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## Special Tax Treatment for Financial Institutions

During these trying times brought about by the COVID-19 pandemic, the six-month loan moratorium announced by the government came as a welcome relief, albeit a temporary one. This was followed by a three-month extension for targeted groups as announced recently by the Prime Minister.

Recognising that this would impact the banking sector, it was announced in the Second Economic Stimulus Package that interest or profits accrued by financial institutions from loan/financing facilities during the moratorium will only be taxable when these are received.

Following this, the Inland Revenue Board (**IRB**) issued an FAQ on the Special Tax Treatment to Financial Institutions in relation to Moratorium Granted to Customers (**FAQ**). In essence, the key points are as outlined below.

### Who qualifies for the special tax treatment?

- Licensed banks
- Licensed investment banks
- Licensed Islamic banks
- Prescribed development financial institutions regulated by Bank Negara Malaysia

### What is the special tax treatment?

Interest or profit income arising from loans/financing that is accrued but deferred during the moratorium period shall not constitute the gross income of that financial institution for that basis period for that year of assessment (**YA**).

As the FAQ was released prior to the announcement of the three-month extension of the loan moratorium, it specifically states that this special tax treatment only applies to the moratorium package starting from 1.4.2020 until 30.9.2020.

## **What type of loan/financing qualifies for the special tax treatment?**

All types of loan or financing (except credit card facilities) granted to individuals, SMEs and corporates which satisfy the following criteria:

- Denominated in Malaysian Ringgit
- Not in arrear exceeding 90 days as at 1.4.2020; and
- Granted moratorium from 1.4.2020 until 30.9.2020

For the purpose of this special tax treatment, the term “SME” follows the definition laid out by SME Corporation Malaysia (Please see “SME Definitions”: <https://www.smecorp.gov.my/index.php/en/policies/2020-02-11-08-01-24/sme-definition>).

## **How does a financial institution report its income with regard to the special tax treatment?**

The accrued interest/profit income from the moratorium portfolio must be reported separately from non-moratorium portfolio according to the customer’s records. This is to ensure that the income is reported and recorded accordingly in the event of an audit.

## **What is the tax treatment for impairment provision in relation to loans or financing involved in the moratorium programme?**

The impairment provision for loans/financing involved under the moratorium programme is not allowed as a tax deduction during the moratorium period.

## **Our views**

Although this relief is much welcomed for the banking industry to soften the blowback suffered from the moratorium, the legal position of the special tax treatment is still encumbered with uncertainties.

For starters, other than the FAQ, there has not been any official written instrument released (or intention to do so) to codify and give legal effect to the special tax treatment for financial institutions, e.g. through orders published in the *Gazette* or legislation. Without any official *Gazette* order or legislation passed by Parliament, the basic legal position under the Income Tax Act 1967 (**ITA**) would still stand — any income accrued in a particular YA shall be charged to income tax in that same YA.<sup>1</sup> At most, the FAQ constitutes a concession by the IRB and can be construed as not having legal effect before a court of law.

As for the FAQ itself, it does not state that the deferred income would be taxable in the YA when it is received as per the announcement made in the Second Economic Stimulus Package. Further, accrued interest/profit that was deferred but still received in YA 2020 (i.e. outside the moratorium period) should be taxable in the same YA. However, this would not be in line with the FAQ, which states that the interest/profit deferred during the moratorium period “*shall not constitute the gross income of that financial institution for that basis period for that year of assessment*”. Hence, the timing in which the deferred income should be taxable is still unclear.

From a practical aspect, financial institutions would face administrative challenges as they are required to segregate and maintain records for every customer and track each payment of the moratorium interest/profits, where their customers could easily run in the thousands. This would undoubtedly incur additional cost and resources. In that regard, it would be beneficial for the government to implement a simple blanket approach for the tax treatment on all deferred moratorium interest/profits.

## Conclusion

Albeit beneficial to the public at large, the tax impact of the loan moratorium would be significant to the banking sector, which was recently announced to have incurred losses up to RM6.4 billion from the six-month moratorium period. In that regard, it is hoped that the government would swiftly address the issues arising from this.

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