ctim
CHARTERED TAX INSTITUTE OF MALAYSIA

tax guardian

Vol.2/No.1/2009/Q1
RM28.00

Authoritative • Relevant • Global Excellence

Corporate Social Responsibility

Implications for Tax Professionals

Official Journal of the Chartered Tax Institute of Malaysia

CCH
a Wolters Kluwer business

ISSN 0128-7583
KDN PP 7829/03/2009/(020916)

Inside:

- Thin Capitalisation
- Financial Reporting Standards: A Malaysian Perspective
- Taxes in Vietnam – What Investors Pay on Vietnam-sourced Incomes
- Industrial Building Allowance for Hotels: A Legal Analysis of Section 30 of the PIA

Hot off the Grill!

Best in Town

The Istana
Redefining Refinement

HOTEL ISTANA
KUALA LUMPUR

For reservations call 603-2141 9988 ext 3691

73, Jalan Raja Chulan, 50200 Kuala Lumpur, Malaysia. T : 603-2141 9988 F : 603-2144 0111
E : general@hotelistana.com.my W : www.hotelistana.com.my

Institute Address :

The Secretariat,
Unit B-13-2, Block B, 13th Floor
Megan Avenue II, No. 12 Jalan Yap Kwan Seng, 50450 Kuala Lumpur, Malaysia.
Institute Telephone: 603.2162.8989
Institute Facsimile: 603.2162.8990
Institute E-mail: secretariat@mit.org.my

CTIM Branch Offices/Chairman

East Coast Branch
Mr Wong Seng Chong
1, 2nd Floor, Lorong Pasar Baru 1
25000 Kuantan, Pahang

Malacca Branch
Mr Viknesvaran s/o Arumugam
40-A, Jalan Laksamana 3
Taman Kota Laksamana
75200 Melaka

Southern Branch
Ms Tan Lay Beng
Room 335, 3rd Floor
Johor Tower, Jalan Gereja
80100 Johor Bahru, Johor

Northern Branch
Mr Andrew Ewe Keang Teong
Unit 41-5-1, 5th Floor, Wisma Prudential
41 Jalan Cantonment
10250 Pulau Tikus, Pulau Pinang

Perak Branch
Mr Lam Weng Keat
C 1-03, 1st Floor
No. 2, Persiaran Greentown 3
Greentown Business Centre, 30450 Ipoh, Perak

Sarawak Branch
Mr Fan Kah Seong
9th Floor, Bangunan Binamas
Jalan Padungan
93100 Kuching, Sarawak

Sabah Branch
Mr Michael YS Tong
Damai Plaza, 3rd. Floor, C11 South Wing
Jalan Damai, P.O Box 11003
88811 Kota Kinabalu, Sabah

Editorial Note

Brace yourself, for 2009 is set to be one bumpy ride. Prime Minister designate Datuk Najib Razak was recently quoted in the Dewan Rakyat saying that, "In view of the increasingly challenging international environment, Malaysia is also expected to face the effects of the slowing economy and world trade". The time has come to rally as tax professionals to step up efforts in helping companies, individuals as well as the community to tide the storm.

In the first issue of the *Tax Guardian* in 2009, we are pleased to feature current and thought-provoking articles for your reading pleasure. We put the spotlight on Corporate Social Responsibility and question whether the role of a tax professional has, or should change. Our cover story, "Corporate Social Responsibility – Implications to Tax Professionals" discusses the significance of CSR to tax professionals and why it is subjected to much debate and criticism.

All eyes on Vietnam being the fastest growing market for foreign direct investment within Asean in the recent years, the article highlighting what investors pay for Vietnam-sourced incomes as well as its recent tax reforms. Discover how these reforms aim to improvise Vietnamese taxation system.

With job cuts on the horizon, this worrying trend seems to be the last resort for companies in the economic meltdown. In our regular section on Practice Management, we delve into the issue of retrenchment and redundancy. Find out what steps need to be taken to conduct such an exercise whilst in alignment with the law.

In this issue, the Learning Curve continues the explanation on taxability of business receipts by looking at miscellaneous income and how this income should be reflected in the tax computation.

Finally, preparations are underway in organising the premier tax event of the year – National Tax Conference 2009. The Institute has and will continue to collaborate with the Inland Revenue Board to deliver an impactful event that focuses on current tax issues. Watch out for more information in the forthcoming issue of the *Tax Guardian* scheduled for June and do register early for this annual networking opportunity.

It's timely to remind the readers there is a column feedback on all aspects of the Tax Guardian, in particular on the articles featured in the relevant issues. We look forward to receiving your feedback.

SM Thanneermalai
Chairman
Editorial Committee

Table of Contents

INVITATION TO WRITE

The Institute welcomes original contributions which are of interest to tax professionals, lawyers and academicians. They may cover local or international tax developments. Article contributions should be written in UK English. All articles should be between 2,500 to 5,000 words submitted in a typed single spaced format using font size 10 in Microsoft Word via email.

Contributions intended for publication must include the author's name, contact details and short profile of not more than 60 words, even if a pseudonym is used in the article. The Editorial Committee reserves the right to edit all contributions based on clarity and accuracy of contents and expressions, as may be required.

Contributions may be sent to:

The Chairman, Editorial Committee
Chartered Tax Institute of Malaysia
Unit B-13-2 Block B, 13th Floor
No.12 Jalan Yap Kwan Seng
50450 Kuala Lumpur
Malaysia.
E-mail: publications@mit.org.my

tax guardian
Authoritative • Relevant • Global Excellence

Tax Guardian is the official journal of the Chartered Tax Institute of Malaysia and is distributed to members and students of the CTIM as well as subscribers, both corporate and individual. The contents of Tax Guardian do not necessarily reflect the views or opinions of the CTIM and no liability is accepted in relation thereto. CTIM does not accept liability for any views or opinions published herein. Advertisements appearing within this journal should not be taken to imply any direct support for or sympathy with the views and aims of CTIM.

Publishing Consultant

CCH
a Wolters Kluwer business

For the past 20 years, CCH has been The Professional's First Choice for information, tools and solutions that help professionals make their most critical decisions. The CCH brand has been a market leader since 1913 and five generations of professionals have considered CCH products among the essentials in any office and critical to keeping up with day-to-day changes in the law and practice. It is one of the most respected names among tax professionals, accountants, attorneys and compliance professionals. Over these years, CCH has provided a wide range of high quality contents be it online, in print, software and training for professionals in Asia focusing in the following areas:

Tax & Accounting • Human Resource • Legal • Business

CCH Office : Commerce Clearing House (M) Sdn Bhd
Suite 9.3, 9th Floor, Menara Weld,
76, Jalan Raja Chulan, 50200 Kuala Lumpur,
Malaysia.
☎ : 603.2052.4688
: 603.2026.7003
✉ : support@cch.com.my
: www.cch.com.my
Advertising Enquiry : Commerce Clearing House (M) Sdn Bhd
Designer : DNA Red Services
Printer : Line & Tone Sdn Bhd

Continuing Professional Development (CPD)
CALENDAR OF EVENTS 2ND QUARTER 2009

april

Date	Training Programme	CPD Points	Venue	Fee (RM) Member	Member's Firm Staff	Non-member	Speaker
1 Apr 2009 9.00am - 5.00pm	Workshop: Corporate Restructuring and Tax Management	8	Kuching	315	365	415	Harvindar Singh
7 Apr 2009 9.00am - 5.00pm	Workshop: A Critique of Recent Tax Cases	8	Ipoh	315	365	415	Saravana Kumar
9 Apr 2009 9.00am - 5.00pm	Workshop: Practical Implications on New Public Rulings	8	Kota Kinabalu	315	365	415	Chow Chee Yen
10 Apr 2009 9.00am - 5.00pm	Workshop: Practical Implications on New Public Rulings	8	Kuching	315	365	415	Chow Chee Yen
11 Apr 2009 9.00am - 5.00pm	Workshop: Income Recontruction	8	Penang	315	365	415	Abdul Rahim
20 Apr 2009 9.00am - 5.00pm	Workshop on Taxation on Individual (Employment Income) (in collaboration with MAICSA)	8	Kuala Lumpur	330	NA	440	Chow Chee Yen
21 Apr 2009 9.00am - 5.00pm	Workshop: Tax Planning	8	Kuala Lumpur	330	380	440	Sivaram Nagappan
22 Apr 2009 9.00am - 5.00pm	Workshop: Practical Implications on New Public Rulings	8	Malacca	315	365	415	Sivaram Nagappan
25 Apr 2009 9.00am - 5.00pm	Workshop: Income Recontruction	8	Johor Bahru	315	365	415	Abdul Rahim
28 Apr 2009 9.00am - 5.00pm	Seminar: Understanding the Latest Changes on Transfer Pricing	8	Kuala Lumpur	Early bird 375 Normal 425	Early bird 425 Normal 495	Early bird 495 Normal 545	Various Speakers
29 Apr 2009 9.00am - 5.00pm	Workshop: A Critique of Recent Tax Cases	8	Penang	315	365	415	Saravana Kumar

may

Date	Training Programme	CPD Points	Venue	Member	Member's Firm Staff	Non-member	Speaker
5 May 2009 9.00am - 5.00pm	Workshop: A Critique of Recent Tax Cases	8	Malacca	315	345	415	Saravana Kumar
7 May 2009 9.00am - 5.00pm	Workshop: Capital Allowances Maximisation	8	Petaling Jaya	330	380	440	Harvindar Singh
12 May 2009 9.00am - 5.00pm	Workshop: Latest Development on Transfer Pricing in Malaysia	8	Kuala Lumpur	330	380	440	Chow Chee Yen
12 May 2009 9.00am - 5.00pm	Workshop: A Critique of Recent Tax Cases	8	Johor Bahru	315	365	415	Saravana Kumar
13 May 2009 9.00am - 5.00pm	Workshop: Individual Tax Filling	8	Kuala Lumpur	330	380	440	Sivaram Nagappan
14 May 2009 9.00am - 5.00pm	Workshop: Capital Allowances Maximisation	8	Johor Bahru	315	365	415	Harvindar Singh
18 May 2009 9.00am - 5.00pm	Workshop: Latest Development on Transfer Pricing in Malaysia	8	Kota Kinabalu	315	365	415	Chow Chee Yen
21 May 2009 9.00am - 5.00pm	Workshop: Latest Development on Transfer Pricing in Malaysia	8	Kuching	315	365	415	Chow Chee Yen
27 May 2009 9.00am - 5.00pm	Workshop: Latest Development on Transfer Pricing in Malaysia	8	Penang	315	365	415	Chow Chee Yen
28 May 2009 9.00am - 5.00pm	Workshop: Capital Allowances Maximisation	8	Ipoh	315	365	415	Harvindar Singh

june

Date	Training Programme	CPD Points	Venue	Member	Member's Firm Staff	Non-member	Speaker
4 Jun 2009 9.00am - 5.00pm	Workshop: Latest Development on Transfer Pricing in Malaysia	8	Johor Bahru	315	365	415	Chow Chee Yen
9 Jun 2009 9.00am - 5.00pm	Workshop: Latest Development on Transfer Pricing in Malaysia	8	Malacca	315	365	415	Chow Chee Yen
12 Jun 2009 9.00am - 5.00pm	Workshop: Latest Development on Transfer Pricing in Malaysia	8	Ipoh	315	365	415	Chow Chee Yen
17 Jun 2009 9.00am - 5.00pm	Workshop: A Critique of Recent Tax Cases	8	Kota Kinabalu	315	365	415	Saravana Kumar
18 Jun 2009 9.00am - 5.00pm	Workshop: A Critique of Recent Tax Cases	8	Kuching	315	365	415	Saravana Kumar
18 Jun 2009 9.00am - 5.00pm	Seminar: Topic to be advised	8	Kuala Lumpur	Early bird 375 Normal 425	Early bird 425 Normal 495	Early bird 495 Normal 545	Various Speakers
22 Jun 2009 9.00am - 5.00pm	Workshop: Capital Allowances Maximisation	8	Penang	315	365	415	Harvindar Singh
24 Jun 2009 9.00am - 5.00pm	Workshop: Capital Allowances Maximisation	8	Kota Kinabalu	315	365	415	Harvindar Singh
25 Jun 2009 9.00am - 5.00pm	Workshop: Capital Allowances Maximisation	8	Kuching	315	365	415	Harvindar Singh

DISCLAIMER: MIT reserves the right to change the speaker(s)/date(s), venue and/or cancel the events without notice at their discretion.

ENQUIRIES: Please call Ms Latha, Ms Ally or Ms Nur at 03-2162 8989 ext 108, 113 and 106 respectively or refer to MIT's website www.mit.org.my for more information on the CPD programmes.

Seminar on A Critique of Recent Tax Cases – Discerning the Judicial Mood

Participants at the seminar

The Institute successfully conducted its seminar on "A Critique of Recent Tax Cases – Discerning the Judicial Mood" on 17 February 2009 at the Equatorial Hotel, Kuala Lumpur. More than 100 participants attended the seminar.

Details of the seminar are shown in the following table:

Speaker's name	Topic
Mr Maniam Kuppusamy	Latest developments in the law relating to the valuation and the assessment of customs duties in respect of royalties paid to the brand owners of the imported goods by local importers.
Mr Saravana Kumar	*OPD Sdn Bhd v KPHDN* (Rayuan PKCP 53/2006).
Mr Anand Raj	Court of Appeal decision in the case *Castrol (Aspac Lubricants (M) Sdn Bhd v KPHDN* (2007) MSTC 4,271.
Mr Andrew Davis	*Kerajaan Malaysia v Kemayan Bina Sdn Bhd* (2008) MSTC 4,334
Encik Nik Saghir Mohd Nor	*DD Dev Sdn Bhd v KPHDN* (2008) MSTC 3,726
Mr Sudharsanan Thillainathan	*Richard Allen Sonnet & Anor v KPHDN*

CPD Event News

Dato Raymond Liew, Mr Sudharsanan Thillainathan and Mr Saravana Kumar


Participant asking a question to the panel


Full concentration


Participants networking during the tea break

Tax and Cross Border Transactions

Withholding tax is an important provision within the Malaysian income tax system. Understanding the practical issues and latest developments in relation to withholding tax is essential in avoiding penalties being imposed for non-compliance. In view of this, CTIM conducted a workshop on “Withholding Tax and Cross Border Transactions” on 12 January 2009 at PNB Darby Park, Kuala Lumpur. A total of 50 participants attended and benefited from the workshop.

Corporate Tax Management and Restructuring

CTIM successfully conducted the workshop on “Corporate Tax Management and Restructuring” on 5 February 2009 at PNB Darby Park, Kuala Lumpur. Participants at the workshop obtained invaluable advice on managing their company’s taxation matters. The speaker shared his widespread experience in this area and provided practical and technical solutions to manage risks that invariably exist in the self assessment system. In addition, there was a detailed discussion on corporate restructuring schemes and tax planning.

Report on Branches

MALACCA BRANCH

Members' Dialogue and Visit to IRB Malacca Branch

From left: Mr Abd Halim Bin Husin, Dr Veerinderjeet, Mr Viknesvaran and Mr Tan Sek Hwee

CTIM Malacca Branch members had a dialogue with the President of the Institute, Dr Veerinderjeet Singh on 21 November 2008 at Malacca Straits Hotel. The dialogue was a good platform for members to raise tax practice matters, feedback and suggestions.

Earlier before the dialogue, the CTIM President, Malacca Branch Chairman and Committee Members visited the IRB Malacca Branch and were given a tour of the office. Amongst the discussion was a request to IRB to hold annual dialogues with the CTIM to exchange views and ideas.

From left: Mr Viknesvaran, Malacca Branch Chairman, Dr Veerinderjeet and Tuan Haji Mohd Faiz Ismail, Principal Assistant Director, IRB Malacca Branch

Evening Talk on Taxation

Members of CTIM Malacca Branch Committee and Malacca Bar Committee

The CTIM Malacca Branch Committee and the Malacca Bar Committee jointly organised an evening talk on taxation on 13 November 2008. The talk, which was attended by forty members, covered areas of Self Assessment, Tax Audit and the Tax Treatment of Legal Practitioners.

SOUTHERN BRANCH

Members' Dialogue

CTIM Southern Branch members had a dialogue with the President of the Institute, Dr Veerinderjeet Singh on 13 December 2008 at The Hokkien Association. The dialogue was a good platform for members to raise tax practice matters, feedback and suggestions.

From left: Roslina Salleh, Teoh Siew Hoon, Tan Lay Beng, Dr Veerinderjeet and Tony Seah

Dialogue in progress

16th Asia–Oceania Tax Consultants' Association General Council Meeting and 8th General Meeting


AOTCA meeting

The 16th AOTCA General Council Meeting and 8th General Meeting were held in Shanghai on 27 November 2008. The host organisation for this year was the Chinese Certified Tax Agent Association (CCTAA). The Meetings were attended by delegates from the member organisations including the Chartered Tax Institute of Malaysia (CTIM).

Technical sessions were held on the following day. There were five technical sessions as listed below:

- The Chinese Tax System and Development
  Speaker : Mr Wang Li, Deputy Commissioner of State Administration of Taxation, China
  Moderator : Mr Gilson John Levy, Deputy President of AOTCA
- The Chinese Corporate Law
  Speaker : Mr Miao Huipin, General-Director of Income Taxation Department, State Administration of Taxation, China
  Moderator : Mr Xu Shan Da, President of CCTAA
- Current Tax Development in Europe
  Speaker : Ms Maria Lourdes Perez-Luque, President of CFE
  Moderator : Mr Thomas Lee, AOTCA Advisor
- AOTCA: Catalyst for Best Practice in Tax Administration
  Speaker : Ms Gracia M. Pulido-Tan, Attorney-at-Law, CPA, Former Undersecretary of Revenue Operations, Department of Finance, the Philippines
  Moderator : Mr Thomas Lee, AOTCA Advisor
- The Current Situation of Chinese Certified Tax Agents and its Development
  Speaker : Mr Xu Shan Da, President of CCTAA
  Moderator : Mr David Graham Russell, Honorary Advisor, AOTCA

AOTCA President delivering his speech

SIGNING OF MEMORANDUMS OF UNDERSTANDING


MoU signing with CCTAA

The CTIM signed Memorandums of Understanding (MoU) with two foreign tax bodies. The signing took place on 27 November in Shanghai during the AOTCA meeting there.

One MoU was signed with the Chinese Certified Tax Agent Association (CCTAA) and the other was signed with the Taxation Institute of Australia (TIA).

The main objectives of the MoU are to promote the exchange of information regarding the tax legislation in each jurisdiction and to conduct training and continuing professional development events which will mutually benefit both parties. In addition, the MoU with TIA also provides for the sharing of information on the design and promotion of the professional examinations of TIA.

Mr Harpal Singh Dhillon, the Deputy Chairman of the CTIM's International Affairs Committee, represented the CTIM at the signing of the MoUs. Mr Xu Shan Da represented CCTAA while TIA was represented by Mr Gilson John Levy.

