# Single tier company income tax system

Business, Company

1. 0 Introduction Singapore already start adopting a one-tier corporate tax system effect from 1 January 2003. In Malaysia, it is referred as the ‘ single tier’ system. The government allowed a six-year transitional period to enable companies with unutilized dividend franking credits to pay franked dividends. From 1 January 2008, all resident companies in Singapore will come under the one-tier system. Meanwhile, other countries including Hong Kong, Ireland and also Malaysia are adopting the one-tier system effective from 1 January 2014.

Generally, the Malaysian dividend system has undergone a complete overhaul in 2008 with the objective of providing companies, shareholders and the government with a simple, transparent, efficient and equitable system. With effect from Year Assessment (YA) 2008, a single tier dividend system replaces the tax imputation system on dividend payments to shareholders. All the changes from changing of dividend system have arisen as a result of legislative amendments introduced byFinanceAct 2007 (Act 683) gazette by the government on 28 December 2007.

The new corporate tax system is called the single tier system because profits earned by companies are only taxed once and the profits distributed are no longer taxable on shareholders of the company. In this regard, the principal Income Tax Act 1967 is amended by substituting sec 108 with the following: 108. where a dividend is paid or credited by a company to any of its shareholders in the basis period for a year of assessment, the company shall not be entitled to deduct tax from such dividend paid or credited. 1. Chart: The Single Tier Company Income Tax System The company Company shareholders Income from the Income Profits business operations from investments in the company Tax on company profits The profits after taxes Profits after tax Net dividend aid out as dividends 2. 0 Advantages of Single Tier Dividend System First, single tier dividend system allows complete free flow in the channeling of profits of the company to the shareholders as exempt dividends. There are two sources of profits that can be identified. It is including revenue gains (where income tax has been paid) or capital gains from the disposal of long-term investments like, shares, landed property, plant, machinery, and factory by the company. The company may now frank out these profits as dividends to shareholders without any restrictions.

From YA 2008, companies are no longer subject to the restrictions of having to maintain a tax imputation balance on dividend payments. Besides that, the second advantage is shareholders who receiving the exempt dividends are not requires to report the dividend income in their tax return. However, they are required to keep records and documents on their exempt dividend income for 7 years to substantiate this income in the event of a tax audit. The third advantages is that the company are no longer have a section 108 (6) charge issues. Single tier system simplifies tax compliance.

At the same time, it is enhancing efficiency of tax administrative system because no need keep track of tax paid and also dividends amount distributed to shareholders. However, under the previous dividend imputation system, a company whose payment of dividends is in excess of its tax credit balance [s 108 (6) balance] will end up paying s 108 (6) charge to the tax authorities. It is indicates company has to involve additional expenditure. Similarly, any excess in the dividend payment for capital gains over the tax credit balance will cause the company to incur the s 108 charge.

This is no tax efficient to the company and increase the cost of dividend payment. While, the fourth advantage is shareholders whose marginal tax rate is at 27% will not be paying additional tax on dividend. As a comparison to previous imputation system, the income tax payment by company is imputed as tax credit to individual shareholders upon dividend payments, which is YA 2009, 25% of the dividend income. However, the individual shareholders with the marginal tax rate of 27% will end up paying an additional 2% of tax dividend income received.

With effective from YA 2009, an individual is assessed on 27% tax rate if is chargeable income exceeded RM100, 000. Fifth, it simplifies the job of tax authorities. Now, tax authorities does not need to process tax refunds to the shareholders. Thus, the tax authorities are freed up to focus their time and effort in particular the areas, such as tax audit to ensure complete tax compliance by taxpayers in a self-assessment system. The sixth advantage is single tier dividend system is business friendly, economical and tax efficient as companies are no longer requires to maintain tax credit balance for dividend payment.

A portion of tax administration duties is now abolished so that human assets may focus on tax efficient work. Besides that, the seventh advantage is from a macro point of view. Nowadays, the single tier approach has provided a simple and convenient tax system to the country, companies and shareholders. Human capital assets may be deployed to the productive sectors to ensure that everyone is placed on a competitive edge to take on global challenges. 2. 1 Diagram of Dividends Payment to Shareholders under Imputation System Shareholder| Company Dividend income (gross)

Individual75% x gross dividend| Pay net dividend (a)Received net dividend of 75% of gross dividend(b)Assessed as s 4(c) on gross dividend income(c)Tax credit on dividend income (25% of gross dividend) is available as s 110 set on income tax payable| Income tax payable RMFirst RM 100, 000 14, [email protected]% __xx__ __xxx_-S 110 set off (x) (25% x dividend income) _____Net income tax payable xx_ |

Debit 25% od dividend income to s 108 account| Tax credit ondividend payments xx| Balance b/f xxYA 2009Income tax[email protected]% / 25% nilxx| S 108 account| 3. 0 Single Tier Dividend System VS Imputation System The time line of implementing imputation system and single tier system is totally different. According to Choong (2009), he stated that a single tier dividend system replaces the tax imputation system on dividend payments to shareholders on 1 January 2008 and on YA 2008 onwards.

