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IRB's Public Ruling No 4/2020: Tax Treatment of Sums Received and Debts Owing for Services to be Rendered

On 16 June 2020, the Inland Revenue Board (**IRB**) issued Public Ruling No 4/2020 (**PR 4/2020**) on the "Tax Treatment of Any Sum Received and a Debt Owing that Arises in Respect of Services to be Rendered". Importantly, PR 4/2020 sets out the IRB's interpretation of, among others, s 24(1)(b) and s 24(1A) of the Income Tax Act 1967 (**ITA**). The IRB has clarified that debts owing to the taxpayer arising from, and sums received by the taxpayer, in respect of services to be rendered are to be treated as his gross income in the relevant period.

The law before YA 2016

Prior to year of assessment (**YA**) 2016, s 24(1A) of the ITA did not exist, while s 24(1)(b) provides that debts owing to the relevant person in the relevant period which arise in respect of "any services rendered at any time in the course of carrying on a business" shall be treated as his gross income from the business for the relevant period.

Thus, in respect of advance payments received by taxpayers for services which have yet to be rendered, the law did not require the taxpayer to recognise it as his gross income in the relevant period. This was confirmed by the High Court in the case of *Clear Water Sanctuary Golf Management Berhad v Ketua Pengarah Hasil Dalam Negeri* (2014) MSTC 30-075.

Accordingly, with regard to advance payments received by taxpayers prior to YA 2016, the IRB confirmed that the payments would only have to be treated as the taxpayer's gross income after the service has been rendered.^[1]

The law after YA 2016

However, with effect from YA 2016, s 24(1)(b) was amended to the effect that debts owing to the relevant person in the relevant

^[1] See para 6 and Example 9 of PR 4/2020

period arising from services “to be rendered” were also to be treated as his gross income in that period. Additionally, s 24(1A) was inserted to the effect that sums received by the taxpayer in the course of his business in respect of services to be rendered shall also be treated as his gross income in the relevant period, notwithstanding that no debt is owing to him in respect of such services.

Thus, the cumulative effect of the amendment to s 24(1)(b) and s 24(1A) is such that a taxpayer would be taxed on:

- a) The amount of debt owing to him in respect of services rendered or to be rendered, notwithstanding that he may not have received the amount owing to him in the relevant period;^[2] and
- b) The amount which he has actually received in the relevant period, notwithstanding that such services have yet to be rendered and notwithstanding that no debt is yet owed to him in respect of such services.^[3]

What would be the impact in the event that:

- (a) Debts which have been recognised as gross income under s 24(1)(b) of the ITA subsequently prove to be irrecoverable?

While PR 4/2020 does not address this issue, irrecoverable debts that have been recognised as gross income under s 24(1)(b) of the ITA, would presumably be deductible under s 34(2) of the ITA, provided that the necessary conditions are fulfilled.^[4]

- (b) Sums received which have been recognised as gross income under s 24(1A) of the ITA were subsequently refunded?

Together with s 24(1A), s 34(7A) was also introduced into the ITA which provides that where a sum received by the taxpayer that has been treated as his gross income under s 24(1A) is refunded, the amount shall be deducted from his gross income for the basis period of that YA in which the refund was made. This has similarly been recognised by the IRB.^[5]

Conclusion and practical considerations for taxpayers

Taxpayers should be aware of the legal implications of the above provisions, and the commercial considerations in managing and

^[2] See Example 1 of PR 4/2020

^[3] See para 4.2 and Example 2 of PR 4/2020

^[4] See also Public Ruling No 4/2019 on Tax Treatment of Wholly & Partly Irrecoverable Debts and Debt Recoveries (PR 4/2019)

^[5] See para 7 and Example 10 of PR 4/2020

structuring their business affairs. For instance, if the contract provides for payments to be payable in the relevant period, then such payments would be taxable as gross income, notwithstanding that they may relate to services which have yet to be rendered, and notwithstanding that such payments have not been received by the taxpayer^[6] in the relevant period. The cash flow considerations arising from the need to pay tax on income which has yet to be actually received ought to be fully considered. Further, careful consideration ought to be given before discounts are granted on debts which have previously been recognised as gross income. The IRB has indicated that only discounts with a “commercial basis” supported by evidence can be written off and deductible under s 34(2) of the ITA.^[7]

Finally, as detailed at paragraph 8 of PR 4/2020, the tax treatment of certain services may differ. These include services under construction contract or property development, as well as services provided by a non-resident person.

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If you have any queries pertaining to the tax treatment of sums received and debts owing in respect of services to be rendered, please contact associate Chris Toh Pei Roo or Tax, SST & Customs partners, **Dato’ Nitin Nadkarni** and **Jason Tan Jia Xin**, at tax@lh-ag.com

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^[6] See e.g. Example 1 of PR 4/2020

^[7] See para 7.3.2 and Example 7 of PR 4/2019