IIUM's Accounting Students Conference 2008

The Malaysian Institute of Taxation was one of the sponsors for the Accounting Students Conference 2008 (ASC2008) organised by the Bachelor of Accounting (BACC) Association of International Islamic University Malaysia (IIUM). The Conference was held on 1–2 December 2008 at the International Islamic University Malaysia (IIUM). CTIM supported the event with the objective of promoting taxation as a future career to the participating students. During the Conference, the Chairman of the CTIM Education Committee, Associate Professor Faridah Ahmad, gave a career talk on taxation.

2009 Budget Commentary and Tax Information Appreciation Dinner


Members of the Editorial Team taking a break during the dinner


Standing L to R: Ann Vong, Foo Yoke Pin, Ho Fong Moi. Seated L to R: Jonathan Seifman, Poon Yew Ho, Datuk Nordin Baharuddin, Nik Mohd Hasyudeen and Harpal Singh


BB09 Co-Chairman Mr Harpal Singh with CTIM staff

A dinner was held on 6 February in Hilton Petaling Jaya in appreciation of the contributions of the Editorial Board of the 2009 Budget Commentary and Tax Information. There were lucky draws during the dinner with prizes jointly sponsored by the three professional bodies namely the CTIM, MICPA and MIA and CCH.

The 2009 Budget Commentary and Tax Information is a joint publication by the CTIM, MICPA and MIA in association with several major accounting firms.


BB09 Co-Chairman Mr Poon Yew How delivering his speech

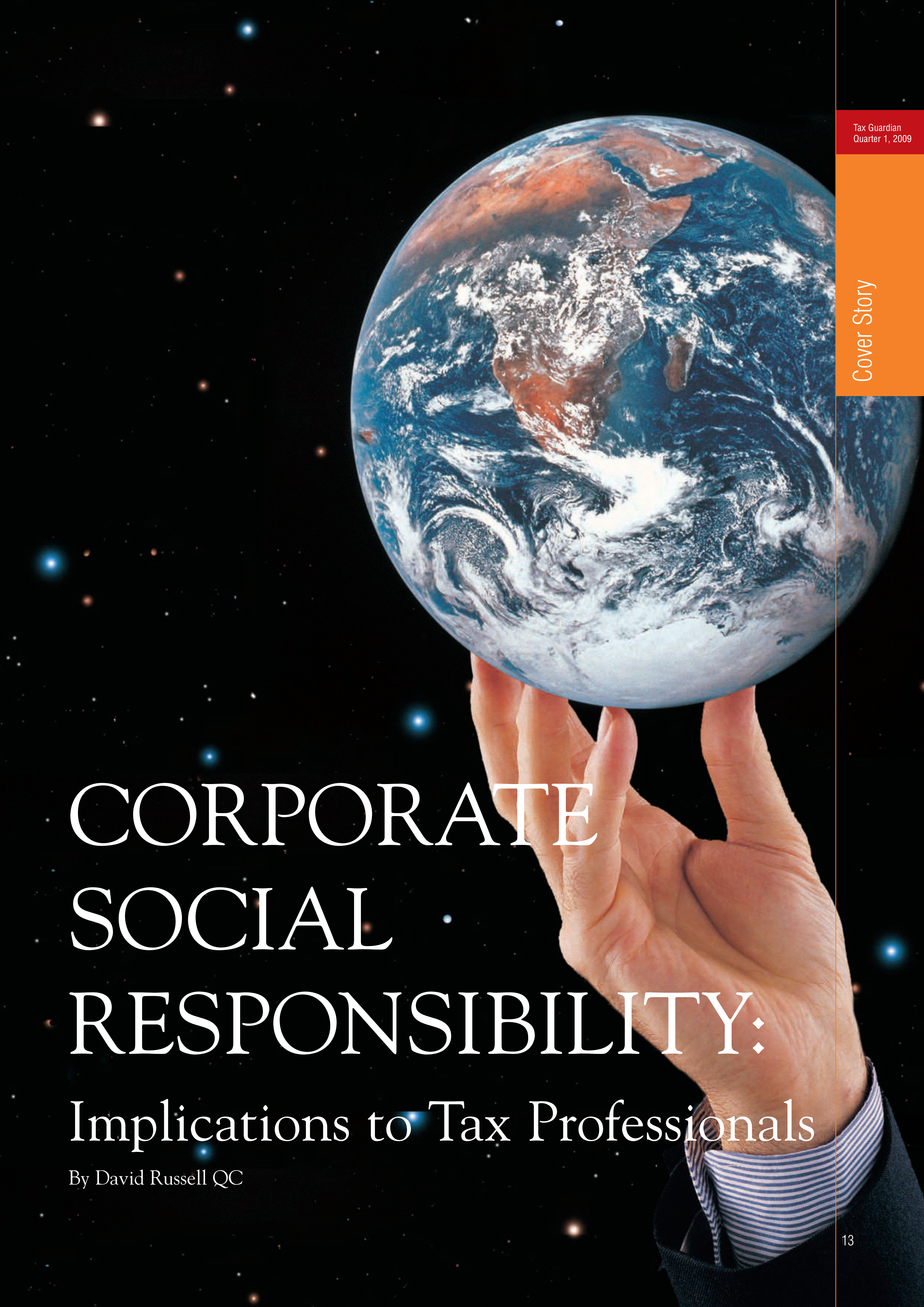

The President of MICPA giving the first prize to Ms Yeoh Wen Ching

Professional Examinations


Students attempting the CTIM Dec 2008 examinations

The Chartered Tax Institute of Malaysia (CTIM) held its week-long professional examinations for candidates in Kuala Lumpur and at various branch offices throughout Malaysia. The examination centers were in Kuala Lumpur, Pulau Pinang, Johor, Melaka, Perak, Kelantan, Sabah and Sarawak.

A total of 237 candidates sat for the examinations which were conducted from 15 – 19 December 2008 in eight centers nationwide. The Institute organised its first examination in 1995 and it is the only professional taxation examination in Malaysia. The objective of the examinations is to build a pool of qualified taxation personnel as well as to maintain the highest standard of professional ethics and competency among members.



CORPORATE SOCIAL RESPONSIBILITY:

Implications to Tax Professionals

By David Russell QC

The Malaysian Government plans to encourage greater private sector participation by widening the scope of community projects eligible for tax deductions such as poverty alleviation and environmental protection projects. Local heavyweights like Tenaga Nasional Berhad, Proton Holdings Berhad and Maxis Communication Berhad are just some of the many companies committed in their support of the Government's Corporate Social Responsibility (CSR) initiatives. These corporations exercise their power of philanthropy in key social areas such as education, sports, environment and helping the underprivileged.

This article discusses the significance of CSR to tax professionals.

Corporate social responsibility (CSR, also called corporate responsibility, corporate citizenship, responsible business and corporate social opportunity) is a concept whereby organizations consider the interests of society by taking responsibility for the impact of their activities on customers, suppliers, employees, shareholders, communities and other stakeholders, as well as the environment. This obligation is seen to extend beyond the statutory obligation to comply with legislation and sees organizations voluntarily taking further steps to improve the quality of life for employees and their families as well as for the local community and society at large.

The practice of CSR is subject to much debate and criticism. Proponents argue that there is a strong business case for CSR, in that corporations benefit in multiple ways by operating with a perspective broader and longer than their own immediate, short-term profits. Critics argue that CSR distracts from the fundamental economic role of businesses; others argue that it is nothing more than superficial window-dressing; still others argue that it is an attempt to pre-empt the role of governments as a watchdog over powerful multinational corporations.

> *Critics argue that CSR distracts from the fundamental economic role of businesses; others argue that it is nothing more than superficial window-dressing…*

Social accounting, auditing and reporting

Taking responsibility for its impact on society means in the first instance that a company accounts for its actions. Social accounting, a concept describing the communication of social and environmental effects of a company's economic actions to particular interest groups within society and to society at large, is thus an important element of CSR.

The FTSE Group publishes the FTSE4Good Index, an evaluation of CSR performance of companies.
In some nations, legal requirements for social accounting, auditing and reporting exist (e.g. in the French bilan social), though agreement on meaningful measurements of social and environmental performance is difficult. Many companies now produce externally audited annual reports that cover Sustainable Development and CSR issues ("Triple Bottom Line Reports"), but the reports vary widely in format, style, and evaluation methodology (even within the same industry). Critics dismiss these reports as lip service, citing examples such as Enron's yearly "Corporate Responsibility Annual Report" and tobacco corporations' social reports.

Potential business benefits

The scale and nature of the benefits of CSR for an organization can vary depending on the nature of the enterprise, and are difficult to quantify, though there is a large body of literature exhorting business to adopt measures beyond financial ones (e.g., Deming's Fourteen Points, balanced scorecards). Orlizty, Schmidt, and Rynes found a correlation between social/environmental performance and financial performance. However, businesses may not be looking at short-run financial returns when developing their CSR strategy.

The definition of CSR used within an organization can vary from the strict "stakeholder impacts" definition used by many CSR advocates and will often include charitable efforts and volunteering. CSR may be based within the human resources, business development or public relations departments of an organisation, or may be given a separate unit reporting to the CEO or in some cases directly to the board. Some companies may implement CSR-type values without a clearly defined team or programme.

The business case for CSR within a company will likely rest on one or more of these arguments namely human resources, risk management, brand differentiation and license to operate.

Human resources

A CSR programme can be seen as an aid to recruitment and retention, particularly within the competitive graduate student market. Potential recruits often ask about a firm's CSR policy during an interview, and having a comprehensive policy can give an advantage. CSR can also help to improve the perception of a company among its staff, particularly when staff can become involved through payroll giving, fundraising activities or community volunteering.

Risk management

Managing risk is a central part of many corporate strategies. Reputations that take decades to build up can be ruined in hours through incidents such as corruption scandals or environmental accidents. These events can also draw unwanted attention from regulators, courts, governments and media. Building a genuine culture of 'doing the right thing' within a corporation can offset these risks.

Brand differentiation

In crowded marketplaces, companies strive for a unique selling proposition which can separate them from the competition in the minds of consumers. CSR can play a role in building customer loyalty based on distinctive ethical values. Several major brands, such as The Co-operative Group and The Body Shop are built on ethical values. Business service organisations can benefit too from building a reputation for integrity and best practice.

License to operate

Corporations are keen to avoid interference in their business through taxation or regulations. By taking substantive voluntary steps, they can persuade governments and the wider public that they are taking issues such as health and safety, diversity or the environment seriously, and so avoid intervention. This also applies to firms seeking to justify eye-catching profits and high levels of boardroom pay. Those operating away from their home country can make sure they stay welcome by being good corporate citizens with respect to labour standards and impacts on the environment.

The tax context

There are 3 aspects in the tax context to consider; specifically, the traditional approach, CSR in the tax context and lastly the implications for tax professionals.

The traditional approach

Application of CSR in a tax context may be thought to require a departure from traditional approaches to tax analysis. Taxation is, at its essence, an exercise of state power to appropriate private property without compensation. For that reason the Courts have traditionally regarded it as an area in which strict approach to statutory construction is appropriate. This, in turn, led to the notion that a taxpayer was free to so arrange his affairs so as to fall outside the letter of the law.

CSR in the tax context

CSR arises in two contexts: the approach to be adopted by the corporation in relation to tax planning which is expected to be successful, and the approach adopted in relation to compliance. Anti-avoidance rules, both general and specific, clearly attempt to reduce that capacity and judicial attitudes to such rules nowadays are such as to give them a meaningful operation. A tax liability arising under the application of such a rule is as much a tax liability as is one arising under specific provisions of the legislation. No additional question arises in relation to such a state of affairs from the perspective of Corporate Social Responsibility because in such a case, the liability to tax is not altered (often, with penalties, it will be increased) and the taxpayer will be obligated to pay the tax.

It should be noted that the issue with respect to tax planning is a quite different one to that which normally arises in a CSR context: CSR in general is concerned with the desirability of a corporation doing more to contribute to the community than the law requires. Whilst application of CSR principles would often result in a corporation adopting philanthropic attitudes, payment of amounts to revenue authorities in the form of tax which are not actually owing seems an odd form of philanthropy and, moreover, one which would be difficult to argue for as advancing wider corporate objectives. It may even lead to tax or other defaults elsewhere, as, for example, where a tax liability in one jurisdiction gives rise to an entitlement to a credit in another, or is taken into account in calculating liability to another tax within the same jurisdiction, or where in order to pay the higher amount of tax profits are overstated to justify the liability.

The position may be thought to be different where a tax liability is altered by deliberate planning. In such a case, a Corporation (which after all is a legal entity with a defined set of obligations) has a choice as to whether or not to alter the liability. It also has a number of choices as to how it interacts with revenue authorities in its host countries.

The classic view was that a Corporation, having an obligation to carry on business and make profits for its members, has a right (and arguably a duty) to see tax as just another cost of doing business and, like other costs, one capable of reduction in the interests of shareholders. Revenue authorities in such a context were unlikely to be seen as natural allies of the Corporation: rather, they were entities whose activities were capable of reducing its profits and interaction with them was to be approached from the perspective of the Corporation's profit maximizing obligations.

Application of CSR in this context involves little more than keeping in mind that for a corporation intending to remain in business for a long time, profit maximization is a marathon, not a sprint. A short term gain, in the form of a reduced tax liability, may be a long term loss if it results in damage to reputation, consumer or government resistance to its products, or increased compliance activity by revenue authorities.

Implications for Tax Professionals

In the light of the widespread acceptance of CSR, the question arises whether the role of the tax professional has, or should, change.

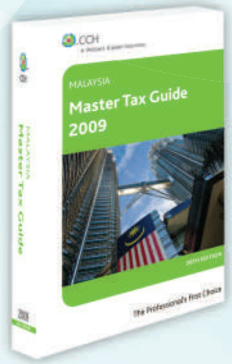
CCH
a Wolters Kluwer business

Minimise the global financial impact with the latest tax knowledge

You can hardly open a newspaper or turn on the radio or TV these days without hearing about the "Global Economic Situation". The immediate solutions that you might have now: examining all of your costs and tighten your belt.

Tax is a major business cost. With effective tax planning, you can achieve reduction of tax liability, minimise litigation and yield a productive investment. Before structuring any tax planning, it is important for businesses to understand the tax compliance environment they are operating in and this includes knowledge of the tax laws. The purpose is for taxpayers to manage their tax planning without compromising with any tax compliance. Understanding tax compliance will assist in searching for avenues that provide tax relief or incentives.

Here are two must-have tax resources that can help you.



MALAYSIA
Master Tax Guide 2009

The 26th Edition highlights all significant income tax developments up to 19 January 2009 as a result of legislative amendments and 2009 Budget announcement. The updates are:

- Reduction of tax rates on individuals and increase in tax rebate
- Self amendment of tax return for additional assessment
- Assessment of small and medium enterprises
- Single tier tax system – amount of tax discharged, remitted or refunded, submission of Form R31, transitional provisions for dividend payment
- Tax exemption on benefits-in-kind, meal allowance, travelling and entertainment allowances, interest subsidy
- Withholding tax on interest received by individuals
- Withholding tax exemption for non-resident expert
- Exemption on income from dealing in non-ringgit sukuk and issuance and trading of sukuk
- Incentive for listing of foreign companies and foreign products in Bursa Malaysia
- Thin capitalisation
- Advance pricing arrangement
- Pre-commencement of business expenses relating to employee recruitment
- Double deduction for promotion of Malaysia international islamic financial centre
- Accelerated capital allowance for ICT equipment and plant and machinery used by SMEs
- Income distributed by REITs to non-resident unit holders
- Tax incentives for hotels in East Malaysia
- Group relief for resident companies
- Examples on tax computations of individuals and companies
- Example on capital allowances computation
- Recent cases: *VKM Sdn Bhd v KPHDN, DGIR vs Hypergrowth Sdn Bhd, BR Sdn Bhd v KPHDN, PR Sdn BHd v KPHDN, KPHDN v Hock Lee Holdings Sdn Bhd*
- 2008 Public Rulings: PR 1/2008, 2/2008, 3/2008
- 2008 IRB Guidelines: 1/2008, 2/2008, 3/2008

Author

Written by CCH Tax Editors with Consultant Editors : Dr Veerinderjeet Singh and Teoh Boon Kee

Handy Guide for Corporate Professionals	Must-Have Reference for Business Consultants	Essential Reference for Foreign Businesses	Comprehensive Guide for Taxpayers
Highlights current tax laws and changes affecting your organisations at one glance with practical, accurate and reliable presentation of the structures, features and ambit of Malaysian income tax law.	Comprehensive coverage on tax law that is relevant to individuals, partnerships, corporations and other taxable entities.	Comprehensive coverage on industrial and investment incentives and special concessions granted under the tax treaties.	Presented in layman terms, taxpayers can gain better understanding of the tax legislative requirements and their responsibilities towards tax-return preparation and submission.

Readers are guided with concise, practical explanation of the income tax laws, including legislative changes, gazette orders, rules and public rulings, and tax decisions cases from both Malaysian and the Commonwealth tax jurisdictions.

Essential Tax Planning Strategies in Malaysia

Written to cover on two areas, namely tax compliance and tax planning in Malaysia with other topics include issues in anti-avoidance. Written in an easy to understand manner, you will gain insights on:

- Overview of the investment framework and the governing regime in Malaysia
- Tax compliance environment in Malaysia which include personal and Corporate income tax, other taxes such as sales tax and service, tax incentives and etc
- Tax planning with discussion on issues such as issues in tax deductibility, planning for inbound investment, tax planning for outbound investor, transfer pricing issues and others
- Anti-avoidance issues and trends in taxation
- Challenges faced in tax planning thus to avoid any potential pitfalls

Author

Adeline Wong is a partner at Wong & Partners, a correspondent law firm in Malaysia of Baker & McKenzie. Head of the tax practice group, Adeline has more than 12 years of practice experience in Malaysian corporate and personal tax and international tax planning.

Why you should own one

- Covers all the important issues that must be considered when structuring a tax planning strategy. Case law decisions are also used to further explain the applicability of law and principles of taxation.
- Topics are focused on practical and relevant issues faced by businesses and investors such as financing the local subsidiary, withholding tax, tax treatment of a foreign service provider, structuring a foreign business, repatriation of profits, use of tax treaties and others.
- Explains tax compliance matters which are necessary to ensure businesses or corporation strategise their planning within the ambit of the law.
- Comprehensive coverage of all aspects of tax planning issues.
- Tax laws interpretation and case laws decision are used to enhance readers' understanding of the topic of discussion.
- Includes summaries of important tax deadline and tax rates for quick reference
- Easy to read — presented in a clear, straight to the point manner

Our Pledge To You

In times of financial uncertainty, knowledge is the currency with the highest value. It gives tax professionals like you the ability to minimise compliance risk and maximise tax efficiency. We understand you may have constraint in your investment priority. Hence, we are committed to support you on your journey ahead with rare savings.

- **5% savings on any book purchased.**
- **10% savings on any TWO books purchased.**

But hurry! Savings are only applicable for purchase made by 30 April 2009.

