group relief

After many years of refusing to act, the Malaysian Government has introduced group relief for companies, with effect from the year of assessment 2006. The law on this is contained in Section 44A of the Income Tax Act 1967, as amended. At the same time, Schedule 4C of the Act, which had contained a form of group relief limited to approved food production projects, was repealed.

Group relief is an examinable topic for Paper 3.2 (MYS) (*Syllabus* item 3(d) and *Study Guide* item 3(g)). It is an important topic, and one which will also be examined in Paper P6 (MYS) from December 2007.

For Paper P6 (MYS), the topic is covered under three separate headings in item 2(d) of the *Study Guide*:

ii Understand the meaning of 'related company' for the purposes of group relief

iii Advise on the operation of group relief

iv Advise on the penal consequences for a surrendering company which gives incorrect information about its adjusted loss.

TERMINOLOGY

Candidates need to understand the meanings of certain terms used in Section 44A in order to be able to identify the nature and relationship of the companies involved and the extent to which they are entitled to participate. Some of the key terms are:

- **Surrendering company**
  A company having an adjusted loss in the basis period for a year of assessment.
- **Claimant company**
  A company which is related to the surrendering company.
- **Related company**
  The meaning of this expression was required in Question 7(c) of Paper 3.2 (MYS) in December 2006 where the answer given was:
  Companies are related in the context of Section 44A, if at least:
  - 70% of the paid-up ordinary capital of the surrendering company is directly or indirectly owned by the claimant company, or
  - 70% of the paid-up ordinary capital of the claimant company is directly or indirectly owned by the surrendering company, or
  - 70% of the paid-up ordinary capital of both the surrendering company and the claimant company are directly or indirectly owned by another company resident and incorporated in Malaysia.

'Indirectly owned' means through the medium of other companies resident and incorporated in Malaysia. 'Ordinary share' means any share other than one carrying the right to a fixed percentage of the nominal value of the share or of the profits of the company.

PRE-CONDITIONS FOR ELIGIBILITY

Candidates need to appreciate that entitlement to group relief is very restricted. There are many obstacles to be overcome in order to establish a valid claim. Before making any calculations, it is necessary to find out whether all of the pre-conditions have been met. Exam questions, like Question 7(c) in December 2006, may dwell more on these aspects than on the computations. The following requirements apply to both the surrendering company and the claimant company:

- They must be related companies throughout the basis period for the year of assessment (of claim) and the 12 months preceding.
- Both must have a paid-up share capital of more than RM2.5m at the beginning of the basis period for the year of assessment (of claim).
- Both must be resident in Malaysia for the basis period for the year of assessment (of claim).
- Both must be incorporated in Malaysia.
- Both must have a 12-month basis period ending on the same day.
- Both must be subject to tax at the full rate (not the reduced rate of 20%).

If any of the following apply in the basis period for the year of assessment concerned, a company will be prevented from taking part as a surrendering or a claimant company:

- The company is a pioneer company, or has been granted approval for investment tax allowance.
- The company enjoys either a tax exemption in respect of a shipping operation, or a ministerial exemption.
- The company has made a claim for reinvestment allowance.
- The company has claimed a deduction for an approved food production project.
- The company has claimed a deduction for the cost of acquisition of proprietary rights.
- The company has been granted a deduction for the cost of acquiring a foreign-owned company.
- The company has claimed a deduction under any rules made under s.154 (a PU Order) which prohibit the application of group relief.

The following requirements also apply:

- The surrendering company must have an adjusted loss in the basis period for the year of assessment (of claim).
- The claimant company must have a defined aggregate income (see below) for the year of assessment (of claim).
- The residual assets and residual profits test (see below) must be satisfied.
- Both companies must make an irrevocable election to surrender or claim an amount of adjusted loss in the return (Form C) furnished for the year of assessment (of claim).

Candidates need to understand the meanings of certain terms used in Section 44A in order to be able to identify the nature and relationship of the companies involved and the extent to which they are entitled to participate.