Meanwhile, transitional rules applies for six-year period to 31 December 2013, during which the two systems will co-exist. From 1 January 2014, all resident companies will come under single tier system. However, imputation system implemented prior to YA 2008 until 31 December 2007 only. There are another comparison perspectives is in terms of income tax paid by the company. Under single tier system, dividend is final tax and the divided paid out to shareholders would be an exempted tax in the hands of shareholders.

From here, the mechanism of single tier dividend system is treated as a separate tax entity without any integration with the shareholders. However, under imputation tax system, any excess in the dividend payment for capital gain over the tax credit balance will cause the company to incur the s108 charge. Thus, lead not final tax to the company while will increase the cost of dividend payment. Here, imputation system will allow integration between company and shareholders whereby a company in its essence does not pay tax.

The actual tax is calculated on the shareholders upon receiving dividend income The next comparison is in the perspective of maintaining tax credit account (s 108 account). Maintaining tax credit account (s 108 account) require single tier dividend with no more than tax credit balance of companies to monitor because the company no longer has s108 charge issues and shareholders with authorities. However, it requires imputation tax system to maintain an imputation account to record income tax paid annually in credit side of the s108 account.

A differences also occurs in payment of dividends to shareholders. For payment of dividends to shareholders under single tier divided for tax authorities, there is no more tax credit balance (s108 account) of companies to monitor. Hence, it also no necessity for them to process tax refunds to the shareholders and also no restriction for dividends payment. However, imputation tax system leading 108 account are to be debited the tax portion in s108 account. Continuing is the comparison perspective payment of capital gains as dividends to shareholders.

Under single tier system, the company frank out profits such as dividends to shareholders without any restrictions in order to maintaining a tax imputation balance on dividend payments. However, imputation system stated any excess in the dividend payment for capital gain over the tax credit balance will cause the company to incur the s108 charge. Another comparison perspective is dividend income to shareholders. Frequently, shareholders receive the exempt dividend in single tier dividend which is not required to report the dividend income in their tax return.

However, they have to keep all the record and documents on this exempt dividend income for 7 years to substantiate this income in the event of a tax audit. In contrast, under imputation system, shareholders receiving net dividend would be assessed on gross dividend income under s4(c) while the tax deducted on dividend income would be given a deduction (s 110set off) against their income tax payable in that YA. Next is the comparison of interest expense incurred to acquire shares. Now, the interest expense incurred to acquire shares is disregarded in the single tier dividend system as the dividend income is now tax exempt.

In contrast, under imputation system, the dividend income is assesses under s4c of the Act which allowed interest expense to be deducted against gross dividend to arrive at statutory income. Thus, this will result in cash refund as the tax credit on dividend income exceeds tax payable on statutory income of dividend. Lastly is the differences of implementation. The existing company with s 108 credit balances has to apply transitional period from 1 January 2008 until 31 December 2013 according to ss 38-57 of the Finance Act 2007(Act 683/2007).

During transitional period, existing companies are slowly phase out from imputation system. Shareholders will not suffer immediately because many listed companies will continue to use imputation system to frank out dividends until 31 December 2013. After a transitional period, a single tier system will fully take place on 1 January 2104. Hence, the imputation system no longer using anymore. At the same time, any unutilized credit balance at s 108 account balance is deemed nil at 31 December. 3. 1 A Summary Table of Comparison between Single Tier Dividend and Imputation Tax System Single tier dividend| Imputation tax system| | (1. 1. 2008 on YA 2008 onwards)| (Prior to YA 2008 till 31. 12. 2007)| (a) Income tax paid by the company| Final tax| Not final tax. The amount is allowed to be credited to s108 account to pay dividend to shareholders. | (b) Integration to shareholders| No. company and shareholders regarded as separate and individual entities| Allow integration between company and shareholders whereby a company in its essence does not pay tax. The actual tax is calculated on the shareholders upon receiving dividend income. (c) Maintaining tax credit account (s 108 account) (d) Payment of dividends to shareholders (e) Payment of capital gains as dividends to shareholders (f) Dividend income to shareholders (g) Interest expense incurred on loan to acquire shares (h) implementation| NoNo restrictionNo restrictionExempt dividendInterest expense is disregarded. Permanent lossFully in place on 1. 1. 2014| YesSubject to the availability credit in s 108 accountHas to incurred additional cash as s 108(6) chargeTaxable dividend with tax credit on dividend income. s 110 set off ]. It will be used to set of the income tax payable for the YADeductible. The excess of interest expense over dividend income is not allowedExisting s 108 a/c balance may be used to pay dividend for YA 2018 till 31. 12. 2013. Section 108 a/c is deemed nil at 31. 12. 2013| 4. 0 Examples 4. 1 New Company If there are any new companies that are planning to commence their businesses in YA 2008 or subsequent YAs, they will automatically start implementing single tier dividend system. The final tax will be monthly income tax paid by company.