Order Form — Fax to : 03.2026.7003 — Order Ref : MA 149

Title	Code	Retail Price (RM)	Discount	Qty	Amount (RM)
Malaysia Master Tax Guide 2009	1801M	198.00			
Essential Tax Planning Strategies in Malaysia	1788M	168.00			
❒ I would like to subscribe to eBiz Alert About eBiz Alert - eBiz Alert is a free all-in-one monthly business e-newsletter that delivers concise current issues, trends and regulatory watch to the subscriber. It covers topic areas on Tax & Accounting, Corporate Law, Human Resource and overall business/economy in the Asia Pacific region and globally.					FREE
				Total Amount (RM)	

Payment Option

❒ I enclose a cheque made payable to **"Commerce Clearing House (M) Sdn Bhd"**

Cheque No. ______________________ RM ______________

❒ Please debit my ○ Visa ○ MasterCard RM ______________

Card No.: ☐☐☐☐-☐☐☐☐-☐☐☐☐-☐☐☐☐ Expiry Date ____/____

Card Holder's Name: ______________________ Card Holder's Signature: ______________

Contact Details

Mr/Ms Name: ______________________ Job Title: ______________

Company: ______________________________

(As per business registration)

Business Registration No.: ______________________ Business Nature: ______________

Company Size ☐ 1-4 ☐ 5-9 ☐ 10-19 ☐ 20-49 ☐ 50-99 ☐ 100-199 ☐ 200-499 ☐ 500-999 ☐ 1000+

Address: ______________________________

Postcode: ____________ State: ______________________ Tel: ______________

Fax: ____________ Email: ______________________ *(Important to receive future special update/news)*

Authorised Signature & Company Stamp

Date

Terms & Conditions:

1. Order is subject to acceptance by CCH.
2. Price(s) is valid in Malaysia and is subject to change without prior notice.
3. Book(s) will only be delivered upon receipt of payment.
4. Good(s) sold is not returnable. If the book is received in an unsatisfactory condition, it should be exchanged within a week of receipt.
5. Promotion valid until 30 April 2009.

Commerce Clearing House (M) Sdn Bhd (216303-M)

Suite 9.3, 9th Floor, Menara Weld,
No. 76, Jalan Raja Chulan,
50200 Kuala Lumpur, Malaysia.

Toll Free Customer Service Hotline : 1-800-181-151
Fax : 603 2026 7003
Website : www.cch.com.my
Email : mktg@cch.com.my

To the extent that CSR motivates a client to adopt a more conservative view of tax planning opportunities which may be available, the tax professional can readily adjust because after all these are decisions which are properly made by the client, not the professional. The professional's role is simply to ensure that the client makes informed decisions in this area.

Likewise with client attitudes to compliance, no one likes becoming involved in unnecessary disputes and client instructions to adopt a co-operative approach to dealings with revenue authorities will make for a quieter life for the professional.

The more interesting question is the extent to which tax professionals have their own social responsibility which should influence the conduct of their practices. In asking this question, the author is not suggesting that there are not already significant legal and ethical obligations on practitioners which must be scrupulously observed. Rather, the inquiry is as to whether more is required or desired.

In the light of the widespread acceptance of CSR, the question arises whether the role of the tax professional has, or should, change.

One sees echoes of this in various projects developed by Revenue authorities relating to the activities of so-called "tax intermediaries": an insulting term if it seeks to characterise tax professionals as mere economic actors in their own interests, and in many ways irrelevant one if it seeks to include within the group not only tax professionals but others whose activities could affect client behaviour (such as financial advisers). But it is difficult to avoid the conclusion that the term is here to stay.

The approach to administration of tax systems has, over time, fluctuated between an adversarial and a co-operative approach. Currently, consistent with a move to a responsive regulatory strategy, revenue authorities have expressed the desire for a co-operative partnership style relationship with the tax advising profession. The profession is seen as a critical leverage point to promote voluntary compliance with the tax system by the bulk of taxpayers.

The advent of a partnership style relationship between revenue authorities and the tax profession raises many issues, primarily, whether the desire to establish this relationship is mere rhetoric employed by both parties in the pursuit of their divergent interests. In fact, the very existence of these opposing interests raises the possibility of ethical conflicts that need to be carefully managed by both parties to the "partnership".

In a penetrating article, *Partners or Combatants: A Comment on the Australian Tax Office's view of its Relationship with the Tax Advising Profession,*[8] Professor Justin Dabner has pointed out that unless these issues are clearly analysed, there is likely to be a great deal of conflict. He concludes

that there is a real risk (in an Australian context) that while there is a good deal of rhetorical flourishes coupled with conduct not particularly consistent with it on both sides.

Conclusion

The difficulty which the author foresees is that unlike their clients, tax professionals are not free to adopt approaches to their responsibilities which ignore their primary obligation to their client. And, as modern tax administration requires that tax professionals deal frankly and openly with their clients, attempts to make them depart from their primary responsibility (whether through undermining confidentiality, or otherwise attempting to control their conduct) necessarily will be self-defeating. TG

***David Russell QC** is a barrister of Ground Floor Wentworth Chambers, Sydney, Australia. The content of this article represents the author's personal views and not that of Ground Floor Wentworth Chambers. The author can be contacted at russell@gibbschambers.com.*

References

1. Grayson, D. and Hodges, A. (2004) *Corporate Social Opportunity! Seven Steps to Make Corporate Social Responsibility Work for your Business*
2. R.H. Gray, D.L.Owen & K.T.Maunders, *Corporate Social Reporting: Accounting and accountability* (Hemel Hempstead: Prentice Hall, 1987)p. IX.
3. Orlitzky, Marc; Frank L. Schmidt, Sara L. Rynes (2003). "Corporate Social and Financial Performance: A Meta-analysis" (PDF). *Organization Studies* 24 (3): 403–441. London: SAGE Publications. doi:10.1177/0170840603024003910. Retrieved on 2008-03-07.
4. "Corporate Social Responsibility and Ethical Careers". University of Edinburgh Careers Service. Retrieved on 2008-03-07.
5. Bhattacharya, C.B., Sankar Sen and Daniel Korschun (2008), "Using Corporate Social Responsibility to Win the War for Talent," CTIM Sloan Management Review, 49 (2), 37-44; "The Good Company", *The Economist* (2005-01-20). Retrieved on 2008-03-07.
6. Kytle, Beth; John Gerard Ruggie (2005). "Corporate Social Responsibility as Risk Management: A Model for Multinationals" (PDF). *Social Responsibility Initiative Working Paper No. 10.*. John F. Kennedy School of Government, Harvard University. Retrieved on 2008-03-07.
7. Paluszek, John (April 6-7, 2005). "Ethics and Brand Value: Strategic Differentiation" (PowerPoint). *Business and Organizational Ethics Partnership Meeting.* Markkula Center for Applied Ethics, Santa Clara University. Retrieved on 2008-03-07.
8. JATTA, 2008.

Thin Capitalisation

By Dr Nakha Ratnam Somasundaram,

Capital financing – whether by equity or debt – has significant effect on its income and tax liability, because of different approaches adopted for the computation of taxable income for the company and for the providers of the finance. This lends itself to some ingenious tax planning particularly in the context of globalisation and foreign direct investment. Recent trends in taxation suggest that Revenue authorities are cognitive of the corporate capital structure and its tax implications, and are introducing legislation on thin capitalisation that work either on its own or in conjunction with transfer pricing legislation or rules. Part I of this article explores the issue of thin capitalisation in the context of Malaysian taxation, in Part II, let's examine the issues of thin capitalisation in some Asian and European countries in the context of the OECD model.

Introduction

There are essentially two different methods of financing a company – one is by issue of shares in the equity of the company, and the other is by borrowing (generally known as 'debt financing').

What is the difference between the two methods? There are three differences – one is legal, the other is economic and for both there is the tax difference – the one that worries the Revenue authorities.

The legal difference

In the equity financing approach, the owner of the shares is entitled to a proportion of the profits of the company, usually distributed by way of dividends. Dividends are declared only when the company makes a profit and it decides to distribute all or part of the profits as dividends. Otherwise, the investment in shares is recoverable only in the instance of the company's dissolution. In any case, the investment risk is limited to the amount of the equity capital subscribed. In some instance, the investor may be able to sell the shares to recover more or less of his original capital.

On the other hand, in debt financing, the lender would be entitled to a periodical interest payment on the sum lent, such interest being payable regardless of whether the company makes a profit or not. As for risk undertaken, the creditor and the investor face the same uncertainty.

The economic difference

The debt financing allows the lender to obtain a steady stream of interest income and the prospect of the return of the capital in case of dissolution.

For the equity investor though there is no expectation of a steady and regular dividend payment – it depends on whether the board of directors of the company decides that they can spare the profit for dividends.

The tax difference

From the tax point of view the important difference is that an equity investment produces a return in the form of dividend – which is not deductible for the company paying the dividend. This is because it is a distribution of capital, while the interest on the debt or loan is for the payer a deductible expenses being regarded as an expense of earning those profits.

This can be illustrated as follows: Assume that in one situation, a resident Company A is 100% equity financed by a non-resident Company B. And in another situation, assume that Company A is 100% debt funded by Company B. In both the situation, the tax impact could be illustrated as follows:

	Situation 1 100% equity RM	Situation 2 100% debt RM
Company A (resident)		
Profit before interest and tax	3,000	3,000
Interest on loan (say)	0	(3,000)
Profit before tax	3,000	0
Tax at 25%	750	0
Profit after tax	2,250	0
Company B (non-resident)		
Dividend /Interest distributed	2,250	3,000
Withholding tax rate (%)	0	15
		(Note 1)
Withholding tax	0	450
Amount received by the non-resident	2,250	2,550
Effective tax rate (%)	25	15
Note 1: Assume there is no Double Taxation Treaty.		

Illustration 1:Tax impact of thin capitalisation

It could be seen from the illustration that where the company was debt financed there is a significant tax advantage both to the company and the recipient of the interest income. It is this fact of using debt financing rather than equity financing which has serious consequences for tax revenue and therefore governments need to review their tax policy to identify the legitimacy of such financing and take action to regulate it.

Thin capitalisation in the business world

In the business world, tax is not the sole consideration in corporate financing. There are other economic and commercial necessities, particularly in relation to dealing with unrelated parties.

Thin capitalisation could be taken advantage of for several other reasons besides tax. One advantage is that in a multinational group setting, the parent in one country with a subsidiary in another may endure an overall lower tax liability if the profits of the subsidiary could be transferred to the parent company by way of interest. The interest is a legitimate deductible expense, being the cost of a loan advanced by the parent company, in arriving at the profit of the subsidiary. If the corporate structure could include a tax haven where foreign income may be taxed at concessionary rate or even exempted, then such arrangement would give a substantial tax advantage to the parent. Similarly if the tax law in the parent company's country exempts remittance of dividends, or gives credit for underlying tax, then the funds could be transferred by way of a large dividend payout, even with low equity capital. Such arrangement facilitates the transfer of funds within multinational enterprises at no cost or with minimum tax costs to the corporate group.

Sometimes, the excessive transfer of funds is achieved by charging abnormally high interest on the money advanced and this then becomes a worry for revenue authorities since it leads to revenue leakage.

Companies also consider a low equity structure for the simple reason of fund mobility. In times of political and financial instability, it is easier to move the loan than the capital, and for this reason it is often the favoured option for multinationals. Such advantages are augmented if the comparative tax rates are favourable to the beneficiary of the interest income.

Financing by way of a debt also affords flexibility with which funds are used. For example, creditors at some stage can convert their debt into a participatory equity in the company. Alternatively, in a no–arms length situation particularly, the interest payment could be tied to the profitability of the company – paying a lower rate of interest if the company is suffering losses and higher rate when it is profitable. This shifting of the funds between equity and loan debt makes it difficult to classify the financing as purely debt or equity financing – and leads to a situation called "hybrid financing".

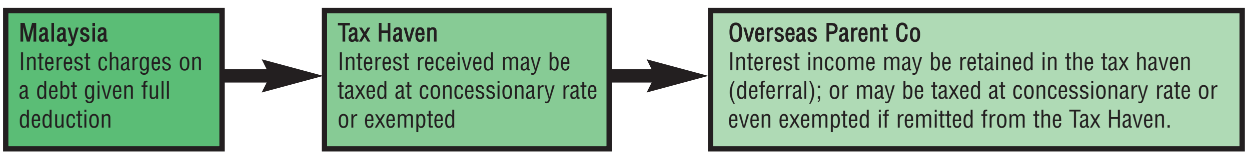
Such financing flexibility blurs the line between loan and equity capital and poses a dilemma for national revenue authorities. As financing takes on a complicated arrangement, with tax being a critical factor, governments are obliged to question the interest payment and whether it reflects the true nature of the payment it is claimed to be. With thin capitalisation leading to fund transfers by way of interest, countries are also concerned about tax leakage, and weakening of the tax base.

Arm's length transaction

Authorities take several approaches to overcome abuse of thin capitalisation – one of them being the arm's length principle. The arm's length question would arise if the loan lent is large, with inadequate security and between related parties. The bottom line is that if the loan exceeds what would have been lent at an arm's length transaction, then the lender must be taken to have an vested interest in the profitability of the particular company and the interest payment over and above an arm's length amount would be considered to be a procurement of the profit, and not the cost of the loan lent.

Determining the excess interest or overcoming the transfer of funds leading to tax leakage is not quite so simple. Generally, revenue authorities have little to fall back on by way of principles because in practice, there are no clear guidelines as to what are the practices adopted by independent parties dealing at arm's length and this leads to the difficulty of devising some reliable and consistent approach to determining if there has indeed been some abuse of the transaction.

Chart 1 – Transfer of funds between tax jurisdictions



In an effort to maintain some consistency in the treatment of interest deductions on debt, some countries adopt the fixed ratio approach. Under this method, if the debtor company's loan exceeds a certain proportion of its equity capital, then the interest on the loan or alternatively the perceived excess interest is disallowed for income tax purposes. Such an approach is not restricted exclusively to related party transactions, but can even be applied in an independent arm's length deal.

Malaysian thin capitalisation rules

New transfer pricing and thin capitalisation provisions, s 140A, have been introduced in the Income Tax Act *vide* Government Gazette dated 8 January 2009 giving the Director General of Inland Revenue (DGIR) powers to substitute the price and also the disallowance of interest in certain transactions. The new section incorporates rules to determine both the price that may be charged for goods and services as well as any charges for financial assistance. In this article, only the latter will be focused on.

Subsection (4) of the new law reads as follows:

(4) where the Director General, having regard to the circumstances of the case, is of the opinion that in the basis period for a year of assessment the value or the aggregate of all financial assistance granted by a person to an associated person who is resident, is excessive in relation to the fixed capital of such person, any interest, finance charge, or other consideration payable for or losses suffered in respect of the financial assistance shall, to the extent to which it relates to the amount which is excessive, be disallowed as a deduction for the purposes of this Act.

> *New transfer pricing and thin capitalisation provisions… giving the DGIR powers to substitute the price and also the disallowance of interest in certain transactions.*

In ss (5) the transaction referred to in ss (4) is to be construed as a transaction or financial assistance between:

- *Person one of whom has control over the other;*
- *Individuals who are relative of each other; or*
- *Persons, both of whom are controlled by some other person.*

The term "relative" and "transaction" have the same meanings assigned to them under s 140(8).

Reading the new legislation, one would find that it applies only to financial assistance between associated persons and when granted to a resident person. However the person granting the financial assistance can be a resident or a non–resident – one can therefore deduce that the rule would apply even to loans between related domestic companies.

In the event the DGIR finds that the interest charged is excessive in relation to the fixed capital of such person, then that amount ie the excessive interest would be disallowed a tax deduction.

The section comes with several gaping holes:

- It is not certain how much is excessive financial assistance and how arm's length standards would figure in the determination of the assistance and interest payments.
- Financial assistance is apparently not restricted to loans and it is not known how this will be defined. In financial terms, financial assistance would include guarantees, interest bearing credit and even an advance. It would be interesting to see what values would be attached to this facility.
- While disallowing the excessive interest – immaterial of how it is calculated – it will have to be seen how this will be treated on the recipient.
- On the other hand if withholding taxes had been applied, will there be a refund on the excess disallowed? In the case of companies that are prime candidates for thin capitalisation rule – would they be given any time frame to readjust or restructure before the law is implemented?
- Alternatively, can companies proceed with the existing structure and seek an advance ruling on the matter (without which such companies being subject to thin capitalisation rules)?

The proposed law also mentions "fixed capital" and at the moment it is not clear what would be included in 'fixed capital'. Also not certain is whether the Revenue would consider any 'safe harbour rules' ie a thin capitalisation threshold under which a certain limit may be prescribed in respect of debt-equity ratios that would allow the company any interest deductions without restrictions. Generally, in countries that have already implemented thin capitalisation rules, an acceptable ratio is 3:1, meaning that the loan or debt should not exceed three times the equity capital. Still, other countries have ratios that vary but nevertheless specified, and therefore providing a safe harbour.

A public ruling on the matter would be useful to allay any uncertainties and also to facilitate taxpayers to adjust as well as adapt to the new law.

Thin capitalisation in other countries

It is notable that many countries in the world have already implemented thin capitalisation rules for several years now. China is one of the latest countries to introduce thin capitalisation rules, and this move underlines the need to protect the country's tax base.

Approaches to thin capitalisation vary from country to country, with emphasis placed on different factors or a combination of factors. Generally, the approaches adopted are as follows:

- The general anti–avoidance approach
- The fixed ratio approach

China is one of the latest countries to introduce thin capitalisation rules and this move underlines the need to protect the country's tax base.

The general anti-avoidance approach

In this approach, emphasis is placed on determining, having regard to all the circumstances, whether the financial contribution represents debt or equity. In this respect, the broad and general anti–avoidance rules contained in most revenue legislations are put to good use particularly in the context of the abuse of the law.

A common denominator of this approach is the adoption of substance over form, and in the process, ignoring the acts of the management or even the process of the transaction, which may be contrived to circumvent the law – thus constituting an abuse of the law.

Arm's length deal

This common approach in tax law looks at the action of the parties in the context of an arm's length deal. In other words, the size of the loan is reviewed in the context of dealing between independent persons dealing at arm's length. Essentially, the Revenue looks at the underlying motive in the transaction. Thus, if the loan advanced is more than what would have been advanced by independent persons dealing at arm's length, then one would be constrained to think that the lender has a vested interest in the profitability of the company and therefore the excess must be taken to procure a part of the profits.

However such approaches are difficult in practice to sustain because one needs to ascertain what would have been the arm's length deal in the first place; and then compare the particular transaction to see whether there has been any excess. As the true arm's length deal are hard to come by on account of the various factors determining a particular deal, adopting such an approach and maintaining them would really tax the authorities.

Fixed ratio approach

It is found that it would be easier if a fixed ratio method is adopted ie if a debtor company's total debts exceed a certain proportion of its equity capital then the interest on the loan or the interest on the excess of the loan over the approved proportion could be disallowed.

