

# From a Dividend Imputation System to a Single Tier Dividend System

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*Malaysia's dividend system has gone for a complete overhaul in 2008, with the objective to provide companies, shareholders and the government a simple, transparent, efficient and equitable system. With effect from YA 2008, a single tier dividend system will replace the tax imputation system on dividend payments to shareholders.*

## Transitional Period (1.1.2008 to 31.12.2013)

New companies commencing business in YA 2008 will be placed on the single tier dividend system immediately. Existing companies with Section 108 credit balance (dividend imputation system) have to apply the following transitional provisions stipulated in Sections 38 to 57 of the Finance Act 2007 (Act 683/2007) to slowly phase out the imputation system and move in completely to the single tier dividend system on 1 January 2014.

Any unutilised credit balance on 31 December 2013 is deemed at nil. During this transitional period, so long as the company has its Section 108 account, the imputation system will apply and tax credit on dividend income is available to shareholders.

## New Company

New companies commencing their first business operations in YA 2008 will be placed on the single tier dividend system. Income tax paid monthly by the company is final tax. The Section 108 account is not required.

Where dividend is paid or credited by such companies to any shareholders in YA 2008 and subsequent YAs, the company is not required to deduct tax from such dividend paid or credited to shareholders. However, companies have to provide a statement to the tax authorities on dividends paid during the YA within seven months after the closing of the account.

Failure to provide the statement of dividends to the tax authorities is an offence. Upon conviction, it will be liable to

- Fine between RM200 to RM2000;
- Imprisonment of not more than six months;
- Both (a) and (b)

Shareholders receiving these dividends are tax exempt and these dividends are not required to be included in the tax compu-

tation or tax return forms. Documentation and records however need to be maintained for tax audit inspection.

## Existing Companies

Existing companies with business operations in YA 2007 will continue to credit the December 2007 monthly installment to the Section 108 account. The balance of the Section 108 account is then frozen on 31 December 2007. This credit balance cannot be increased further and it is only to be used to pay cash dividends on ordinary shares to shareholders until nil balance or at 31 December 2013, whichever is the *earlier*. Thereafter the Section 108 account is deemed to be in nil balance. On 1 January 2014, the company moves in to the single tier dividend system.

The Section 108 account is cut off on 31 December 2007. This would mean that a company with a year end other than 31 December would be able to continue to allow its monthly income tax paid for the YA 2008 to 31 December 2007 to be credited to the Section 108 account. A company with a 31 December year end will have its January 2008 monthly installment (payable for December 2007) to be credited to the Section 108 account. Thereafter credit balance in the Section 108 account is frozen. It cannot be increased further.

### Section 108 Account credit balance:

Company's 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 - 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 Unutilized S 108 balance	Deemed nil	Deemed nil

The Section 108 account will be further reduced by any tax discharged, remitted or refunded in relation to the tax assessment prior to YA 2008. Composite assessment arising from tax investigation, issued after 31 December 2007 shall not be added to the Section 108 account balance.

**Cash dividend on ordinary shares**

The existing frozen Section 108 account balance will be used to pay out cash dividends on ordinary shares. The company will deduct the following amount from the Section 108 account and pay the net amount of dividends to shareholders:

	YA		
	2007	2008	2009
Amount debited to S 108 A/C	27%	26%	25%
Net dividend to shareholders	73%	74%	75%

**Regressing dividend**

The amount received by shareholders will be deemed net amount should the company:

- (a) fail to deduct tax from the Section 108 account; or
- (b) distribute asset in specie

A regross of the dividend will apply and the appropriate tax will then be computed and debited to the Section 108 account accordingly.

The amount debited to the Section 108 account is computed:

$$\left( \frac{\text{Amount received by shareholders (deemed net) (B)}}{1 - \text{tax rate of company}} \right) - B$$

**Example 1**

Joe Chen (Holding) Bhd closes its accounts on 31 December every year. On 14 February 2008, the company pays cash to its shareholders, RM10,000. No tax has been deducted from the Section 108 account.

The income tax rate applied to companies in YA 2008 is 26 per cent. Therefore the amount received by shareholders is deemed at net amount, after tax of 26 per cent. The tax credit on dividend income debited to the Section 108 account of the company will be:

$$\left( \frac{\text{RM}10,000}{1 - 26\%} \right) - \text{RM}10,000 = \text{RM}3,514$$

**Changes in tax rate**

Where there is a revision in the tax rate of companies due to budget and the interim dividend paid is based on the old tax rate, the amount received by the shareholders has to be regrossed using the new rate and the Section 108 account of the company will have to be adjusted.

**Example 2**

Siang Loong (M) Sdn Bhd closes its account on 31 March annually. On 1 May 2007, the company pays net dividends of RM73,000 to its shareholders and debits RM27,000 (27 per cent of the gross dividend) to the Section 108 account.

As the tax rate for the company [legislated by Finance Act 2007 (Act 683/2007), gazetted on 28 December 2007] applicable for YA 2008 is 26 per cent, the shareholders are deemed to have received net of tax 26 per cent and the amount assessable to tax is:

$$\left( \frac{\text{RM}73,000}{1 - 26\%} \right) = \text{RM}98,648$$

The company has to readjust the Section 108 account to RM25,648 instead of RM27,000. The tax credit on dividend income available to the shareholders will be RM25,648. This is deductible from the income tax payable by the shareholders.

**Statement of dividend**

A company paying or distributing dividends to shareholders has to furnish the shareholders with the dividend warrant stating:

- (a) gross dividend;
- (b) tax deducted/deemed deducted from the Section 108 account;
- (c) the net amount paid or market value of asset distributed.

The company is obliged to provide the tax authorities a statement of dividends paid out during the YA and its Section 108 balance within seven months of the closing of the accounting period. This will continue to apply for YA 2008 to 2013 or until the Section 108 account is fully utilised, whichever is earlier.