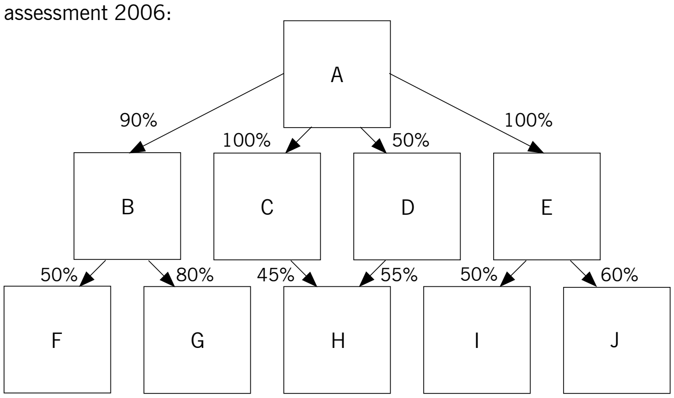
It is assumed that candidates are familiar with the meanings of certain basic terms which will have been covered in Paper 2.3 (MYS), or Paper F6 (MYS), including 'basis period', 'year of assessment', 'resident', and 'adjusted loss'.

The residual assets and residual profits test, effectively an anti-avoidance provision, will be considered in detail later.

RELATED COMPANIES

Unless all the pre-conditions are satisfied, there is no point in working out whether two companies are related because they will not be eligible for any relief. Otherwise, all tests are numeric and are based on the proposition that one company owns at least 70% of the ordinary shares of another company, either directly or indirectly. Ordinary shares are defined, as mentioned above, so as to exclude any share which confers a right to a dividend at a fixed rate or of a fixed amount (such as preference shares) whether participating in profits or not. Control can be followed through any number of eligible links, but there is no provision for 'consortium relief', that is relief given where two or more companies combine to own at least 70% of the shares of a single company.

EXAMPLE 1
A group of companies had the following relationships in the year of assessment 2006:



All of the shareholdings had subsisted throughout the basis period for the year of assessment and for the previous 12 months. Except for G, which is a foreign incorporated company, all of the companies are resident and incorporated in Malaysia. Subject to ascertaining any adjusted loss or defined aggregate income, and applying the residual assets and residual profits test, all other pre-conditions are satisfied.

Required
Ascertain which of the companies are related and able to qualify as a surrendering company and claimant company respectively.

Answer
The qualifying companies are:
- A and B – B is directly owned by A
- A and C – C is directly owned by A
- A and E – E is directly owned by A
- A and H – H is indirectly owned by A (100% x 45% + 50% x 55% = 72.5%)

Companies B, C, E and H are also related to each other due to their common ownership by A.

Company G can be disregarded because it is a foreign incorporated company. Companies F, H, I and J do not have the requisite 70% ownership, except for H, in which A owns more than 70% by indirect ownership.

CALCULATING THE GROUP RELIEF
Any eligible company having an adjusted loss may be a surrendering company. Current year loss relief must be applied first. The amount of loss eligible for surrender is 50% of the adjusted loss for the basis period for the year of assessment, after it is reduced by any aggregate income of the company for that year of assessment. Note that the capital allowances of the surrendering company are not taken into account in any way.

The aggregate income of a claimant company is defined as the aggregate income as reduced by all of the items which qualify for deduction under Section 44 when calculating total income, except for group relief itself. These items are:
- current year loss
- qualifying prospecting expenditure
- qualifying pre-operational business expenditure (approved overseas expenditure)
- monetary and other gifts, such as approved donations.

Aggregate income is computed in the normal way in each case, being:
- aggregate of statutory business income from all sources, reduced by unabsorbed losses brought forward
- aggregate of statutory income from all other sources
- claw-back of qualifying prospecting expenditure.

EXAMPLE 2
Facts as in **Example 1**. Company E is non-active and has no income, but companies A, B, C and H had the following results for the year of assessment 2006:

	A	**B**	**C**	**H**
	RM	**RM**	**RM**	**RM**
Business adjusted income/(loss)	-	480,000	-	(265,000)
Capital allowances – current and previous year	-	280,000	-	150,000
Unabsorbed losses brought forward	-	450,000	-	-
Dividends	100,000	-	65,000	-
Interest	-	17,000	-	25,000
Approved donations	30,000	2,000	-	10,000

Required
Calculate the amount of loss available for surrender, and the amount(s) of any defined aggregate income.