The rule can be applied in the context of associated enterprise domestically or cross border transactions, or in a restricted circumstances. Generally this fixed ratio approach leads to the adoption of a safe haven – a ratio within which a company's capital to equity ratio may be termed as reasonable, or acceptable.

Developments in other countries

The United Kingdom (UK)

Following the anti–discrimination judgments by the European Court of Justice in the case of *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* (Case C-324/00), the UK had made substantial changes to its thin capitalisation and transfer pricing rules.

A major change involves the withdrawal of the thin capitalisation exemption for transactions within the UK. In other words, the new rules would now apply for the groups within the UK as well as for cross border transactions.

The rules apply not only for loans between related parties but also between unrelated parties, especially where it is supported by guarantee or back–to–back loan from the borrower's parent or other related party. The thin capitalisation works together with the transfer pricing rules and would apply where one of the parties is a company or a partnership and the other party is any legal person (ie an enterprise) which controls the first.

To avoid double tax burdens, compensating adjustments are put in place. For example, in the UK, UK loan, the way the adjustment will work is to give the lender the right to reduce its UK tax liability by an amount equal to any interest deduction denied to the borrower on thin capitalisation grounds.

Where there is an associated UK guarantor, then to the extent the guarantee would support the extra deduction, the guarantor can claim the compensating adjustments. In other words, the compensating adjustment would give the excess deduction to other members of the UK group.

As thin capitalisation has implications for withholding taxes, the Inland Revenue had made the relevant adjustments to the double tax agreements to misapply the article on interest in the case of thin capitalisation. In that case, the "Other income" article would apply that would bar any withholding tax at source. Where in other cases the interest is outside the scope of the article, it would be subject to the full UK withholding tax.

Essentially, the concern of the Inland Revenue is to check the possibility of excessive tax deductions for interest – and the legislation on thin capitalisation seeks to counteract this.

Several exemptions were also introduced. For example, where the taxpayer is sufficiently small (meaning with less than 250 staff and either the turnover is less than €50 million or assets no more than €43 million – a threshold determined by reference to the entire worldwide group of the taxpayer. The exemption is subject to only two exceptions: (i) the exemption do not apply to any transaction where the lender or the borrower is resident in a country with which the UK has no double taxation agreement or the Double Tax Agreement has no non-discrimination article. (ii)The same would apply if there was a guarantor or if there was any other party that is involved in the loan in such a country. It does not matter if the non–DTA party is completely independent from the other party.

The Inland Revenue too retains the power to withdraw the exemption if they consider that a significant amount of tax is at stake. The withdrawal will be by way of an issue of a "transfer pricing notice" after the taxpayer has filed his returns. The taxpayer then has 90–days to apply an arm's length principle to whatever transactions with associates specified in the notice.

New Zealand

In New Zealand the thin capitalisation rules consists of a general regime and a specific regime. The general regime apportions and reduces deductions for interest if a single non–resident allocates a disproportionate level of its worldwide debt funding to its New Zealand entities or operations.

A two hurdle test decides whether apportionment of interest expenditure is required. The taxpayer's New Zealand group debt percentage must exceed both:

- The 75% (a safe harbour); and
- 100% of the taxpayer's worldwide group debt percentage in the case where the taxpayer is a company or a trustee.

On the other hand, the specific regime rules for foreign owned banks apply with effect from June 2005. The rules limit the extent to which foreign–owned bank can fund their New Zealand operations with debt and fund their offshore investment out of New Zealand. They deny interest deductions to foreign–owned banks if they do not hold a level of capital equal to 40% of their New Zealand banking assets weighted for risk. Foreign–owned banks in New Zealand must also have enough capital to fund their offshore investments, interest on which is not tax deductible.

Australia

Since 1987, the Australian tax law had sought to ensure that foreign investors having an interest of at least 15% in an Australian business maintained an appropriate balance between the debt the business owes to them and their equity in that business.
The objective was to prevent the use of excessive "in-house" loans which would undermine Australian revenue by shifting profits overseas in the form of tax deductible interest payments that are subject to only 10% withholding tax on interest.

With effect from 2001, new Australian thin capitalisation rules apply to both foreign–controlled Australian investments and to Australian entities investing overseas. The new rules limit the amount of debt used to fund those Australian operations or investments, by disallowing the debt deductions that an entity can claim against Australian assessable income when the entity's debt to equity ratio exceeds certain limits.

Certain expenses are excluded from being debt deductions under the legislation, including rental expenses on certain leases and some foreign currency losses.

The new rules do not apply to an entity whose debt deductions, together with those of its associated entities are $250,000 or less for an income year. They also do not apply where the foreign assets of an entity and its associates represent 10% or less of their combined Australian and foreign assets.

The new thin capitalisation rules affect entities with operations or investments both in Australia and overseas, and apply to both inward investing entities and outward investing entities, as well as to associated entities of outward investing entities. Affected entities are companies, trusts, partnerships and individuals.

The thin capitalisation rules apply differently to an entity depending on whether the entity is:

- an inward investing entity or an outward investing entity;
- a general entity or a financial entity (eg finance companies or securities dealers); or
- an authorized deposit–taking institution (ADI) (eg Australian banks and foreign banks with branches in Australia).

The categories determine how to calculate the maximum allowable debt. Under the first category, the new rules require an inward investing entity/outward investing entity to calculate its adjusted average debt and then compare it to

the maximum allowable debt as prescribed under the rules. Debt deductions will be disallowed to the extent that the amount of adjusted average debt used to fund an entity's Australian operations exceeds the prescribed maximum allowable debt.

For the outward investing entity, the maximum allowable debt is the greatest of the following amounts:

- The safe harbour debt amount (which is three-quarters of the average value of the entity's Australian assets, for entities that are not financial entities). This is also known as the safe harbour ratio of 3:1;
- the arm's length debt amount; or
- the worldwide gearing debt amount.

For the inward investing entity, the maximum allowable debt is the greater of the following amounts:

- the safe harbour debt amount; or
- the arm's length debt amount.

Australian resident entities can choose to form a group to apply the thin capitalisation rules rather than have them applied to the individual entities within the group. The thin capitalisation group can include wholly–owned resident companies, trusts and partnerships.

The Australian thin capitalisation measures are aimed at foreign companies from acquiring or investing in a local company through significant debt borrowing when compared to the actual amount of equity invested.

Conclusion

The general thinking among tax practitioners is that the Malaysian law on thin capitalisation is a little too early, and may be of concern to foreign investors particularly. This is particularly so at a time of global financial crisis when investment may be hard to come by and countries in the region like Singapore, Indonesia, Thailand and Vietnam have not introduced thin capitalisation laws or even rules. This would make Malaysia, financially speaking, less competitive in the region. TG

***Dr Nakha Ratnam Somasundaram** is a lecturer at the Multimedia University, Cyberjaya Campus, Malaysia. The content of this article represents the author's views and not that of Multimedia University. The author can be contacted at nakharatnam@yahoo.com*

Financial Reporting Standards: A Malaysian Tax Perspective

By Phan Wai Kuan

It has been three years since the Malaysian corporate reporting sector embarked on the journey of gradual convergence to international financial reporting standards (IFRS) for financial reporting purposes. Since 2006 when the Malaysian Accounting Standards Board (MASB) mandated all entities other than private entities[1] to adopt our Malaysianised version of the accounting standards known as Financial Reporting Standards (FRS), 43 FRS have been issued with more in the pipeline. We can be well assured that this trend will continue in view of MASB's announcement in August 2008 of Malaysia's plan to move towards full convergence with IFRS by 1 January 2012.

The relationship between FRS and tax

In reviewing how and to what extent the convergence to IFRS would impact tax, let's go back to basics – the relationship between FRS and tax.

The relationship between IFRS and tax was succinctly expressed by Dr Christopher Nobes, professor of Accounting at University of Reading in 2003 as follows:–

> *"The adoption of IFRS will change the net profit figure, so it will change the starting point for the calculation of taxable income …"*

1 Private entity is a private company incorporated under the Companies Act that (1) is not itself required to prepare or lodge any financial statements under law administered by the Securities Commission or Bank Negara Malaysia; and (2) is not a subsidiary or associate of, or jointly controlled by, an entity which is required to prepare or lodge any financial statements under law administered by the Securities Commission or Bank Negara Malaysia. For FRS purposes, fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Functional currency is defined in FRS 121 as the currency of the primary economic environment in which the company operates.

As the main focus of FRS is to enhance the comparability of the financials of different companies irrespective of the location of the companies, the fundamental principles underlying FRS are different from tax principles. This has contributed to the change to the net profit figure in financial statements. For example, FRS focuses on the balance sheet rather than the profit and loss account or income statement. The prime objective is the preparation of a statement of the financial position of a company at a specific point in time whereas tax focuses on the profit and loss account as tax is computed on the profit of a company for a specified financial period. Secondly, fair value rather than historical cost is regarded as a better measure of a company's ability to generate cash and cash equivalents for accounting purposes while historical cost is generally adopted for tax purposes. In addition, accounting adopts a substance over form approach.

As the main focus of FRS is to enhance the comparability of the financials of different companies irrespective of the location of the companies, the fundamental principles underlying FRS are different from tax principles.

While accounting standards have evolved over the years, the fundamental tax principles (eg capital versus revenue, realisation) have not changed. The convergence of Malaysian accounting standards to IFRS has inevitably led to a greater divergence between accounting and tax. Hence, the nature and extent of tax adjustments that are required to be made in arriving at chargeable income are significantly different. The big challenge to taxpayers and tax practitioners is knowing what to adjust for tax purposes, followed by determining how to adjust.

Tax approach

In the last three years, the affected Malaysian companies as well as tax practitioners have been trying to come to grips with FRS by focusing on changes from the previous accounting standards, analysing the tax implications and taking positions in tax computations prepared based on the FRS compliant accounts.

A review of countries which had converged to IFRS for financial reporting purposes show that three tax approaches have generally been adopted: (1) full convergence or dependent approach, (2) partial convergence, and (3) non-convergence or independent approach.

Under the full convergence approach, chargeable income is computed in accordance with accounting profit. Although this approach is simple, it can potentially lead to significant tax mismatches.

In the last three years, the affected Malaysian companies as well as tax practitioners have been trying to come to grips with FRS by focusing on changes from the previous accounting standards, analysing the tax implications and taking positions in tax computations prepared based on the FRS compliant accounts.

Some tax jurisdictions have opted for the partial convergence approach where IFRS–based accounts are used as the starting point for computing chargeable income but specific policy is made by the tax authorities in allowing certain departures from tax principles due to practical difficulties. While the attractiveness of this approach is the requirement to maintain a single set of accounts for both accounting and tax and flexibility is accorded to policy makers/tax authorities to address specific areas, more often than not, this leads to the introduction of complex legislation.

The independent/non-convergence approach effectively requires the maintenance of two sets of books (an independent set of tax accounts in addition to the statutory accounts which are IFRS compliant).

FRS — Malaysian tax perspective

The key accounting differences and challenges from a tax perspective stem from the following areas:–

- Accounting classification
- Measurement rules – Departure from historical cost and adoption of fair value
- Recognition of previously non-recognised transactions (e.g. share based payments).
- Introduction of functional currency

1. Accounting classification

One of the key changes observed with the convergence of Malaysian accounting standards to IFRS is in the area of accounting classification of assets and liabilities. The most notable changes include debt versus equity classification as well as the introduction of new asset classifications e.g. assets held–for–sale.

Debt versus equity

The classification of a financial instrument under FRS is determined by its substance rather than legal form. In certain situations, the substance of an instrument may not be consistent with its legal form e.g. redeemable preference share which is treated as a debt rather than an equity instrument. Other examples include certain hybrid instruments which comprise both a liability and an equity component which are required to be reflected separately in the financial statements; e.g. a bond which is convertible into shares is required to be split into a liability portion and an equity (under FRS 132 "Financial instruments – Disclosure and presentation") or an embedded derivative portion (FRS 139 "Financial instruments – Recognition and measurement") depending on the specific case.

In the absence of specific tax rules dealing with the debt/equity classification or reclassification under FRS, redeemable preference shares and the dividend paid thereon (which is reflected as interest expense in the accounts) would continue to be treated as equity and dividend for tax purposes. Similarly, a convertible bond would continue to be treated as a debt instrument of the issuer for tax purposes although it is reflected as two separate components in the financial statements: a debt and an equity or embedded derivative portion.

It is important not to overlook the flow–on implications on other areas such as interest restriction computation under s 33(2) of the *Income Tax Act 1967*. As the amount of interest restricted is computed based on the proportion of investments and loans given over total borrowings of a company, care should be taken to ensure that correct debt balances as well as interest expense are used in the computation or the resulting amount of interest which is restricted would be distorted. Amounts as reflected in the balance sheet or income statement may need to be adjusted due to the accounting debt/equity classification.

Another area which could be impacted is the newly introduced thin capitalisation rules which came into effect from 1 January 2009. The extent of the impact of FRS on thin capitalisation can only be evaluated when the detailed rules are issued by the Malaysian tax authorities. (The detailed thin capitalisation rules have not been issued at the time of writing this article.) A common issue faced by countries which have adopted IFRS and have thin capitalisation rules (eg Australia, New Zealand, United Kingdom) is the computation of the safe harbour limits (maximum debt to equity ratio) using accounting figures which may have to be adjusted in view of the FRS treatment of debt/equity and the corresponding measurement rules. In dealing with this issue, some foreign jurisdictions have introduced transitional measures which permit companies to continue to use the old GAAP for the purpose of performing safe harbour limits for thin capitalisation purposes; eg Australia.

New asset classification

To improve the information which is available to users of financial statements, a new classification of assets was introduced into the balance sheet for non–current assets which are held for sale under FRS 5 "Non–current assets held for sale and discontinued operations". This FRS requires non-current assets which are available for sale and where the sale is likely to take place within one year, to be reclassified as asset held–for–sale. Upon such reclassification, depreciation on the asset ceases. If there are subsequent changes to the plan to sell or where the sale is not likely to take place within one year, the asset would be transferred out of asset held–for–sale.

From a tax perspective, two related questions are relevant. Firstly, is the reclassification of the non-current asset to the held–for–sale category tantamount to a disposal for tax purposes? The word "disposal" is given a special meaning under Sch 3 of the ITA and the meaning includes cessation of use for purposes of business. Secondly, if the initial reclassification of the asset to held–for–sale is treated as a disposal and subsequently the asset is reversed out from the held–for–sale category upon abandonment of the plan to sell, how is this treated for tax purposes and is any adjustment to past year's tax computation necessary?

2. Measurement rules

Fair value

Measurement is an area which is closely related to accounting classification as different classes of assets could have different measurement basis. The departure from historical cost and the adoption of fair value[2] in the measurement of assets and liabilities is by far the most significant accounting change and difficult area that tax authorities and tax practitioners around the world have to grapple with.

The significance of fair value is that its adoption as a measurement basis can potentially lead to much volatility to the financial results of a company. Fair value changes would either flow through the income statement or equity depending on the classification of the asset. In considering the tax approach, the relevant authorities have to weigh the benefits of simplicity by full convergence of tax to accounting against compromising on the well established tax principle — the principle of realisation. The principle of realisation of neither taxing gains nor deducting losses until the point of realisation is well founded based on a multitude of case laws. Aligning the tax treatment to accounting treatment is no doubt simple and reduces administrative costs, but the downside is the acceleration of the taxing point. This could pose cashflow issues as the company would have to pay the tax on the unrealised gain upfront. If the unrealised gain subsequently reverses into a loss position upon realisation, the company may not necessarily be able to use the realised loss immediately or surrender the loss to another company within the group under the group relief provision. There is no provision for loss carry back in the Malaysian tax legislation.

This issue is particularly relevant to FRS 139 which will come into effect from 1 January 2010. Some Malaysian companies have early adopted FRS 139 as they are part of a

foreign group of companies which have adopted the equivalent of the FRS in their respective jurisdictions.

Another example is the application of FRS 5 as discussed above. When an asset is transferred to asset held-for-sale, the asset would be revalued at the lower of the net book value or fair value less costs to sell. It is important that due consideration be given to the change in valuation and to ensure that adjustments (if applicable) are made accordingly for tax purposes.

Impairment

An issue related to measurement which needs to be considered for tax purposes is impairment. The application of the impairment rules to trade debts would have an impact on the deduction for provision for doubtful trade debts currently allowed under s 34(2) of the ITA. Upon adoption of FRS 139, debts would be subjected to impairment testing and the current practice and method of making provisions for doubtful debts would cease. The tax authorities would need to review the criteria for the claim of tax deduction under s 34(2) and the Public Ruling 1/2002 "Deduction for bad and doubtful debts and treatment of recoveries" would have to be revised accordingly to permit a claim for deduction for the impairment of trade debts.

2 For FRS purposes, fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

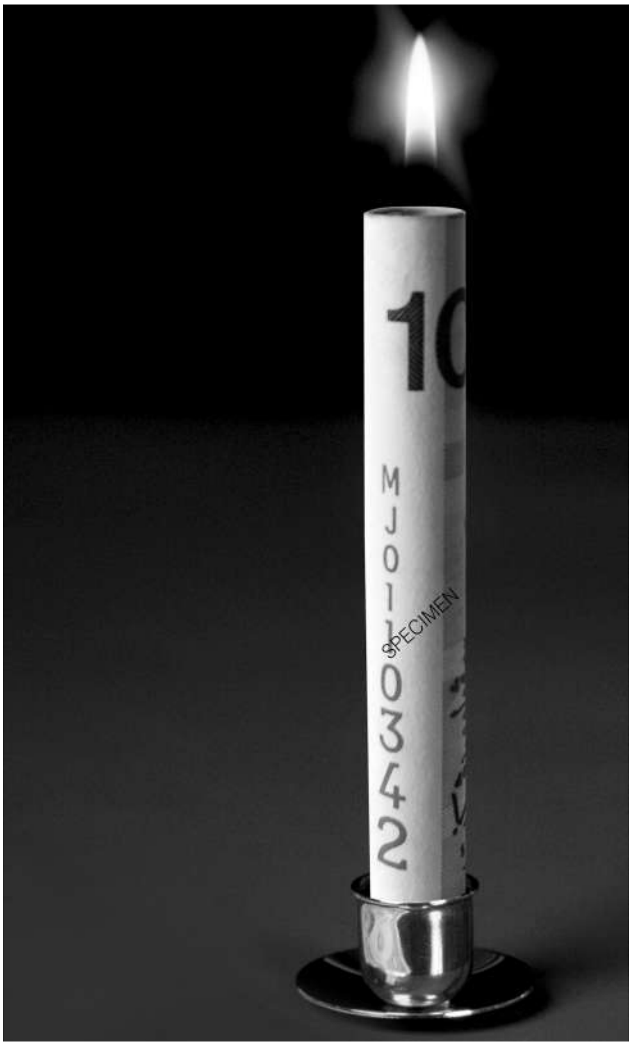
3. Recognition of previously non-recognised transactions

Employee share option scheme (ESOS)

The major tax issue on FRS 2 "Share-based payments" relates to employee share options although the scope of the FRS is wider. The application of FRS 2 extends to transactions with parties other than employees, in which goods or services are received as consideration for the issue of shares, share options or other equity instruments, as well as payments in cash (or other assets) that are based on the price of a company's shares or other equity instruments, eg share appreciation rights.