**Section 108 account**

The Section 108 account will be reduced by dividends paid for:

- (a) YA 2008 to 31 December 2007 (for companies with year ends other than 31 December)
- (b) 1.1.2008 to 31.12.2013 until nil balance.

Where the amount debited to the Section 108 account exceeds the credit balance, the excess is a debt due from the company to the Government and needs to be accounted to the IRB [Section 108(6) charge] within seven months from the date of closing the account (due date).

The amount of the Section 108 charge which is not paid within the due date shall be without notice increased by 10 per cent of the Section 108 charge. Both the Section 108 charge and the increased sum of 10 per cent shall be debt due to the Government and payable to the tax authorities.

The DG, however, at his discretion may waive the 10 per cent penalty or part of the penalty.

**Moving to single tier dividend system**

Where the existing company has the following circumstances:

- (a) The Section 108 balance is nil as at 31.12.2007;
- (b) The Section 108 balance is nil as at any date from 1.1.2008 to 31.12.2013;
- (c) The Section 108 balance is nil due to tax discharge, remittance or refund for tax assessment prior to YA 2008;
- (d) The Company exercised irrecoverable option between 1.1.2008 and 31.12.2013 to self zeroise the Section 108 balance to nil; the company then must move to the single tier dividend system.

Any dividends paid after the event of (a) to (d), need not be accounted for tax and shareholders receiving such dividends will be tax exempt. In the event the shareholder is a company, the subsequent payment of dividends from these exempt incomes is also exempt dividends to shareholders.

On 1 January 2014, all companies are on the single tier dividend system. Any Section 108 balance as at 31 December 2013 is

deemed at nil balance.

### Election to disregard Section 108 credit balance

Section 50 of the Finance Act 2007 allows a company to elect to disregard the credit balance of the Section 108 account and opt in to the single tier system. The form to fill is Form R50 and it should be submitted to the processing centre located in Pandan Indah, Kuala Lumpur. This election is an irrevocable option and can be exercised any time from 1 January 2008 to 31 December 2013.

Every company within a group of companies is treated as a separate legal entity. A holding company that elects to disregard the balance of the Section 108 account will not affect the subsidiaries. Subsidiaries maintaining the Section 108 account will continue under the imputation system. Any dividends to the holding company will have to be debited to the Section 108 account and the holding company will have its Section 110 set off when receiving dividends.

It is felt that listed companies should not elect to disregard the Section 108 balance as there may be lower income groups depending on the tax credit on dividend income. As to unquoted companies where the shareholders pay the marginal tax rate of 27/28 per cent, such companies should opt to disregard the Section 108 balance for tax efficiency purposes.

### Anti tax evasion

The tax authorities would issue a written requisition calling the company to account for

- (a) tax deducted on gross dividends; and
- (b) penalty not exceeding 100 per cent of tax deducted on gross dividends

should the company in any event fail to pay dividends (without Section 108 balance) but nonetheless issue a dividend warrant to its shareholders showing the tax deducted on dividend. This will allow the shareholders to claim the tax credit on dividend income and result in a loss of revenue to the Government.

Both these amounts are debt due from the company to the Government and shall be payable to the tax authorities upon the service of the written requisition. The DG however at his discretion may waive the penalty or part of the penalty if the company can adduce evidence that it is a genuine error or mistake.

### Shareholders

Where the existing company pays dividends to the shareholders using the Section 108 balance, the tax credit on dividends (YA 2008, 26 per cent of gross dividends) is available as a set off against the income tax payable by the shareholders (S110 set off). Excess tax credit over income tax payable will be a cash refund to the shareholders.

Section 110 set off is however not available in the following circumstances:

- (a) Shareholder is a Labuan Offshore Company paying income tax under Labuan Offshore Business Activity Tax Act 1990,
- (b) Shareholder acquires unquoted shares whereby the holding period between the dividend receipt and disposal of shares is

less than 90 days. This however applies to holding of unquoted shares only. Disposal of listed shares shall continue to be allowed tax credit on dividend income.

### Anti avoidance where shareholder is a company

Companies within a group can enjoy group loss relief whereby a loss making company may surrender 50 per cent of its current year business losses to the holding company. This will result in a cash refund on dividend income in the event the holding company also derives dividend income from other subsidiaries.

Section 53 of the Finance Act 2007 serves as an anti avoidance legislation. A company receiving dividend income from a company paying dividends using the Section 108 account (in the imputation system), where the statutory income of the dividend income is deemed as total income or part of the total income of that company for that YA.

The objective of deeming statutory income of dividend income as total income is to ensure no tax refund is made by tax authorities due to current year business loss.

Statutory income	RM
S4 (a) Business	x
S4 (c) Interest	x
S4 (d) Rental	<u>x</u>
Aggregate income	xx
- Current year business loss	(x)
excess unabsorbed business loss c/f	
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Total Income	nil
S4 (C) Dividend income	<u>xx</u>
Chargeable income	<u>xx</u>
Income tax payable	26 per cent
- S110 set off	(26 per cent)
Net income tax payable	<u>nil</u>

Without the deeming provision, dividend income would be part of aggregate income, able to set off the current year's business loss and chargeable income would then be nil. Tax credit on dividend income will result in a cash refund to the company.

### Non application of Section 108 account

The Section 108 account is not applicable to the payment of exempt dividends utilising the tax incentives exempt income account such as reinvestment allowance, investment tax allowance, increased export allowance etc.

### Conclusion

The single tier dividend system is business friendly, economical and tax efficient for the business environment as a company is no longer required to maintain a tax credit balance for dividend payment. A portion of tax administration duties is now abolished so that human assets are able to focus on tax efficiency. ■

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