From here, there is a non-existing of section 108 account after commencement of new company start from YA 2008. Hence, new company doesn't have a necessity to maintain section 108 account. Meanwhile, a change has been made on dividend payment by company to shareholders. Now, it is not required to deduct tax from dividend paid or credited to shareholders. However, the company still has to follow one regulation at the same time. It will provide a statement on dividends paid to the tax authorities. The period must be dividend paid during the YA within 7 months after closing the accounts.

If afailureto do so by company is an offence, liable and conviction to either a) a fine of between RM200 and RM2000 b) imprisonment of not more than 6 months c) or both. The dividends received by shareholders are not entitled to tax computation or tax return forms. It is also tax exempted on dividends received. However, shareholders need to keep their documentations and records. The main purpose is for future tax audit inspections. 4. 2 Existing Company Any existing company in YA 2007 is continuing to maintain section 108 account until the cut off and frozen at 31 December 2007.

The existing company has the following circumstances: a) Section 108 balance nil as at 31. 12. 2007. b) Section 108 balance is nil as at any date from 1. 1. 2008 to 31. 12. 2013. c) Section 108 balance is nil due to tax discharge, remittance or refund for tax assessments prior to YA 2008. d) Company exercised an irrevocable option during 1. 1. 2008 to 31. 12. 2013 to self zerolise section 108 balance to nil. The existing company will continue credit the last installment that is December 2007 monthly installment to section 108 account. In YA 2008, section 108 is not applicable anymore.

While on 31 December 2007, the credit balance in section 108 is frozen. From this date onwards, credit balance will keep decreasing rather than increasing. It is used to pay cash dividend on ordinary shares until nil balance at 31 December 2013 or earlier than that. On 1 Jan 2014, all companies including existing companies are moved into a single tier dividend system. Companies with different year end have different treatment. A company with 31 December year end will have January 2008 monthly installment, and it is actually payable for December 2007 credited to section 108 account.

In contrast, a company with non 31 December year end is allowed to have monthly income tax paid for the YA 2008 until 31 December 2007. On 31 December 2007, section 108 account is frozen and cut off. This account is keep continuing decrease by tax discharge, remittance or refund for tax assessments prior to YA 2008. Meanwhile, the composite assessment arising through tax investigation which is issued after 31 December 2007 shall not added to section 108 account balance. Below is the table showing companies ending with different year end: Table 4. 0 Section 108 account credit balance

Companies Year End| 31 December| Non 31 December| YA 2007 (31. 12. 2007)| Last installment in Jan 2008| N/A| YA 2008| N/A| Monthly installment till 31. 12. 2007| 31. 12. 2007| Credit balance frozen| Credit balance frozen| 1. 1. 2008 to 31. 12. 2013| To pay cash dividend on ordinary shares till nil balance| To pay cash dividend on ordinary shares till nil balance| 1. 1. 2014: Utilised s 108 balance| Deemed nil| Deemed nil| 5. 0 Conclusion In a overview, single tier dividend system means that the dividend from the companies is an tax exempt dividend to shareholders.

Company will no longer have section 108 (6) change issues and also shareholders will not face any additional taxes, even though their marginal tax reach 28%. Even tax authorization on the other end, no longer needs to monitor the tax credit balance section (108 account) of the company and also processing of the tax refunds to the shareholders. They are now able to intensify on tax audits to ensure complete tax compliance with the self assessment system. The single tier dividend system is deemed to be business friendly, economically and tax efficiency for the businessenvironment.

It is because it is no longer are a requirement to maintain tax credit balance for dividend payment. A portion of tax administration duties is now abolished so that human assets would be able to focus on tax efficiency duties. The change in the tax structure from imputation to the single tier system are the most significant changes as deemed in Malaysian tax laws. It is clearly a progressive measure, one that accords with international trends. In an international setting, the single-tier system or exemption system is seen by commentators as being more neutral than imputation .

It achieves simplicity, resulting in efficiency savings for both businesses and tax authorities. It plugs tax leakages since no tax refunds are made under any circumstances. While imputation system discriminates against the non-resident shareholder (who is not granted a tax credit) in favour of the resident shareholder (who is granted a credit), however the single tier system eliminates this, thereby removing adiscriminationagainst regional and multinational companies seeking a holding company locations in Malaysia.

The government realized that the imputation system is not very sustainable anymore in we see it in the long run. So, if the tax rates were to be reduced further down in the future, the government needs a perfect system that will allow company's tax to be deemed as a final tax. In this case, the government have certainly had taken a bold step to move in the right direction. References 1. Choong. K.. F. (2009). Malaysian Taxation Principles and Practice. (15th ed. ) Malaysia: InfoWorld. 2. Kasipillai. J. (2009). A Comprehensive Guide to Malaysian Taxation. (4th ed. ) Malaysia: McGraw-Hill.