Prior to FRS 2, share options granted to employees under an ESOS were not reflected in the employer's accounts and hence tax deductibility was a non-issue. The new FRS 2 requires the share options granted under an ESOS to be fair valued and charged as an expense in the employer's accounts over the option vesting period or at the time of grant if the options vest immediately.

In determining whether the cost charged to the employer's books is deductible, the relevant question is whether the employer has incurred an expense under s 33(1) of the ITA. In the House of Lords decision in *Lowry v Consolidated African Selection Trust* [1940] 23 TD 259, the taxpayer sought to claim a tax deduction for the difference between the exercise price of the share options granted to its employees and the market value of the shares at the option grant date. It was held that the amount was not deductible as no expenditure had been incurred by the company in issuing shares to its employees. The taxpayer's argument that it had incurred a trading expense equal to the opportunity cost forgone of not issuing shares at a premium was rejected by the judges on the basis that *"an amount forgone is not … deductible, and that there is no principle under which such sum can be treated as a disbursement or expense of the trade."* Hence the cost charged to the employer's accounts is not deductible on the basis that the incurrence test is not met.



In situations where share options in a listed holding company are given to employees of a subsidiary company and the subsidiary company is charged for the share options given, the subsidiary company should be entitled to claim a tax deduction for the actual cost charged. This can be contrasted from the Lowry case as an actual as opposed to a "notional" expense incurred by the subsidiary and the expense forms part of employee costs. There is a basis to argue that the amount received by the listed holding company from the subsidiary company is a capital receipt and hence should not be taxable.

Where a company purchases treasury shares to fulfill its ESOS obligations, the actual cost incurred (ie the difference between the cost incurred in purchasing the treasury shares and the amount payable by the employees ie the exercise price) should be deductible under s 33(1).

4. Functional currency

In line with IFRS, FRS 121 "The effects of changes in foreign exchange rates" was revised and among the major changes made is the requirement for an entity to determine its functional currency[3] and to measure its financial results in that currency.

With the introduction of functional currency, all currencies other than the entity's functional currency is its foreign currency. Hence, an entity which is incorporated and resident as well as operating in Malaysia with a non–Ringgit functional currency will treat Ringgit as its foreign currency! Prior to these amendments, a one–step translation was required in respect of non–Ringgit denominated transactions. However, the revised standard now requires an entity to determine its functional currency and then translates all foreign currencies (including Ringgit if Ringgit is not the entity's functional currency) into functional currency first, followed by a translation to Ringgit for financial reporting purposes as per the requirements of the Companies Act 1965.

This two–step translation process to comply with both FRS 121 and the CA 1965 could potentially give rise to different financials and hence different tax liabilities as compared to the position prior to the introduction of functional currency. Compounding this problem is the issue of dealing with

3 Functional currency is defined in FRS 121 as the currency of the primary economic environment in which the company operates.

translation differences and reconciling amounts in the accounts and tax computation to source documents eg invoices, agreements, etc.

A possible option for the tax authorities' consideration is granting the flexibility to companies to adopt the following accounts besides the statutory accounts for the purpose of preparing tax computations: functional currency or Ringgit (without applying the revised FRS 121). The advantage of using accounts prepared in functional currency is the elimination of translation differences due to the two–step translation process. In granting this option, the tax authorities should issue clear guidelines to address the transition from Ringgit Malaysia to functional currency in the first year of adoption of the functional currency books for tax purposes. Areas to be covered in the guidelines include the treatment of unabsorbed allowances brought forward, unabsorbed tax losses, group relief (as different companies may have different functional currencies albeit within the same group), cost and written down value of assets and adjustment (if any) when a company changes its functional currency, etc.

The advantage of the second option (separate set of books denominated in Ringgit without applying the revised FRS 121) is the accounts would reconcile to source documents, eg invoices, agreements, and problems with exchange differences can be avoided. The downside is of course the increased costs in maintaining two sets of accounts.

Response from the Malaysian authorities

In April 2008, the Ministry of Finance issued the "Guidelines on income tax treatment from adopting FRS 139" (the Guidelines) which specifically applies to financial institutions which are regulated by Bank Negara Malaysia. These guidelines are effective from the year of assessment 2008. This initiative was largely prompted by the revised guidelines on financial reporting for licensed institutions (GP 8) effective from 1 January 2005 which have incorporated many principles of FRS 139.

The Guidelines may provide an insight into the possible treatment of FRS 139 in general when the standard comes into force in 2010.

The Guidelines propose to align the tax treatment with accounting treatment to the extent that the accounting treatment represents a timing difference as far as taxation or deduction is concerned. What this effectively means is the capital versus revenue distinction is still relevant. Once it is determined that a transaction is on revenue account, the accounting treatment is adopted for tax purposes; ie unrealised gains and unrealised losses would be taxed and deductible.

While the Guidelines have provided clarity on the treatment of financial instruments for financial institutions, there are still a few other issues in FRS 139 that need to be addressed from a tax perspective when the standard is adopted in Malaysia; such as the treatment of embedded derivatives, hedge accounting especially whether the tax

treatment would converge to accounting regardless of whether the company qualifies for hedge accounting, tax treatment of impairment, trade debts as discussed above, etc.

Conclusion

The above is merely a flavour of some observations made on the Malaysian tax perspective of FRS. In helping companies and tax practitioners navigate through the FRS maze and apply tax rules effectively, two aspects are critical:–

- A good understanding of the changes to accounting standards brought about by the convergence of Malaysian FRS to IFRS;
- Guidance from the Malaysian tax authorities on the tax approach to be adopted (as discussed in the earlier part of this article).

The experience of dealing with the tax impact of FRS thus far has shown that being able to understand financial statements is absolutely critical for effective application of the tax legislation.

With the spate of changes that are taking place in the financial reporting world, Malaysia's commitment to move towards full convergence to IFRS by 2012 and in the wake of the current global economic downturn, there is a pressing need to ensure certainty in a company's tax position. All parties involved in navigating through the FRS maze and trying to come to a landing on the tax treatment to be adopted have the heavy task of balancing between the technical aspects with the business or practical aspects. TG

***Phan Wai Kuan** is an Executive Director in PricewaterhouseCoopers Taxation Services Sdn Bhd. The content of this article represents the author's personal views and not that of PricewaterhouseCoopers Taxation Services Sdn Bhd. The author can be contacted at wai.kuan.phan@my.pwc.com.*

Taxes in Vietnam –

What Investors Pay on Vietnam–sourced Incomes

By Phan Ho Thien Vu and Dong Hoang Nam

Recent Tax Reforms

Vietnam's efforts to integrate into the world's economy, recently landmarked by its accession to the World Trade Organisation in 2007, have inspired fairly comprehensive, wide-ranging tax reforms. As from 1 January 2009, a number of new or amended tax laws came into effect: Law on Corporate Income Tax (new CIT Law), Law on Value Added Tax (new VAT Law), Law on Personal Income Tax, and so forth. All previous regulations on the same subjects were repealed. Those new regulations govern the most important taxes of Vietnam — Corporate Income Tax (CIT), Value Added Tax (VAT), Foreign Contractor Tax (FCT) and Personal Income Tax (PIT).

Beside these, import and export tariffs have also changed, and continue to change, significantly to reflect Vietnam's implementation of its commitments to the WTO members under its accession agreements and, among others, ASEAN countries which are party to the AFTA Effective Preferential Tariff Scheme. Most of the changes aim to eliminate or reduce import duty rates. Vietnam has also amended regulations on Special Consumption Tax (SCT), which is levied on import and consumption of certain luxury goods and services. Generally, new SCT rates will be increased for services, and lowered for goods. The list of goods which are subject to SCT is expanded under the new SCT Law.

All Vietnam–sourced profits of foreign companies and profits of Vietnamese companies (including foreign–invested companies) generally fall within the scope of the CIT and the FCT. CIT is levied on a foreign investor's subsidiary operating in Vietnam and FCT is levied on a foreign investor conducting business in Vietnam on the basis of contracts with local partners. This article looks at the new features of the CIT and discusses considerable points of the FCT, which will have direct implementations on foreign investors.

Corporate Income Tax (CIT)

CIT applicable only to taxpayers operating in a corporate form

The new CIT Law now applies only to taxpayers which operate in a corporate form in Vietnam. This is the first change to the CIT regime, and was made in conjunction with the change in the new PIT Law. Previously, individuals conducting business activities of their own were generally subject to CIT. Now, they will pay PIT on earnings, even though the earnings are derived from their own businesses.

The new CIT Law provides a number of new provisions dealing with foreign companies and their income which will be subject to CIT. Foreign companies will be taxed on their Vietnam–sourced profits irrespective of whether they have a permanent establishment in Vietnam or not.

Standard CIT rate reduced to 25%

The most welcomed amendment in the new CIT Law is the reduction of the standard CIT rate to 25%, from 28% in the previous law. This reduction is seen as one of Vietnam's efforts to enhance its competitiveness in the region and globally.

An exception still remains for companies operating in the oil and gas industry or companies involved in the exploitation of precious minerals. CIT rates applicable to these companies are in the range of 32% to 50%, depending on the project. The new CIT Law sees a narrower range, compared to the previous law, under which the CIT rates band for these companies ranged from 28% to 50%.

CIT incentives – less favourable and narrower in application

Another major change relates to CIT incentives. The CIT incentives under the new CIT Law are less favourable and significantly narrower in their application than those under the previous law.

Similar to the previous law, CIT incentives are based on the preferential sectors/industries and locations of newly established projects. However, the long list of preferential sectors/industries under the old CIT law is largely curtailed in the new CIT Law. The remaining sectors, investment in which may be entitled to preferential CIT rates are now mainly: education, healthcare, sports/culture, high technology, scientific research and technology development, environmental protection, computer software manufacture, and special important infrastructure facilities of the State. A number of sectors which were previously considered preferential sectors, and based on which many investors had obtained CIT incentives are now removed; for example, investment in a labour intensive project, in the agriculture industry, various types of manufacturing, including chemical, paper, textile, leather goods.

In addition, the preferential CIT rate of 15% was also removed. The two CIT preferential rates that survive are 10% and 20%.

The CIT preferential rates are available for a period of 10 years or 15 years, commencing from the year in which the

revenue was first generated. When the preferential period expires, the standard CIT rate will apply.

Newly established companies may also be eligible for tax holidays. The holidays are in the form of exemption from CIT for a certain period, and followed by a period where CIT is reduced to 50%. The exemption/reduction period under the new CIT Law will be calculated from the first profitable year, but no later than the fourth year of operation. That is, if a company entitled to exemption/reduction of CIT does not derive profits for the first three years from the date of operation, the exemption/reduction period will start to calculate from the fourth year of operation. The old CIT law does not have this three–year period restriction.

Furthermore, the new CIT Law provides that this three-year period restriction applies retrospectively to existing companies that were entitled to exemption/reduction of CIT but has not generated a profit from its operation. The three-year period will be calculated from the effective date of the new CIT Law (ie 1 January, 2009). Implementation of this restriction may adversely affect the existing investors. It is not clear at this time how the Government will address this issue in its actual implementation, considering the commitment on protection of investors in the case of changes of law.

Another step backward under the new CIT Law, compared to the old law, is that it no longer provides tax incentives for business expansion or relocation.

The CIT incentives under the new CIT Law are less favourable and significantly narrower in their application than those under the previous law.

The CIT incentives under the new CIT Law can be summarised as follows:

- 10% CIT rate for 15 years, four years of tax exemption and nine years of 50% reduction are granted to newly-established companies which (i) invest in a preferential CIT sectors or (ii) operate in a locality with especially difficult socio–economic conditions, in economic zones, and high tech zones.

- 20% CIT rate for 10 years, two years of tax exemption and four years of 50% reduction are available to newly–established companies which operate in a locality with difficult socio–economic conditions.

Foreign Contractor Tax (FCT)

FCT is a form of withholding tax. It is a tax that is specific to Vietnam. FCT makes income of a foreign party, that is sourced from Vietnam but that would otherwise be out of reach of the Vietnam tax authorities, taxable. The principal legislation governing FCT is Circular 134 of Ministry of Finance, effective from 1 January, 2009 (Circular 134).

Subject of FCT

Circular 134 covers a broad range of tax payers. Basically, a foreign party that carries out business in Vietnam not in a conventional form of investment is subject to FCT, except for the following cases:

(i) A foreign party provides goods to a Vietnamese party at Vietnamese or foreign border gates, not associated with services provided in Vietnam;

(ii) Income of a foreign party is derived from services provided and consumed outside of Vietnam; or

(iii) Services of airplane and ship repair, advertising, marketing, investment and trade promotion, brokerage for sales of goods, training, international post and telecommunication that are provided abroad.

Common examples of foreign parties that are subject to FCT include foreign banks providing credits to Vietnam-based borrowers where FCT is levied on interests earned, or foreign construction companies performing construction works in Vietnam where FCT is imposed on construction prices collected.

Interestingly, a transaction between a foreign party and its Vietnamese subsidiary (eg, where the foreign parent sells goods or services to its subsidiary in Vietnam), is also caught by FCT.

Applicable taxes

For ease of reference and for consistency with the name of this kind of tax, a foreign party that is subject to FCT, is called a “Foreign Contractor”.

FCT payable by a Foreign Contractor is made up of CIT (in case of a foreign entity) or PIT (in case of foreign individual) and VAT, calculated in accordance with a special formula. A Foreign Contractor can pay FCT either by paying directly upon voluntarily opting for the Vietnamese Accounting System (VAS) mechanism or via a withholding mechanism.

VAS mechanism

This is only available for a Foreign Contractor that has a Vietnamese permanent establishment, that has entered into a contract with a period of more than six months and that registers to apply VAS with the local tax authority. Once VAS has been adopted, the Foreign Contractor is treated as a Vietnamese entity for Vietnamese tax filing purposes. The main implementation is that, the Contractor must include VAT on its invoices at the applicable VAT rate and pay CIT on its actual income.

The Foreign Contractor is required to register with and pay tax directly to the local tax authority. It must also register with the Ministry of Finance and comply with regulations applicable to entities using VAS. Among other things, it must obey the rules on the legally accepted supporting documents and reasonable expenses.

Withholding at source

This means that before making a contractual payment to a Foreign Contractor, the Vietnamese contracting party must deduct and withhold the taxes from the payment and then pay that deducted amount to the tax authority on behalf of the Foreign Contractor.

In this case, the Vietnamese contracting party must register with and pay tax to the local tax authority.

FCT taxable turnover determination

The turnover for calculating FCT is the total turnover from the supply of goods and services, without deducting any payable taxes and that includes all expenses paid by the Vietnamese party on behalf of the Foreign Contractor. To the extent that a foreign contractor assigns a part of its work to a Vietnamese sub-contractor or a foreign sub-contractor, one of two consequences of taxable turnover happens.

If the foreign sub–contractor uses VAS, the taxable turnover of the Foreign Contractor does not include the value of the sub–contracted portion performed by the foreign sub–contractor. That means the Foreign Contractor may include payments it makes to its foreign sub–contractor as expenses. However, if VAS has not been adopted by the foreign sub–contractor, the Foreign Contractor must include the value of the sub-contracted portion in its taxable turnover. That being said, payments that the Foreign Contractor makes to its sub–contractor is not considered as expenses.

> *Interestingly, a transaction between a foreign party and its Vietnamese subsidiary (eg where the foreign parent sells goods or services to its subsidiary in Vietnam) is also caught by FCT.*

Two mechanisms, one choice

An appropriate FCT calculation and payment may benefit for Foreign Contractors. A Foreign Contractor may not opt for both. Under the old regulation, the 'hybrid' filing method was allowed. A Foreign Contractor could choose to pay VAT under the VAS method but pay CIT on the withholding mechanism. This method was effective in cases where a Foreign Contractor wished to recover a significant local VAT costs and did not want to apply VAS to calculate CIT.

Because FCT under the VAS mechanism is deductible, it is more advantageous for a Contractor that specialises in an industry that is subject to a high level of input VAT. Conversely, VAS may not be a good option for firms that use mostly human resources and low material input VAT.

Under the second option, the Foreign Contractor pays tax regardless of its profit or loss and regardless of how much input VAT that may set off against output VAT. Therefore, the Contractor may predetermine how much FCT it must pay and include that amount in the contractual prices, eventually paid by the end customers.

Double Tax Avoidance Agreement and FCT

A Foreign Contractor may avoid FCT by virtue of a double tax avoidance agreement (DTA). As at 1 January 2009, Vietnam has signed totally 54 DTAs. One rule that is often provided in DTAs is that a non–resident company may only be taxed on its business income in the source country if it has a permanent establishment in the source country to which the income is attributed. As such, a Foreign Contractor of a country that has a DTA with Vietnam may avoid FCT if it does not set up a permanent establishment in Vietnam. What constitutes a permanent establishment may vary in each DTA.

In addition, a Foreign Contractor may claim a tax credit for FCT paid in Vietnam or enjoy tax incentives in certain cases. Of course, the Foreign Contractor must comply with other conditions or procedures in DTAs and Vietnamese tax regulations if it refers to a DTA.

Conclusion

The combination of various taxes, mainly CIT and FCT, wraps around all kinds of income sourced from Vietnam.

Recent tax reforms aim to improve the Vietnamese tax system. However, the objective to make Vietnam a more competitive environment in terms of a lower standard tax bracket seems somehow to be undermined by the elimination or shrinking of a number of tax incentives that were previously furnished to the same activities.

The tax system is still under its way to becoming an advanced, comprehensive system. The actual implementation of the general principles is usually subject to specific interpretation and/or guidance of the tax authorities.

Good tax advice and appropriate tax planning are essential. TG

__Phan Ho Thien Vu__ and __Dong Hoang Nam__ are Associates with Russin & Vecchi, Vietnam. The content of this article represents the authors' personal views and not that of Russin & Vecchi Vietnam. The authors can be contacted at lawyers@russinvecchi.com.vn.

Industrial Building Allowance for Hotels:

A Legal Analysis of Section 30 of the PIA

By Datuk D.P. Naban & S. Saravana Kumar

1. *Introduction*

Maju Sdn Bhd owns and manages a hotel by the name of Hotel Five Star, which is registered with the Ministry of Tourism. Since the tourism industry was growing well, the company decided to expand and modernise its hotel business. It decided to construct a ten-storey block with 200 guest rooms, three function rooms, a banquet hall. It also decided to renovate the existing hotel building. The company applied for investment tax allowance, which was approved by the Ministry of International Trade and Industry on 2 January 1994. The investment tax allowance was given for a period of five years, effective from 2 January 1992. The total investment tax allowance is 60% of the capital expenditure incurred.

As the company was granted investment tax allowance, it was also entitled to industrial building allowance from the YA 1993. The investment tax allowance ceased on 1 January 1997. The company continued to claim industrial building allowance on the residual value of the capital expenditure incurred although the investment tax allowance had expired. The Inland Revenue Board ("IRB") disallowed this on the premise that since the investment tax allowance had expired, the company was not entitled to industrial building allowance anymore.

