



TAX OBLIGATIONS FOR SELF-EMPLOYED ENTREPRENEURS: WHAT YOU SHOULD KNOW

With the rise of self-employed entrepreneurs, here are some tax compliance obligations and common oversights.

There has been a dramatic growth in recent years on the number of self-employed entrepreneurs in Malaysia. From 2017 to 2018 alone, this number increased from 2.57 million to 2.86 million, an increase of 11.3% (source: *Department of Statistics, Malaysia*). In 2018, the self-employed are the second largest category (19.3%) in the Malaysian workforce out of a total of 14.8 million working adults.

Malaysia adopts a self-assessment system where taxpayers are responsible to determine their own tax liability and to submit their tax returns accordingly. As the number of self-employed entrepreneurs continues to grow in the Covid-19 economy, it is important for the

self-employed to be aware of one's tax obligations especially in the area of tax compliance. Failure to do so could result in penalties and additional tax payable.

A self-employed person is an independent contractor or a sole proprietor. The self-employed consists of sub-contractors working in the trades or construction sectors to professionals such as doctors, lawyers, accountants, engineers, and management consultants. Recent iterations include freelancers working in the commonly named "gig economy" (such as e-hailing drivers).

Here are some tax compliance obligations a self-employed individual should take note of:

1. Registration of Tax Identification Number (TIN) and submission of tax return

A self-employed individual should register for a TIN when the person has taxable income which exceeds a threshold of approximately RM28,000 per annum. A TIN can be registered at the nearest Inland Revenue Branch (IRB) branch or via e-Daftar at the IRB website.

For entrepreneurs running a business, the income tax return (Form B) will need to be submitted by 30 June the following year (eg. Form B for the year of assessment 2020 is due by 30 June 2021).

2. Estimate of Tax Payable

Under the Malaysian tax regime, a taxpayer pays income taxes on a “Pay-As-You-Earn” basis. Where an individual taxpayer receives other than employment income, the IRB may issue a Form CP500 setting out the estimate of tax payable under an instalment scheme. The Form CP500 is determined based on the tax liability of the previous year. What should you take note of:

- The tax estimate is six (6) bi-monthly instalments commencing from the month of March every year.
- Each tax instalment payment needs to be made within 30 days from the due date.
- The remittance slip (Form CP501) should be submitted together with the instalment payment.
- Should there be a need to revise the tax estimate which affects the instalment amount, you must submit Form CP502 to the IRB not later than 30 June each year on the revision payments. The IRB will issue a Form CP503 if the application is successful.
- The penalty for late payment of 10% shall be imposed on the unpaid amount if the tax instalment payment has not been paid within 30 days from the due date.
- Where there is a difference between the revised tax estimate submitted



and the final tax liability which exceeds 30% of the tax payable, the difference will be subject to a penalty of 10%.

The following illustration shows the impact when an estimate of tax payable is inaccurate.

3. Employer’s Responsibilities

As an entrepreneur, you might hire employees to expand your business. In this case, you will be considered as an Employer for tax purposes. The responsibilities of an Employer are as follows:

- (a) The Employer is to inform IRB of any new employees within one month from the date of commencement of employment.
- (b) Submission of *Return of Remuneration* by an Employer (Form E) to the IRB on or before 31 March each year.
- (c) Provide *Statement of Remuneration from Employment* (Form EA) to the employees by end of Feb each year.
- (d) Deduct the Monthly Tax Deduction (MTD) from the remuneration of employee and remit the MTD to the IRB by the 15th of each month

together with *Statement of Tax Deduction by an Employer* (Form CP39).

- (e) The Employer is to inform IRB within one month before the employee ceases its employment.

Other than the above tax obligations, there are also EPF and SOCSO contributions that an employer needs to consider in respect of his / her employees. Be mindful of these responsibilities as failure to comply will attract penalties.

Tax Benefit: Sole proprietor vs Company

When it comes to starting a business, one should ask whether it is more beneficial from a tax perspective to be a sole proprietor or to incorporate a company. An individual is taxed based on a scale tax rate which could reach up to 30%, whereas a company categorised as a small to medium-sized enterprise (SME) is taxed at 17% on the first RM600,000 of chargeable income, and 24% on any subsequent chargeable income.

Assuming that the chargeable income is the same for both sole proprietor and the company, which is

Illustration 1

	RM
Tax liability (A)	50,000
Revised tax estimate	(10,000)
Tax payable (B)	40,000
30% x (A)	15,000
(B) - (C)	25,000
10% penalty	2,500

Illustration 2

	Sole Proprietor (RM)	Company (RM)
Business income	1,200,000	1,200,000
Less: Allowable expenses	(200,000)	(200,000)
Chargeable income	1,000,000	1,000,000
Tax liability on the first RM1,000,000	237,450	
Tax liability @ 17% for first RM600,000		102,000
Tax liability @ 24% for remaining RM400,000		96,000
		198,000

A company with a paid-up capital of RM2.5 million and less and having gross income from source or sources consisting of a business of not more than RM50 million.

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RM1 million, the tax liability for an SME company is significantly lower. The SME company will enjoy a tax savings of RM39,450 (RM237,450 – RM198,000).

However, the tax compliance calendar for a company is different from a self-employed individual. For example, the filing of tax return (Form C) for a company is due seven months from the date following the close of the accounting period (e.g. a December year end company must file the Form C for the year of assessment 2020 by 31 July 2021). A company is also required to have a set of audited financial statements for each year of assessment.

Segregation of private and business expenses

It can be difficult for a self-employed entrepreneur to segregate their private and business expenses. For example, motor vehicles could be used for private and business purposes simultaneously. Tax deductions will likely be restricted, or in a worst case scenario, not allowable if private and business expenses are mixed. Here are some suggestions to differentiate

between the two:

- Open a separate bank account solely for business use
- Have separate credit cards for business and personal use
- Record mileage when motor vehicle is used for business
- Use an accounting system to record business expenses incurred

Supporting documents must be kept on file to substantiate any claim made on business expenses. The documents will need to be kept in record for a period of seven years in the event of a tax audit.

Concluding remarks

As the economy continues to recover from the effects of Covid-19 pandemic, the number of self-employed entrepreneurs will continue to increase in Malaysia. This means that entrepreneurs should always be aware of tax compliance obligations and penalties involved in case of non-compliance.

There may be instances where carrying on a business through an incorporated entity may result in lower

tax exposure to the self-employed entrepreneur. There is also the added benefit of limiting liability by setting up a locally incorporated company.

Of course, it is always advisable to consult a tax professional if you are self-employed and unsure whether you should file a tax return. It is better to get it right first time than to face tax consequences later. ❗



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