

New Tax Guideline on Treating Rental Income as Business Income

Generally speaking, income that is subject to Malaysian income tax is assessed either as business source of income [section 4(a)] or non-business source of income. Non-business source of income includes employment income, dividend, interest and rental income. Rental income from letting of real property is generally regarded as non-business source of income and assessed under section 4(d). However, where the property concerned is managed and let in such a systematic or organized manner that the letting can be regarded as carrying on a business, the income from the letting can be charged to tax under section 4(a) of the Act.

In practice, whether rental income of a taxpayer should be regarded as business income or not can sometime be very judgmental. For administration purposes and as a concession, IRB has issued a guideline in 1995 that sets out criteria for rental income to be treated as business income. A new guideline in the form of Public Ruling 1/2004 dated 30-6-2004 has recently been released by IRB which provide more comprehensive guideline on treatment of rental as business income [section 4(a)] and also as section 4(d) income. The Public Ruling takes effect from year of assessment 2004 onward and supercedes the 1995 guideline.

The criterias set out in Public Ruling 1/2004 on treating rental as business income make a difference between different taxpayer groups and different type of properties.

1. For all taxpayers

Where, in conjunction with the letting of a property, a person also provides ancillary or support services/ facilities, the letting of the property can be considered a business source of income of that person and the income received charged to tax under section (a).

To qualify for the treatment mentioned in paragraph above, the services/ facilities should be actively provided by the person (that is, the services/ facilities are procured, managed and/ or supplied by the person who lets the property) and not passively or incidentally derived from the ownership or lease of the property, as in the case of services and facilities provided by the management corporation of a subdivided building to the proprietors/ tenants of the individual units.

2. Special treatment for company only

Public Ruling 1/2004 provides special treatment for a company (other than an investment holding company or a company limited by guarantee which is taxed as a club or association) where rental can be regarded as a business source. The criteria are based on the following two group of properties.

(a) Special-purpose commercial building

The letting of a special-purpose building built:

- (i) for commercial purpose such as a commercial complex, an office complex or a shopping complex; or
- (ii) as factory or warehouse

can be considered a business source of a company and the income therefrom charged to tax under section 4(a).

(b) Commercial units, shophouses and residential properties

The letting of 4 or more commercial units, 4 or more floors of shophouses or 4 or more residential properties or any combination of 4 units of the above may be treated as a business source of a company and the income therefrom charged to tax under section 4(a).

It should be noted that under the Public Ruling 1/2004,

- (i) the size and value of each unit of property is irrelevant
- (ii) for shophouse, each floor is considered as a unit whether or not it is a separate title. Hence, two double storey shophouses will fulfil the criteria.
- (iii) vacant land is excluded
- (iv) sub-division of unit by way of partition is not allowed unless separate title is issued
- (v) any unit that is let to or occupied by a related or connected person is to be disregarded unless it can be shown that it is an arms length transaction (there must be a payment at market rate.)
- (vi) the 4 units criteria need not be for the entire 12 months period of the basis period. So long as there were 4 units under letting at some point of time during the basis period.
- (vii) temporary vacant is allowed so long as there is effort to get tenant.

Treatment of all properties as a single source/ several source

- Where rental income of a person is treated as business income, all properties of the person should be treated as one business source of income.
- Where rental income assessed as non-business source, a concession is given under Public Ruling 1/2004 where the properties can be grouped into 3 categories as follows:
 - a. residential properties
 - b. shophouses/ commercial properties
 - c. vacant land

However only those properties that have commenced receiving rental income can be grouped together. This is beneficial to taxpayer as 'adjusted loss' of shop-lot A can be offset against adjusted income of shop-lot B.

What are the advantages of treating rental as business income?

If you are wondering what is the importance of treating rental as business source, below are 3 possible tax advantages:

- (a) more expenses may qualify for deduction as long as the expenses are incurred for generating the rental income.
- (ii) where there is an adjusted loss, the loss can be offset against other income of that person for that year and hence reduce the tax payable. Any loss not absorbed can be further carried forward to offset future business income.
- (iii) Capital allowances can be claimed on plant and machinery and industrial building.

All taxpayers who are serious in property investment should do proper tax planning to make sure he/ she is qualified to enjoy the tax advantages of treating rental as business income. Public Ruling 1/2004 will be a good guide for this purpose. However, it should be highlighted that Public Ruling is not a law. If a taxpayer does not meet the guideline in Public Ruling 1/2004 but could justify why his/her/its rental income should be treated as business income, he/she/ it may go ahead to do so.

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