> *The Inland Revenue Board ("IRB") disallowed this on the premise that since the investment tax allowance had expired, the company was not entitled to industrial building allowance anymore.*

2. *Is the IRB's approach correct?*

Presently, a building used as a hotel is treated as an industrial building and is eligible for industrial building allowance. This was made possible by an amendment[1] to the Income Tax Act 1967 ("ITA"), which inserted para 37F to Sch 3 of the ITA. Para 37F reads as follows: *"The provisions of this Sch relating to industrial buildings shall apply, mutatis mutandis, to a building or part thereof used by a person solely for the purpose of a hotel and that hotel is registered with the Ministry of Tourism."*

Prior to the insertion of para 37F, as a general rule, a building used as a hotel is not treated as an industrial building and does not qualify for industrial building allowance[2]. However, there are two exceptions to the general rule, which allow such a building to qualify for industrial building allowance. The exceptions were made available by s 19 and s 30 of the Promotion of Investments Act 1986 ("PIA"), whereby industrial building allowance is available for hotel building of a company which either enjoys pioneer status or investment tax allowance[3].

Although s 19 and s 30 of the PIA prescribe the circumstances where a company is entitled to industrial building allowance for its hotel building, the provisions are silent as to the duration for which such company may enjoy the industrial building allowance. Thus, the question arises as to whether the availability of industrial building allowance is limited only to the duration in which a company enjoys pioneer status or investment tax allowance. This article aims to discuss this anomaly but the authors will be focusing on s 30 of the PIA only.

In that regard, this article analyses s 30 with the view of determining whether a company may continue to claim industrial building allowance on the residual value[4] of the hotel's qualifying capital expenditure even after the expiration of investment tax allowance. There are two schools of thought on this matter. The first (contended more frequently by the IRB) is that the availability of industrial building

1 Para 37F was first inserted vide s 8 of the Finance Act 2002. It was subsequently amended vide s 31 of the Finance Act 2006, where the words "Culture, Arts and" were deleted from original provision.
2 See para 65(3), Sch 3 of the ITA 1967, which read as follows before an amendment in 2002:
Subject to para 67B, a building used as a dwelling house (not being for accommodation of the kind mentioned in sub–para (2)) or a retail shop, showroom, hotel or office is not and shall not be treated as an industrial building.
3 Provided the conditions in para 37F of Sch 3 are met, a hotel building qualifies as an industrial building today notwithstanding whether the company owning the hotel is granted pioneer status or investment tax allowance.
4 Presently, the industrial building allowance rate is at 3% per annum.

allowance is limited to the duration in which a company enjoys investment tax allowance. This means industrial building allowance is only available for five years (i.e. the duration of investment tax allowance) and there is no industrial building allowance on the residual value of the hotel's qualifying capital expenditure. The second view is that once industrial building allowance is granted, it continues to be available on the residual value of the qualifying capital expenditure notwithstanding the expiration of the investment tax allowance. In order to ascertain the correct position, the authors propose that one must examine:

(a) The provisions of the PIA;
(b) The purpose of the PIA and the purposive approach;
(c) Whether Industrial Building Allowance is available until it is exhausted; and
(d) The ambiguity in interpretation.

S 30 of the PIA reads:

> *"Where an hotel business is carried on in Malaysia by a company granted an approval under s 27 in an hotel building of the approved standard or in the extended or modernized part of an existing hotel building where such extension or modernization is of an approval standard,* ***s 19 shall apply, mutatis mutandis, to that hotel building or such extended or modernized part thereof*** *(authors' emphasis)."*

3. The provisions of the PIA

S 30 of the PIA states that s 19 shall apply *mutatis mutandis* to a company granted an approval under s 27(1) of the PIA[5]. The legal maxim, *"mutatis mutandis"* means *"with the necessary changes in points of details"*[6]. The *necessary changes* to be made to s 19 by reason of s 30 are in our view the solution to the difference of views. An illustration of the application of this maxim can be seen from the judgment of Justice Edgar Joseph Jr in the Federal Court case of *The Co-operative Central Bank Ltd v Feyen Development Sdn Bhd*[7]:

> *"In our view, every word of what Lord Hailsham said regarding the status of judgments and relevance of precedent in the House of Lords, the circumstances, and the duty of the Court of Appeal to accept loyally the decisions of the House of Lords, and the chaotic consequences which would follow should the Court of Appeal fail in this duty, apply with full force,* ***mutatis mutandis****, to this country and we adopt what he said. Clearly, the Court of Appeal in Harta Empat flew in the face of the principles enunciated by Lord Hailsham and we can only express the hope that it will not be necessary for the Federal Court hereafter to have to remind the Court of Appeal of those principles."*

S 19(1) of the PIA[8] provides that where a hotel business is carried on in a building by a pioneer company, such a hotel building is deemed to be an industrial building and is eligible for industrial building allowance notwithstanding para 65(3) of Sch 3 of the ITA; provided the capital expenditure was incurred:

(i) on an hotel building of the approved standard in Malaysia; or
(ii) in extending or modernising an existing hotel building to the approved standard in Malaysia.

Thus, the authors are of the view that the words *"pioneer company"* in s 19 of the PIA are to be changed to *"a company which is granted an approval under s 27"* by the reason of s 30 of the PIA.

Meanwhile, the word *"hotel"* is defined under s 2 of the PIA as any accommodation, which includes a hotel, a motel, chalet or hostel, of the approved standard registered with the Ministry of Tourism. "Approved standard"[9] is defined as in relation to a hotel, means the standard as determined by the defined authority. The *"defined authority"*[10] is the Minister of International Trade and Industry with the concurrence in writing of the Minister of Finance.

S 19, s 27 and s 30 of the PIA are silent as to whether industrial building allowance expires upon the expiration of investment tax allowance. Literal construction is the normal method that is employed to construe or interpret a legal provision or statute. In this regard, applying the literal construction to s 30, the authors are of the view that once investment tax allowance is granted, hotels are entitled to industrial building allowance. Further, the general principle is that the industrial building allowance is available until it has been exhausted[11]. Therefore, had Parliament intended the industrial building allowance to be restricted only to the period where investment tax allowance is applicable, then Parliament would have specified this clearly in the PIA, especially in s 30 of the PIA.

4. The purpose of PIA and the purposive approach

The PIA, which was first introduced in 1986, was part of the tax incentive measures by the government to promote and stimulate industrialisation and manufacturing as the core of the Malaysian economy. The purpose of PIA received judicial notice in ***Director***

5 S 27(1) of the PIA reads:
"The Minister may grant approval in respect of an application for an investment tax allowance made under s 26(1) subject to such terms and conditions as he deems fit, and such approval may be granted retrospectively from a date not earlier than the dale from which the activity or the product has been determined to be a promoted activity or a promoted product under s 4."

6 Jowitt's Dictionary of English Law, 1977, Sweet & Maxwell Limited.

7 [1997] 3 CLJ 365.

8 S 19 of the PIA reads:
"Where a company has incurred capital expenditure on a hotel building of the approval standard in Malaysia or incurred capital expenditure in extending or modernizing an existing hotel building to the approved standard in Malaysia, and a hotel business is carried on in that building by a pioneer company, such hotel building or such extended or modernised part thereof, as the case may be, shall not withstanding para 65(3) of Sch 3 to the principal Act be deemed to be an industrial building for the purpose of that Sch:

Provided that where the defined authority is not satisfied that the hotel building, including any extended or modernized part thereof, is maintained to the approved standard in a basis period for a YA, that building or the extended or modernized part thereof shall cense to be an industrial building for that YA and subsequent YA."

9 See s 2 of the PIA.

10 Also see s 2 of the PIA.

11 See *GASMSB v Ketua Pengarah Hasil Dalam Negeri* [1996] 1 MLJ 358 and the discussion below.

General of Inland Revenue v Sebangun Sdn Bhd[12], where the High Court observed:

> *"In the early 1980s the Government in its effort to turn the economy of the country from an agricultural based to that of industrialisation had introduced many novel things or steps: and some of which were taken through legislation.*
>
> *Thus in pursuance of this policy that the Promotion of Investments Act 1986 was conceived, which replaced the investment Incentive Act 1968 and which makes provision for promotion by way of relief from income tax the establishment and development in Malaysia of industrial, agricultural and other commercial enterprises, the promotion of exports or incidental and related purposes..."*

In *Sebangun,* the High Court in considering the meaning of *"manufacture"* pursuant to s 36(1) of the PIA held that the word must be given the meaning that Parliament intended it to mean, that is to say, it must be interpreted in the spirit and intendment of the legislation. In deciphering Parliament's intention, the High Court commented that it is necessary in seeking the intention of the legislation that one has to trace it from its beginning, i.e. the inception of the Act.

The authors would like to add that following the case of *Sebangun* in interpreting s 30 of the PIA, besides using literal construction, one may also consider the purpose of Parliament in legislating the Act or sections. The granting of the investment tax allowance and industrial building allowance is consistent with the objectives of the PIA to promote industrialisation as the catalyst to boost economic development.

> *… granting of the investment tax allowance and industrial building allowance is consistent with the objectives of the PIA…*

In this regard, can Parliament be said to have only intended to grant industrial building allowance for a hotel for a period of five years, i.e. only as long as the hotel was enjoying the investment tax allowance? The authors submit that since the purpose of the PIA is to promote economic development by way of tax incentives, Parliament would not have taken such a restrictive view. Therefore, the industrial building allowance is available until it is exhausted is the preferred view.

In addition to the above, the application of purposive approach to construe s 30 of the PIA is in accordance with s 17A of the Interpretation Act 1948 and 1976. The purposive approach was applied to interpret tax statutes by the Federal Court in ***Palm Oil Research And Development Board Malaysia & Anor v Premium Vegetable Oils Sdn Bhd***[13].

Since Parliament did not expressly limit the period for which industrial building allowance is available, to include such limitation period to s 19 and 30 of the PIA would be akin to re-writing the provisions. Justice *Gopal Sri Ram* in *Palm Oil Research And Development Board Malaysia* commented *"…If this court were to accept the argument of counsel for the appellant, then we would not be promoting the purpose or object of the 1979 Act but be defeating it. For, in such event we would, through unauthorised legislative power, be re-writing statute."*

Interestingly, in ***South India Paper Mills Ltd v Director of Inspection and Audit (Customs and Central Excise) and Anr***[14], the Indian High Court held that:

> *"When Parliament has not prescribed any period of limitation for claiming the benefits under this chapter it is not open to the Central Govt. to transgress beyond its power to prescribe the time-limit in order to avail of the benefit of the scheme."*

In these circumstances, the authors respectfully submit that the IRB cannot act beyond its power to prescribe time limit for which industrial building allowance is to be allowed. Therefore, the entitlement of industrial building allowance shall not be restricted to the duration of investment tax allowance alone.

5. Whether Industrial Building Allowance is available until it is exhausted

Further, s 1(2) of the PIA states that the PIA shall be read and construed as one with the ITA. In this regard, the industrial building allowance will be regulated pursuant to Sch 3 of the ITA. The position under Sch 3 is that industrial building allowance will last for a period of 30 years (with an initial allowance of 10% and annual allowance of 3%).

In ***GASMSB v Ketua Pengarah Hasil Dalam Negeri***[15], the Special Commissioners stated that:

> *"The allowances are calculated by reference to the estimated useful life of the asset which is reflected in the*

12 [1997] 3 AMR 3101.
13 [2004] 2 CLJ 265.
14 [1984] 145 ITR 194.
15 [1996] 1 BLJ 358.

rates prescribed by the Director-General of Inland Revenue. The allowances commence in the year when the expenditure is incurred and continue to be given in subsequent years until the qualifying expenditure is fully set-off or the asset is disposed. The allowances due for each year of assessment are calculated on the written down value or residual expenditure of the asset."

Although *GASMSB* concerns the issue on capital allowance, the principle stated in that case is also the general position under Sch 3 for industrial building allowance. This clearly supports the authors' contention that the industrial building allowance is available until it is fully exhausted. This is because, if the interpretation contended by the IRB is correct, it means a hotel is only entitled to claim a total of 25% (initial allowance of 10% and 3% allowance for the five years) of the total industrial building allowance. This certainly cannot be the intention of Parliament.

In legislating and introducing industrial building allowance via s 30 of the PIA, Parliament would have certainly known it will take a hotel a period of 30 years to exhaust the allowance granted to it. This construction finds support from the following observation made by the High Court in *Sebangun:*

> *"In Lim Phin Khian v Kho Su Ming (1996) 1 MLJ 1 the Federal Court said that there is an unrebuttable presumption Parliament is presumed to know all the relevant law upon the particular subject upon which it legislates. The correct approach is to look at the substance amid general purpose of the legislation in order to discover its objective aim or general purpose..."*

In this regard, given that:

(i) Parliament is presumed to know that it wilt take hotels 30 years to exhaust the industrial building allowance; and
(i) the intention of Parliament in legislating the PIA is to promote economic development by way of tax incentives,

it is logical to contend that the industrial building allowance granted to hotels does not cease upon the expiration of investment tax allowance. Had Parliament intended otherwise, it would have been expressly prescribed in s 30 of the PIA or Parliament would have provided for accelerated industrial building allowance, which would enable hotels to exhaust the allowance in five years like investment tax allowance. Hence, pursuant to Sch 3 of the ITA and the observation made by the Special Commissioners in *GASMSB*, it is only logical that a hotel is entitled to claim industrial building allowance until the total qualifying capital expenditure has been exhausted.

In addition, it is also recognised by the Malaysian Industrial Development Authority ("MIDA"), one of the authorities established by Ministry of International Trade and Industry, that industrial building allowance is available until fully exhausted. In one of MIDA's booklets, it is stated that:

> *"An industrial building allowance is granted to companies incurring capital expenditure on the construction or purchase of a building that is used for specific purposes, including... hotels that are registered with the Ministry of Tourism. Such companies are eligible for an initial allowance of 10% and an annual allowance of 3%. As such, the expenditure can be written off in 30 years.[16]"*

This shows that it is the intention of Parliament that industrial building allowance is available until it is fully exhausted and there is no time restriction for a hotel to claim industrial building allowance.

6. Ambiguity in interpretation

Notwithstanding the above, in the event that there is a doubt on the interpretation of s 30 of the PIA, it should be resolved in favour of the hotels. In ***NLF Co-operative Society Ltd v Director-General of Inland Revenue***[17], the Supreme Court held that in the event that there is a doubt in any legislation regarding Parliament's intention, the ambiguity must be construed in favour of the taxpayer, i.e. the hotels. Justice *Gunn Chit Tuan* commented:

> *"The provisions in Income Tax Act 1967 must be construed having regard to the Interpretation Acts 1948 and 1967. There is therefore a doubt whether the Legislature had intended to impair the existing right of the tax payer and inflict a detriment to it as it takes away a vested right under the existing law to exemption from tax. As there is a doubt the ambiguity must be construed in favour of the tax payer as the said exemption from tax has not been removed by sufficiently clear words to achieve that purpose."*

7. Conclusion

For the reasons articulated above, hotels are entitled to continue claiming industrial building allowance under s 30 of the PIA on the residual value of the qualifying capital expenditure until it has been fully utilised even if the investment tax allowance granted under s 27 of the PIA had expired. TG

Datuk D.P. Naban *is a Senior Partner of Lee Hishammuddin Allen & Gledhill. He also heads the firm's Tax Practice Group and chairs the Bar Council's Tax Practice Sub-Committee. Datuk Naban can be contacted at tax@lh-ag.com*
S. Saravana Kumar *is a tax lawyer with Lee Hishammuddin Allen & Gledhill. He appears regularly before the Commissioners of Income Tax and High Court for various tax and custom matters. He also advises business enterprises on tax advisory and tax planning matters. Saravana can be contacted at tax@lh.ag.com.*

16 See page 17 of *The Guide For Malaysian Manufacturers (Book 3)*, MIDA (April 2007).
17 [1994] 4 BLJ 33.

TECHNICAL UPDATES

Technical Updates are summarised from selected Government Gazettes published between 12 November 2008 and 8 February 2009.

FINANCE ACT 2009 [Act 693]

The Act introduces several important provisions announced in the 2009 Budget speech such as withholding tax on 'other income', thin capitalization and the 'arm's length 'principle for related party transactions.

The Act received Royal Assent on 6 January 2009 and was published in the Government Gazette on 8 January 2009.

The Act amends the *Income Tax 1967*, the *Stamp Act 1949*, the *Petroleum (Income Tax) Act 1967* and the *Labuan Offshore Business Activity Act 1990.*

INCOME TAX

- **Income Tax (Deduction from Remuneration) (Amendment) Rules 2008 [P.U.(A) 468/2008]**

  A new Schedular Tax Deduction system is being implemented to ensure accurate deductions from the employees' remuneration by the employers. The new system allows for employees to claim allowable deductions and rebates in any month in the current year. To claim the deductions and rebates, the employee has to submit a prescribed form to the employer. The employee must also submit a prescribed form to the employer if the employee wishes to include benefits in kind and value of living accommodation as part of his monthly remuneration.

  The schedule for Schedular Tax Deductions under the *Income Tax (Deduction from Remuneration) Rules 1994* has been amended by the *Income Tax (Deduction from Remuneration)(Amendment) Rules 2008.*

  The Rules come into operation on 1 January 2009.

- **Income Tax (Returns by Employers) Order 2009 [P.U.(A) 5/2009]**

  This Order requires employers to furnish a return (Form E) within 30 days of the date of the gazette. The Order also provides for employers to prepare and deliver to each employee on or before 30 March 2009 a salary statement in either CP8A (private sector) or CP 8C(public sector). The Order was published in a Government *Gazette* dated 7 January 2009.

PROMOTION OF INVESTMENTS

- **Promotion of Investments (Criteria for the Grant of Investment Tax Allowance to a Small Company) Order 2008 [P.U.(A) 457/2008]**

- **Promotion of Investments (Criteria for the Grant of Pioneer Status to a Small Company) Order 2008 [P.U.(A) 459/2008].** This Order revokes the Promotion of Investments (Criteria for the Grant of Pioneer Status to a Small Scale Company) Order 1990 [P.U.(A) 196/1990].

  Both of the above incentives are granted to a small company provided the following criteria are fulfilled:

  (a) the small company shall participate in a promoted activity or produce a promoted product and achieve at least 15% value added in its activity or product; or
  (b) the small company's participation in the promoted activity or production of promoted product contributes towards the socio-economic development of the rural areas in Malaysia.

  "Value added" refers to total gross sales less cost of raw materials.

  The Promotion of Incentives Act 1986 defines a small company as a company –
  (a) incorporated in Malaysia under the Companies Act 1965; and
  (b) resident in the basis year for a year of assessment.; whose shareholders' funds as at date of the grant of pioneer status and the issue of the pioneer certificate do not exceed an amount published in a gazette.

  The last gazette notification was in 1989 which indicates the funds should not exceed RM500,000.

  The Order is deemed to have come into operation on 21 May 2003.