Answer
Company H has an amount of adjusted loss available for surrender, calculated as follows:

	RM
Adjusted loss	265,000
Aggregate income – interest	(25,000)
	240,000
Adjusted loss available for surrender – 50%	120,000

Defined aggregate income is computed as follows:

	A	**B**	**C**	**H**
	RM	**RM**	**RM**	**RM**
Business adjusted income		480,000		
Capital allowances		(280,000)		
Business statutory income		200,000		

Unabsorbed losses brought forward		(200,000)		
Business statutory income		-		
Dividends and interest – statutory income	100,000	17,000	65,000	25,000
Aggregate income	100,000	17,000	65,000	25,000
Less: current year loss	-	-	-	(25,000)
Approved donations	(30,000)	(2,000)	-	-
Defined aggregate income	70,000	15,000	65,000	-

A, B and C are eligible to be claimant companies.

If there is more than one surrendering company, or more than one claimant company, the companies themselves may decide the order of set off. Otherwise, the Director General may make the decision. Candidates will always be given sufficient information in an exam question to settle any doubt about allocation.

EXAMPLE 3

Facts as in **Example 2**. Companies A, B, C and H have not settled any order of priority of set off, and the Director General has decided that the adjusted loss of H should be set off in proportion to the respective defined aggregate incomes.

Required

Prepare a table showing the amounts of chargeable income and unabsorbed losses carried forward.

Answer

	A RM	B RM	C RM	H RM
Chargeable income				
Defined aggregate income	70,000	15,000	65,000	-
Adjusted loss of H – allocated pro rata	(56,000)	(12,000)	(52,000)	-
Chargeable income	14,000	3,000	13,000	-
Unabsorbed losses				
Current year loss				265,000
Loss surrendered	56,000	12,000	52,000	(120,000)
	56,000	12,000	52,000	145,000
Less: set off against current year income	(56,000)	(12,000)	(52,000)	(25,000)
	-	-	-	120,000
Unabsorbed loss brought forward		450,000		-
Less: set off against current year business income		(200,000)		-
Unabsorbed loss carried forward		250,000		120,000

THE RESIDUAL ASSETS AND RESIDUAL PROFITS TEST

This is an anti-avoidance provision designed to prevent companies from being structured in such a way that any losses surrendered are merely paper losses, and not losses which are actually borne by the group. Candidates are expected to have an awareness of this provision but it will not be tested in detail. It is not examinable in June 2007.

The test must be applied to any company which owns at least 70% of the paid-up ordinary share capital of a surrendering company, or to a claimant company for the purposes of the related company test. The relationship will fail unless the owning company is beneficially entitled to at least 70% of:

- any residual profits of the other company which are available for distribution to the other company's equity holders
  and
- any residual assets of the other company which are available for distribution to that other company's equity holders on a winding-up.

'Residual profits' means the profits of a surrendering company or a claimant company after the deduction of any dividend which is:

- a fixed amount or at a fixed rate per cent of the nominal value of the shares of that company
  or
- a fixed rate per cent of the profits of that company.

'Residual assets' means the net assets of a surrendering company or a claimant company after distribution to creditors in respect of fixed rate loans and holders of shares other than ordinary shares, but not after any return to a loan creditor which is not at a fixed rate or amount of the borrowing or of the profits of the company.

In any case, where residual profits or residual assets are nil, a nominal sum of RM100 is substituted.

PENALTY FOR INCORRECT INFORMATION

The penalty provisions are not examinable in June 2007. Where a loss surrender has resulted in a wrong loss set off for a claimant company, the Director General has power to make an assessment or additional assessment in the year in which the incorrect set off is discovered, and within the following six years. This would be by an assessment on the claimant company to make good a loss of tax which is likely to lead to penalties.

A penalty can also be imposed on the surrendering company where the company has given incorrect information, in its annual tax return, about the amount of an adjusted loss. The amount of penalty prescribed is equal to the amount of tax that the claimant company has or would have underpaid as a result of the incorrect information. The surrendering company has the right to appeal against the imposition of the penalty within 30 days of the issue of the penalty notice, and it will be dealt with in the same way as an appeal against an assessment. ■