		700,000
Less:		
Property management fee	12,000	
Assessment and quit rent	10,000	
Fire insurance	5,000	27,000
		673,000
Less: Special deduction for qualifying capital expenditure: Qualifying capital expenditure is: Cost of elevator 900,000 Cost of alteration 600,000 1,500,000 Allowance = 10% of 1,500,000 = 150,000		150,000
		523,000
Dividend (tax exempt)		NIL
Interest (tax exempt)		NIL
Aggregate income		523,000
Less: Special deduction for permitted expenses[6] Formula: $A \times \dfrac{B}{4C}$ $67{,}000 \times \dfrac{700{,}000}{4 \times 1{,}605{,}000} = 7{,}305$ or 10% of 67,000 = 6,700 whichever is the greater		7,305
Chargeable income		515,695

Tax on RM515,695 @ 25%	128,923.75
Tax payable	128,923.75

[6]Note:	
Permitted expenses Total permitted expenses incurred for the basis period **(A)**:	
Management fee for fund	24,000
Share registration expenses	20,000
Audit, accounting & secretarial fees	12,000
Telephone and stationery	6,000
Printing and postage	5,000
	67,000
Gross income consisting of rent chargeable to tax (**B**):	
Rent	700,000
Aggregate of the gross income (whether chargeable or not)(**C**)	
Malaysian dividend (single-tier)	400,000
Dividend (pioneer company)	100,000
Dividend from overseas	100,000
Interest (tax exempt)	5,000
Rent (gross)	700,000
Gains on disposal of investments	300,000
	1,605,000

9. Updates and Amendments

	Amendments
This PR replaces Public Ruling No.6/2013 published on 23 May 2013.	This PR has incorporated the contents of Public Ruling No. 6/2013 with the following changes:

Paragraph	Explanation
6.2	Amended to explain the Budget 2014 amendment in the formula for the special deduction for expenses
6.3	New paragraph inserted for clarification

	Paragraph	Explanation
	7.3	Examples 2, 3 and 4 of the previous PR replaced.
	8.10	Example 5 of the previous PR replaced.
		Paragraph 9 of the previous PR deleted.

Director General of Inland Revenue,
Inland Revenue Board of Malaysia.