- **Promotion of Investments (Promoted Activities and Promoted Products for Selected Industries) Order 2008 [P.U.(A) 458/2008]**

  The following activities and products in selected industries have been determined as promoted activities or promoted products :

Industry	Activities/Products	Effective date
Machinery and equipment	(1) Machine tools (2) Plastic injection machines (3) Material handling equipment (4) Robotic and factory automation equipment (5) Parts and components for the above items	20 Oct 2001
Specialised machinery and equipment	(1) Specialised or process machinery or equipment for specific industry (2) Packaging machinery (3) Plastic extrusion machinery (4) Parts and components for the above items	21 Sep 2002
Oil palm biomass	(1) Utilisation of oil palm biomass to produce value added products	13 Sep 2003
Renewable energy	(1) Generation of renewable energy	1 Oct 2005
Conservation of energy	(1) Conservation of energy	8 Sep 2007

PUBLIC RULING

Living Accommodation Benefit Provided for the Employee by the Employer: Addendum to Public Ruling No. 3/2005

This Addendum provides clarification on the determination of value of living accommodation benefit provided for the employee by the employer. For the purposes of determining the value of living accommodation benefit, the IRB has taken the position that the employee's gross income under s 13(1)(a) of the ITA excludes the amount of gross income in respect of the right to acquire shares in a company. The Addendum is available at the IRB website.

This Addendum is issued on 5 February 2009 and forms part of the Public Ruling No. 3/2005. It is effective from the year of assessment 2009.

GUIDELINES

- **Guideline on Ascertaining the Amount of Set-off on Actuarial Surplus in the Life Fund of Insurance Companies**
  Further to the Income Tax (Set-off for Tax Charged on Acturial Surplus) Rules 2008, the IRB has issued a comprehensive guideline detailing the method of determining the set–off which will be available as a credit under s 110B, Income Tax Act 1967. The Guidelines were issued by the IRB on 5 November 2008 and are available at the IRB website(www.hasil.gov.my/cP/Upload/InfoTax/GPanduanAmaun.pdf).

- **Revised Guideline on Tax Treatment of Unabsorbed Business Losses and Capital Allowances Carried Forward**
  Effective from the YA 2006, the unabsorbed business losses and capital allowances of a company can no longer be carried forward where there is a change of 50% or more in the shareholdings of the taxpayer. The Ministry of Finance (MoF) made a concession in 2008 that only dormat companies will be subject to these provisions and which was effective retrospectively to the YA 2006. The meaning of "dormant company" was not provided at the time of the announcement of the concession. In the revised guideline, the MoF has provided guidance on the meaning of a "dormant company" for this purpose.

  The Guideline is available at the IRB website (http://www.hasil.gov.my/cP/upload/InfoTax/GPanduanTeknikal08.pdf).

CUSTOMS

GUIDELINES

- **Guidelines for Application of Sales Tax Exemption for the Local Bus Operators on the Purchase of Locally Assembled Buses with Pre–installed Air conditioners**

  The Guidelines are issued by the MoF pursuant to the 2009 Budget proposal. The Guidelines set out the eligibility and procedures for the application of sales tax exemption and the conditions for exemption. The application form (Borang BAC/PB/2008) to be used is attached to the guidelines.

  The Guidelines were issued on 3 November 2008 and are available at the MoF website(www2.treasury.gov.my/pdf/percukaian/B2009_pengusaha_bas.pdf).

Case Commentaries

MI (M) Bhd v Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax
Appeal No. PKCP (R) 29/2004
Case stated delivered on 20 July 2006
(2008) MSTC 3,741

The taxpayer was a life insurance company, wherein its policy holders paid premium on a regular basis at periodic intervals, which the taxpayer used to pay claims and expenses or invest or placed in banks as fixed deposits and/or time deposits. The taxpayer contended that the investments in fixed and time deposits were choses in action and when they were reduced into possession, the investments were realised. In calculating the amount of deductible management expenses, the taxpayer used a formula and took into account the gross proceeds received upon maturity or uplift of the deposits in the application of the formula.

However, the Director-General ignored this component as he argued that realisation of a chose in action was not to be equated with the realisation of an investment. He was of the view that in the latter, the issue of realisation did not arise since the maturity or uplift of fixed deposits did not constitute "realisation of investment" within the meaning of s 60(3) of the *Income Tax Act 1967* (ITA). It was different from investments in bonds, repo and negotiable certificate of deposits. As such, the issue before the Special Commissioners was the correct interpretation of s 60(3)(a) and (b) of the ITA prior to its amendment by Act 531 of 1995 with particular reference to its application for the calculation of the amount of management expenses deductible in arriving at the adjusted income of life business of a resident life insurer.

It was a finding of fact that the taxpayer had invested in bonds, repo and negotiable certificate of deposits through banks by placement of money on time deposit. In other words, the fixed deposits were not pure deposits. Since the Special Commissioners of Income Tax (SCIT) had ruled that realisation of stocks and shares as well as other fixed income papers constitute realisation of investment, there seems to be no reason for treating investment in bonds, etc via time deposit differently.

PR Bhd v Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax
Appeal No. PKCP (R) 21/2006
Case stated delivered on 22 February 2008
(2008) MSTC 3,789

The taxpayer was carrying on the business of underwriting of general and life insurance and computed its income tax liability based on s 60(3) of the ITA (before the amendment by Act 531 of 1995). The interest income received from fixed deposits by the taxpayer was brought to tax under s 60(3)(a)(i) of the ITA. The Director-General decided to exclude the proceeds received upon maturity or uplift of the fixed deposits and so issued notices of assessment or additional assessments to which the taxpayer appealed against. The issue before the (SCIT) was whether the sums received by the taxpayer upon maturity or uplift of the fixed deposits in the circumstances of the case amounted to realization of investment for the purpose of s 60(3)(b)(ii) of the ITA.

The facts of this case are substantially similar to those of *MI (M) Bhd v Ketua Pengarah Hasil Dalam Negeri (2008) MSTC 3,741*. Not surprisingly, the appeal of the taxpayer was disallowed. However, there seemed to be no finding of fact that the taxpayer had invested in bonds etc. via the placement of fixed deposits.

NVA Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax
Appeal No. PKCP (R) 19/2007

The taxpayer is in the business of marketing of burial plots, urn compartments and funeral packages. In the course of its business, the taxpayer requires the services of many marketing personnel and thereby appointed agents to undertake the marketing functions. The agents are paid commission for work done. Besides that, from time to time the taxpayer introduces incentive schemes with the aim of motivating agents to increase sales. Under the incentive schemes, upon achieving set targets the agents are paid cash incentives as well as rewarded with various types of incentives such as watches, pens, vases, etc. However, this appeal only concerns cash incentives.

The taxpayer claimed the cash incentives paid to agents as expenses wholly and exclusively incurred in the production of income under s 33(1) of the ITA in their return form for the Years of Assessment 2000 (Current Year), 2001 and 2002. The Director General (DG) disallowed the claim for the reason that the expenses constituted ‘entertainment’ as defined under s 18 of the ITA and therefore it was disallowed under s 39(1)(l) of the ITA. The DG also imposed a 60% penalty under s 113(2) of the ITA for the reason that the taxpayer has incorrectly claimed certain expenses as deduction from its income. The DG raised the additional tax and penalty for the Years of Assessment 2000 (Current Year), 2001 and 2002.

On appeal, the Special Commissioners of Income Tax held in favour of the taxpayer. They ruled that on the evidence adduced, the incentive payments were incurred wholly and exclusively in the production of income. The taxpayer also appealed against penalties imposed pursuant to s 113(2) of the ITA. This aspect of the appeal was also allowed.

SS Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax
Appeal No. PKCP (R) 46/2006

The taxpayer carries on the business of property development. It had purchased a piece of land and subsequently sold the land to one MC Sdn Bhd. The agreement (SPA) contained several conditions precedent. The purchase price of the property was payable as follows: RM678,000.00 as deposit and part payment upon execution of the SPA, and the balance purchase price of RM6,102,000.00 in full upon the fulfillment of the said conditions precedent. The dates of fulfillment for each of the conditions precedent were expressly stipulated and in the event that such conditions precedent were not fulfilled, the SPA shall be deemed to have been terminated and the deposit shall be refunded to the vendor.

The issue for determination by the SCIT was in which year of assessment did the taxpayer derive or earn profit from the sale of the said land, i.e. whether this was the date of the SPA was signed or the date when all the conditions precedent in the SPA were satisfied. The conditions precedent was fulfilled in YA 2000 which was a “tax waiver” year. The SCIT held that the taxpayer only earned the profit when all the conditions were fulfilled.

This is a clear-cut case in respect of the issue when income accrues. It is clear law that in a conditional contract, no income can be said to have accrued or earned unless and until the agreement becomes unconditional. The appeal was allowed.

B Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax
Appeal No. PKCP (R) 35/2006

The taxpayer is in the business of retailing and distributing apparel and related accessories and trades with P on a consignment basis. The taxpayer’s terms of trade with P is such that goods will be distributed to P’s department stores and P will record the sale of the taxpayer’s garments on its cash register system at the point of payment. At the end of every month, P will compute the total sale of the taxpayer’s garments and thereby pay the taxpayer based on their records of sales from the cash register system. The taxpayer periodically issues provisional invoices to P based on monthly stock reports provided by its promoters located at P’s department stores. The issue of provisional invoices had resulted in P overpaying the taxpayer by RM593,598. This overpayment was discovered by P in the year of assessment 1999 and accordingly, P refused to pay the taxpayer for goods supplied to the extent of the overpayment alleged to have been made in prior years. The taxpayer claimed the amount as bad debt.

Subsequent to a field audit of the taxpayer's premise, the Director General of Income Tax issued a Notice of Additional Assessment dated 31.5.2005 to disallow bad debts written off as a deduction on the basis that the duplicate payments received in the years prior to the YA 1999 had not been recorded as sales. The taxpayer objected towards the additional assessment. The issue for determination was whether the amount qualifies for deduction under s 34(1) of the ITA, having regard to the true nature and character of the amount of RM593,598.00 written off in the YA 1999.

The SCIT dismissed the appeal. In doing so, the SCIT did not accept the submission of the taxpayer that following the case of *Margaret Luping & 2 Ors v Ketua Pengarah Hasil Dalam Negeri [2000] 2 AMR 1363*, which laid down, amongst other things, the principle that any income or expenditure must be determined by reference to a particular year of assessment. In other words, although there was an amount written off in YA 1999 because there had been duplicate payments in prior years, the write off are to be disregarded because the taxpayer had received duplicate payments in prior years.

FF Holdings (M) Bhd v Ketua Pengarah Hasil Dalam Negeri Special Commissioners of Income Tax Appeal No. PKCP (R) 42/2007

The taxpayer is an investment holding company, which had given interest-free loans to some of its subsidiaries in 2002 and 2003. The issue for determination by the SCIT was whether the interest expenses for the Years of Assessment 2002 and 2003 arising from borrowings which the taxpayer in turn gave as interest-free loans to subsidiaries were wholly incurred in the production of the gross income within the meaning of s 33(1) of the ITA.

The SCIT held that the principle laid down in the "Multi Purpose" case is not applicable and the interest incurred on loans which are on lent free of interest to subsidiary companies are not incurred in the production of income.

Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v IRC and another Inland Revenue Commissioners [2007] 3 WLR 354

Where overpayments to the Inland Revenue are refunded late, is the taxpayer entitled to claim interest as damages on his claims for such delayed refunds?

Malaysian jurisprudence has to date largely developed over the question of whether interest may be claimed as damages for breach of contract to pay by due date, and may be summarised as that interest is claimable as compensation – see the Federal Court decision in *Newacres Sdn Bhd v Sri Alam Sdn Bhd [2000] 2 MLJ 353 at 385*, and whether that interest should be simple or compounded is dependent on the circumstances of the case. It is simple interest if the withholding party simply keeps the money or actually received such rate, but it is compound if the money was used in the withholding party's business – see the High Court decision in *Trengganu, State Economic Development Corporation v Nadefinco Ltd [1982] 1 MLJ 365* relying on Lord Denning's discourse in *Wallersteiner v Moir (No. 2) [1975] 1 AER 849* which case was cited with approval in the *Newacres* decision.

However, there is no direct authority on the aforesaid question where the underlying cause of action is grounded in restitution rather than in breach of contract.

In this connection, the recent House of Lords decision in *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners and another [2007] 3 WLR 354* is instructive.

There, the taxpayer claimant claimed entitlement to restitution in respect of interest accruing on sums of tax prematurely paid. At the High Court, the judge held that the claimant was entitled to a full remedy restoring it to the position it would have been in had it not been required to make premature payments, and ordered the award to be quantified on the basis of compound, not simple, interest at a rate derived from prevailing levels of interest in the market generally.

The Court of Appeal dismissed the Inland Revenue's appeal.

On appeal by the Inland Revenue, the House of Lords affirmed the Court of Appeal's decision but held that the award should be compound interest at conventional rates calculated by reference to the rates of interest and other terms applicable to borrowing by the Government in the market during the period between making the payments and the date on which the tax became payable.

The basis of a restitutionary remedy as in this case is to reverse an unjust enrichment and here that unjust enrichment was the value of the use of the money over the time period during which the money had been wrongfully retained by the Inland Revenue.

This case has yet to be considered by the Malaysian courts. Nevertheless, being a House of Lords decision, this case would in our view be a very persuasive authority, given that the development of the law of restitution in Malaysia has largely followed English law. TG

Francis L K Tan *and* ***Janice Kon*** *are lawyers with Azman, Davidson & Co. The authors can be contacted at francis.tan@azmandavidson.com.my and Janice.kon@azmandavidson.com.my respectively.*

International News

By Rachel Saw

The column only covers selected developments from countries identified by the CTIM and relates to the period November 2008 to 9 February 2009.

Hong Kong

Advance ruling on derivation of income in Hong Kong

On 20 November 2008, the Hong Kong Inland Revenue Department issued an advance ruling (the Ruling) in respect of Sec. 14 of the Inland Revenue Ordinance to an unnamed company in Country X with a branch in Hong Kong. The Company is incorporated in Country X and is a member of an international group. The branch in Hong Kong was established to fulfill the requirements of the Company's customers in Country X so that they themselves can manage the import related logistics in a more efficient manner.

The Ruling states that based on the facts provided, the trading profits booked in the accounts of the Company's Hong Kong branch do not arise in nor are derived from Hong Kong, and thus are not chargeable to Hong Kong profits tax under Sec. 14(1) of the Inland Revenue Ordinance.

China

Withholding tax on dividends from H shares

The State Administration of Taxation (SAT) has issued a ruling (*Guo Shui Han* [2008] No. 897) stating that from 2008 and onwards, dividends from "H-shares" (i.e. shares of companies incorporated in mainland China, but listed on the Hong Kong Stock Exchange) paid by resident enterprises to non-resident (NR) enterprises abroad are subject to withholding tax (WHT) at a rate of 10%. Previously, such dividends were exempt.

NR enterprises receiving the dividends from "H-shares" may apply for lower rates available under a tax treaty if they are able to provide the necessary documentation to prove that they are the beneficial owner of the dividends.

Regulations on VAT, business tax and consumption tax revised

On 5 November 2008, the State Council approved amendments to the value added tax (VAT), business tax (BT) and consumption tax (CT) effective from 1 January 2009. The key amendments are:

VAT

- Input VAT incurred on the purchase of fixed assets can be credited against the VAT payable;
- Import VAT exemption for fixed assets imported for the purpose of contract processing, assembly or compensation trade has been abolished;

- The VAT rate for small-scale taxpayers has been reduced to 3%;
- 7% of the charges can be credited as input VAT for the transportation charges related to production and supply of goods.

Business tax

- BT is generally calculated on a gross basis. However, certain businesses are allowed to calculate BT on a net basis. The "on-lending" business has been removed from this list and, as a result, the interest on borrowings will

no longer be deductible in calculating the BT on the interest on lending;
- insurance products of Chinese insurance companies, used to insure goods for export will be exempt from BT.

Consumption tax
- CT is calculated either on the basis of the sale proceeds or number of sold products (quantity). The amendments have introduced an additional method, i.e. the combined method. The formula is as follows: Taxable CT = Sales x Tax Rate + Number of Sold Products

Tax treatment of income from air and sea transportation derived by non-resident enterprises

The SAT issued a ruling (*Guo Shui Han* [2008] No. 952) stating that a NR enterprise carrying on a business of air and sea transportation within China is subject to the enterprise income tax on its taxable income. "Taxable income" is defined as 5% of the total revenue attributable to the business operation within China. Thus, the total tax payable is 4.5% (i.e. enterprise income tax of 1.25% and business tax of 3%) of the total taxable income (i.e. 5% of total revenue). The Ruling applies retroactively from 1 January 2008.

Implementation rules on special tax adjustments

The SAT issued the implementation rules on special tax adjustments on thin capitalisation, legal liabilities, General Anti Avoidance Rules, Cost Sharing Agreements, Controlled Foreign Corporations, Advanced Price Agreements, and Transfer pricing. The rules are designed for the tax administration and apply retroactively from 1 January 2008. The key points are highlighted below:-

Thin Capitalisation
- Non-deductible interest stated as in the thin-capitaliation legislation is calculated as = the annual total interest paid to the related parties x (1 – [standard ratio / debt to equity ratio]).
- The applicable debt-equity ratios are 5:1 for financial service enterprises and 2:1 for non-financial enterprises.
- Non-deductible interest cannot be carried over to the following years, and instead is re-characterised as dividends and subject to income tax.

General Anti-Avoidance Rules
- General anti-avoidance rule investigation will specifically target the abuse of tax incentives, treaty shopping, abuse of organisational form of companies, avoidance of taxes via tax havens and other business arrangements without bona fide commercial purposes.
- Tax authorities are required to follow the principle of substance-over–form.
- Tax authorities are authorised to re-characterise an arrangement according to its economic substance, and cancel the tax benefits arising from such arrangement. An enterprise without any economic substance can be disregarded for the tax purposes, especially if it is located in a tax haven and results in tax reduction of the related parties.

Cost-Sharing Agreements (CSA)
- CSAs to jointly develop and assign intangibles, or to provide or receive services are permitted.
- The costs shared must be consistent with the costs paid by an unrelated enterprise for the same benefits under comparable conditions.
- The participants do not need to pay royalties for the use of intangibles developed or transferred under the CSA.
- In the case of compensation adjustment, the amount of adjustment shall be included in the taxable income in the year during which the adjustment is made.
- Buy-in and buy-out payments, and allocation of results from the agreement on intangibles due to termination, must be taxed as purchase or disposal of assets.
- An enterprise can use an APA to reach a CSA.

Corresponding adjustments and international consultation
If an adjustment is made to one party in the framework of transfer pricing, another party shall be allowed to make corresponding adjustment to eliminate double taxation. If an adjustment involves the related transactions with a treaty partner, the mutual agreement procedure can be employed for international consultation.

Controlled foreign corporations
- A "controlled foreign corporation" is defined as a foreign enterprise controlled by a tax resident enterprise or jointly controlled by a tax resident enterprise and a resident individual that is established in a country where the effective tax rate is lower than 50% of the tax rate and whose profit is not distributed or under-distributed for reasons other than reasonable business needs
- The meaning of "control" is defined as effective control in terms of shareholding, financing, business operations, purchase and sales. The control in terms of shareholding refers to the cases where a resident shareholder, either directly or indirectly:
  – individually owns more than 10% of the shares with voting rights of a foreign corporation on any day of a tax year; and
  – jointly owns more than 50% of that foreign corporation's shares.
- CFC rules do not apply to CFCs which:
  – are located in non-low tax countries or regions designated by the SAT;
  – are mainly engaged in active business operations; or
  – whose annual profits do not exceed CNY 5 million.

Transfer pricing
- Related parties and relevant transactions are clearly defined.
- The Rules provided guidance on the filing obligations and the type of contemporaneous documentation required of an enterprise and includes details such as the commercial justification for a related transaction, reasoning behind the comparable analysis selected and justifications for the relevant transfer pricing methods applied.
- Lists enterprises which are exempt from the contemporaneous documentation requirement.
- Both the enterprise engaging in related transactions and the tax authority reviewing and assessing such transactions are required to follow the arm's length principle and select the reasonable transfer pricing method. The following transfer pricing methods are discussed in detail in the regulation:
  (a) Comparable uncontrolled method
  (b) Resale price method
  (c) Cost plus method
  (d) Transactional net margin method
  (e) Profit split method
- The regulation also lists the key factors used in identifying audit targets, which include the number of related transactions, long term losses or low or fluctuating profitability, profit levels that vary from the norm, etc.
- The SAT's scope and powers with regard to investigation and adjustments are discussed in great detail.

Indonesia

Treaty between Indonesia and Mauritius – The Indonesian Tax Court's decision to determine "beneficial ownership" of non-resident taxpayer lies with taxpayer's country of residence.
The Indonesian Tax Court delivered a decision dated 14 March 2008 in the case of PT. Transportasi Gas Indonesia v. Direktur Jenderal Pajak on the subject of "beneficial ownership". Interestingly, the Tax Court held *inter alia* that:
- The determination of beneficial owner lies with the country of residence of the taxpayer. The Indonesian tax authorities have limited means other than via an exchange of information procedure under the treaty.
- As beneficial ownership is a treaty concept, the domestic interpretation of the term in Indonesia should have been agreed with the Mauritian competent authority upon the signing of the treaty, and this meaning should have been publicised when the treaty entered into force;
- A "substance over form" approach should be taken in determining beneficial ownership.

Revision of CFC rules

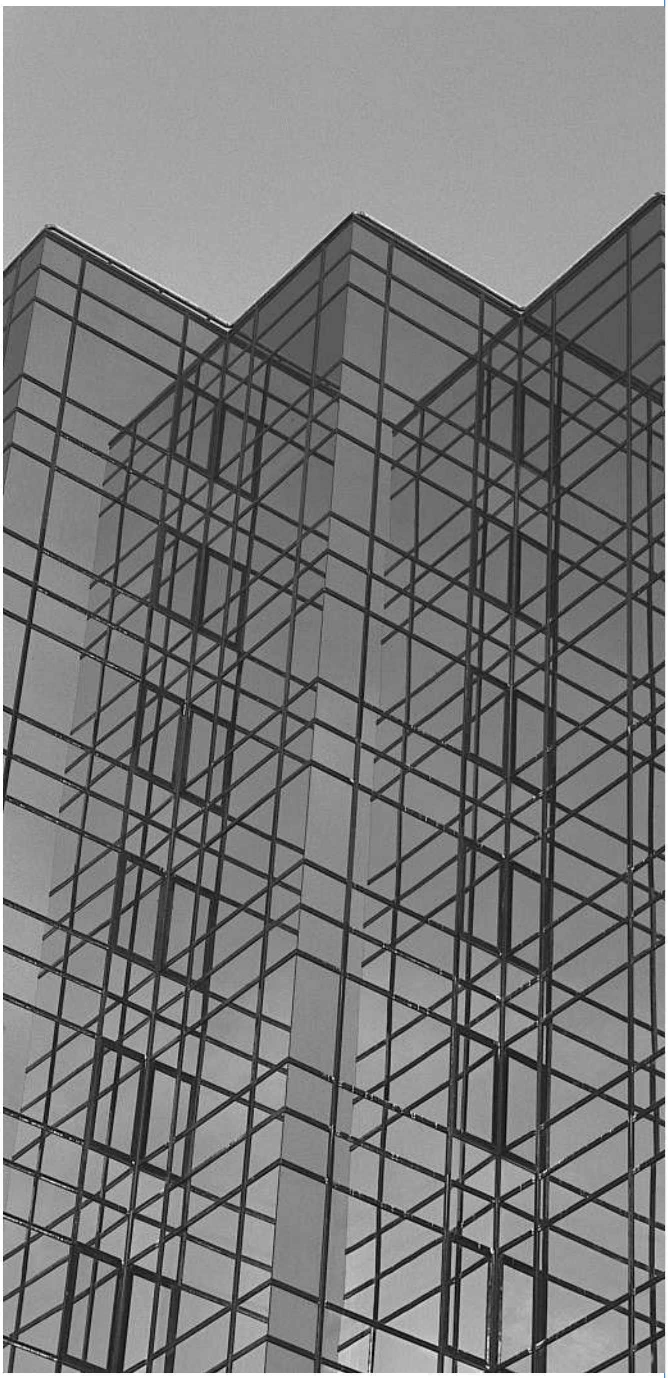
Regulation No. 256/PMK.03/2008 states that, effective from 1 January 2009, the undistributed profits of unlisted companies incorporated in foreign jurisdictions which are 50% or more held directly by Indonesian residents are deemed to be distributed if they are not distributed within 4 months from the submission of the company's tax return in the foreign country. Where the company is not obliged to file a tax return or where the tax filing deadline is not stipulated, the undistributed profits are deemed to be distributed within 7 months from the end of the company's tax year. Any foreign taxes paid on the dividends are creditable against Indonesian tax due on the dividends, pursuant to Indonesia's ordinary foreign tax credit rules. The foreign tax credit rules provide for a country-by-country limitation and do not grant credit for underlying tax. The Regulation is silent on taxes that are deemed to be paid.

The rules apply to *all* foreign subsidiaries, regardless of where they are incorporated.

Regulations for implementation of new Income Tax Act

The government issued numerous regulations for the implementation of Law No. 36 Year 2008 which provides for changes to the income tax regime. The regulations take effect from 1 January 2009 and the key points are as follows:-

- All types of services, including the rental of property (other than land and buildings), technical, management, construction, consultancy and "other services", are subject to 2% withholding tax, provided the recipient of the income has a Tax Identification Number (NPWP). Where the taxpayer does not have a NPWP, an additional withholding tax of 100% applies.
- The after-tax profits of a permanent establishment are exempt from the 20% branch profits tax where:
  - all of the after-tax profits are reinvested in the form of capital participation in a newly-incorporated Indonesian company that is resident in Indonesia;
  - the newly established company conducts business activities in accordance with its deed of establishment no later than 1 year from the date of establishment;
  - the re-investment is done in the same tax year in which the income is received / earned or the year after; and
  - the re-investment is not transferred for a minimum of 2 years from the date the company commences business.
- Effective 1 January 2008, subject to certain conditions, listed companies enjoy a 5% reduction in the income tax rates provided.
- Permanent employees or pensioners may deduct from their gross income:
  - a functional cost of 5% of gross income, subject to a maximum of IDR 6 million per year or IDR 500,000 per month; or
  - a pension cost of 5% of gross income, subject to a maximum of IDR 2.4 million per year, or IDR 200,000 per month.
- Gross income of daily, weekly and other non-permanent workers are exempt from withholding tax on employment income, up to a sum of IDR 150,000 per day. The exemption does not apply where the gross income exceeds IDR 1.32 million per month, or where the income is paid on a monthly basis. The exemption also does not apply to honorarium income or commission paid to retailers of goods and insurance marketing executives.
- Gains from the disposal of shares in a foreign company established or resident in a tax haven country that acts as a special purpose or conduit company to hold shares in an unlisted Indonesian company are subject to withholding tax of 20% of the estimated net income. The estimated net income is set at 25% of the selling price of the shares, such that the effective tax rate is 5%, which is a final tax. The 5% tax is imposed on a deemed gain stipulated by the Finance Minister and is payable regardless of whether the gain is actually realised.



Singapore

The Budget for 2009 was presented to Parliament by the Minister of Finance, and its key points are summarised below:

Direct taxes

- The corporate income tax rate is reduced to 17% with effect from the year of assessment (YA) 2010.
- The tax concession for banks (including merchant banks) and finance companies to deduct impairment provisions will be extended for a further 3 years.
- Capital expenditure incurred on plant and machinery acquired for business purposes in YAs 2010 and 2011 will be eligible for a 75% capital allowance in the 1st year of claim.
- The loss carry-back relief scheme will be temporarily enhanced for YAs 2009 and 2010
- Resident non-individuals and resident partners of Singaporean partnerships will be exempted from tax on their remittance of all foreign-sourced income earned outside Singapore on or before 21 January 2009, if the remittance to Singapore falls during 22 January 2009 to 21 January 2010.
- A new tax framework for qualifying corporate amalgamations will be introduced with details to be issued later.
- A tax rebate of 20% capped at SGD 2,000 is given to resident individuals for YA 2009.
- The income tax on net annual value (NAV) of residential property will be removed with effect from YA 2010.
- A temporary 1-year "jobs credit" scheme is introduced for 2009 which allows employers to receive a 12% cash grant on the first SGD 2,500 of each month's wages for each employee on their Central Provident Fund (CPF) payroll.
- The start-up exemption scheme will be extended to companies limited by guarantee.
- The fund management incentive will be enhanced for funds with a minimum fund size of SGD 50 million.
- The Financial Sector Incentive-Headquarter Services (FSI-HQ) scheme will be enhanced.
- The Commodity Derivatives Traders (CDT) scheme will be extended to December 2013.
- The withholding tax exemption under the Block Transfer Scheme has been to 31 December 2013.

Indirect taxes

- A 40% rebate will be given for commercial, industrial and owner-occupied properties for calendar year 2009.
- Property tax on hotels will remain at 20% in 2009, instead of the previously proposed 25%.
- Qualifying funds that are managed by a prescribed fund manager in Singapore will be allowed to claim a substantial portion of their input GST on prescribed expenses until 31 March 2014.
- From 1 April 2009, the zero rating of GST for qualifying aircrafts will be expanded.

Vietnam

Circular on Personal Income Tax

Circular 84 governing the newly adopted PIT Law, which is effective 1 January 2009, was issued on 30 September 2008.

The key features of Circular 84 are summarised below.

Tax residency

In addition to the 183-day physical presence rule, the PIT also provides that an individual who has a place of habitual residence (either a registered or rented property) in Vietnam, would be deemed a Vietnamese tax resident. A place of habitual residence would include a hotel, motel, guesthouse, working place and office which has been leased, either by the employee or the employer, for more than 90 days for the use of the employee.

Taxable income – employment

Previously exempt fringe benefits such as housing, home leave passage, relocation and tuition fees for school children would be taxable under the new PIT law and benefits such as tax compliance fees, vacation expenses, and salaries of domestic help are specifically taxable and grossed up for the tax element where applicable. Additionally, shares-in-kind provided would be treated as bonus-in-kind.

Taxable income – non-employment

Interest income (except on deposits with credit institutions or Vietnam life insurance policies), dividends (cash and non-cash), capital gains on sale of interest, securities and properties (unless specifically exempt), and inheritances, royalties, winnings in excess of VND 10 million per event is now taxable.

Non-resident individuals

Non-residents would be taxable on all Vietnamese-sourced income, at various flat rates from 1% to 20%.

Circular issued on foreign contractor tax

Circular No.134/2008/TT-BTC (Circular 134) provides detailed regulations on the tax treatment of foreign contractors and subcontractors which are effective from 1 January 2009.

Circular 134's broad scope of taxable entities includes virtually all foreign organisations or individuals once they carry on a business in Vietnam or receive any business income sourced in Vietnam; and specifically includes foreign organisations (with or without a PE) and foreign individuals (resident or non-resident) that conduct business in Vietnam or receive income sourced from Vietnam by way of contracts

with Vietnamese organisations / individuals directly, or who contract with other foreign contractors to carry out part of the work (i.e. as foreign subcontractors).

Circular 134 clearly differentiates between corporate and individual foreign contractors, as either an element of Enterprise Income Tax or Personal Income Tax will apply accordingly. The Guidelines cover the VAT liability of the foreign organisations / individuals and the EIT liability of the foreign organisations only.

Two taxing methods are prescribed and the payment requirements are dependent on the taxing method applied.

(a) Taxing Method 1.

The foreign party is required to pay VAT under the credit method and EIT (currently 25%) on its actual income if:

- it has a PE in Vietnam or is a tax resident of Vietnam;
- the business operations in Vietnam run for at least 183 days from the effective date of the contract; and
- the Vietnamese accounting system is adopted.

Tax filings and payment are done by the foreign party directly to the tax authority. The Vietnamese contractual party has to notify the local tax office of the adoption of the above within 20 days of the signing of the contract.

This allows the foreign party to charge output VAT to clients in Vietnam and offset any input VAT from those amounts to arrive at the VAT amount payable.

(b) Taxing Method 2

If the foreign party does not meet the criteria set out above, it shall pay VAT under the direct calculation method and EIT on a deemed percentage of taxable turnover. The Vietnamese contractual party must register with the local tax office its obligation to pay FCT on behalf of the foreign party, within 20 days of the signing of the contract.

Tax incentives

The incentives include:

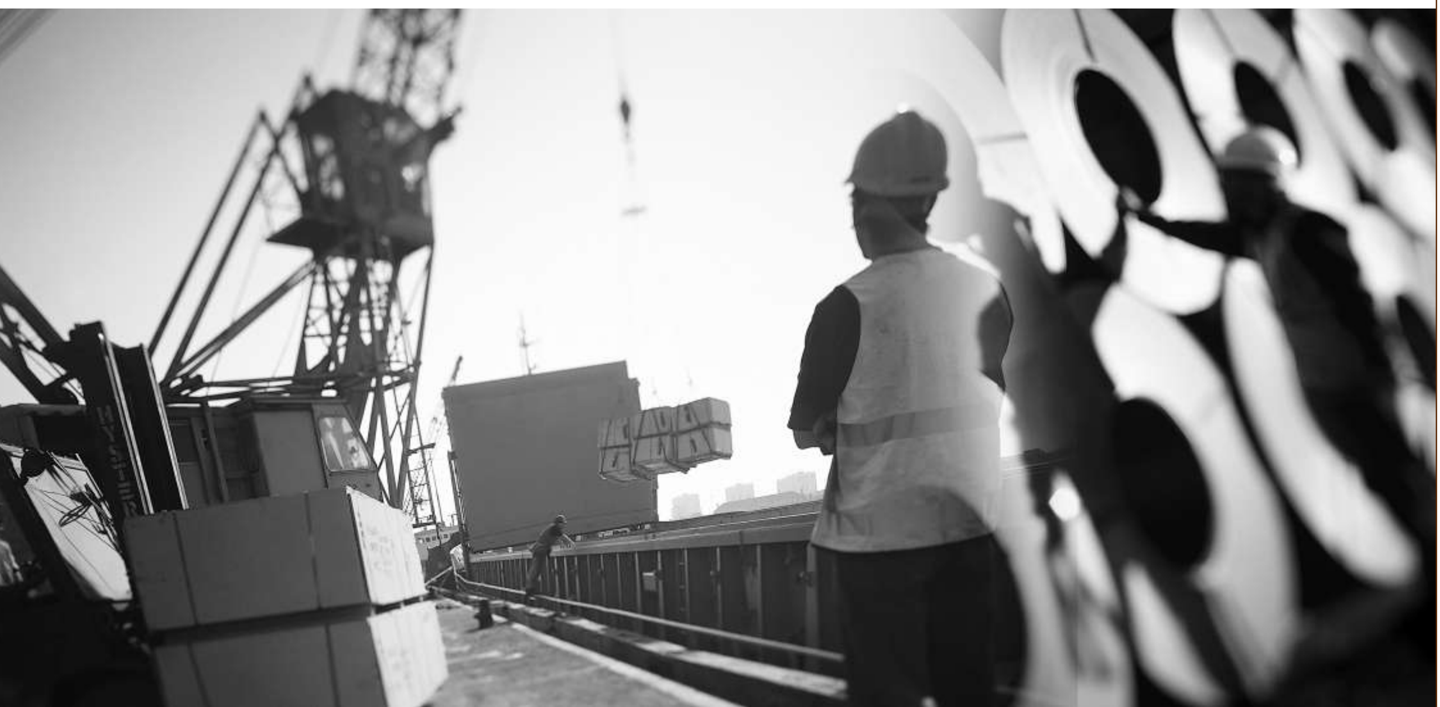
- Reduction by 50% of the VAT rate on goods and services such as coal, chemicals, automobiles and automobile components, transportation (except for international transportation), tourism and hotels etc.;
- Extension of time to 9 months granted for the payment of Enterprise Income Tax due in 2009 on income from (i) manufacturing construction materials, (ii) construction, (iii) installation, (iv) tourism, (v) trading in food, (vi) fertilizers etc. This is in addition to an earlier announced extension for small and medium-sized enterprises; and
- A partial deferral of the new Personal Income Tax Law (PITL), which came into effect on 1 January 2009. Resident taxpayers are entitled to a deferral of the monthly withholding payment of PIT from January 2009 to May 2009, on employment income and other irregular income (e.g. certain capital gains, royalties, etc.). The deferral does not amount to an exemption from income tax.

Malaysia – treaty developments

On 19 November 2008, Turkmenistan and Malaysia signed a Double Tax Agreement (DTA) in Ashgabat.

The DTA and protocol between Kazakhstan and Malaysia, signed on 26 June 2006, entered into force on 22 February 2007. The treaty generally applies in Kazakhstan from 1 January 2008 for withholding taxes and 1 January 2009 for other taxes. In Malaysia, it applies from 1 January 2009 for petroleum income tax and from 1 January 2008 for other taxes. TG

__Rachel Saw__ is a Senior Research Associate at the International Bureau of Fiscal Documentation (IBFD). The International News reports have been sourced from the IBFD's Tax New Service. For further details, kindly contact the IBFD at ibfdasia@ibfd.org



Retrenchment and Redundancy

As Malaysia's economy takes a sharp turn for the worse, businesses are fighting for survival, not just for this year but possibly over the next few years. Local news reports quoted Human Resources Minister Datuk Subramaniam as saying that 102 employers would be retrenching their workers in stages. While according to the Malaysian Employers Federation (MEF), between 200,000 and 400,000 workers are expected to lose their jobs this year. Datuk Subramanian added that the government would look into getting alternative employment for the workers or retrains them and will ensure "the retrenchment is done fairly".

This phenomenon is not just limited to Malaysia. Companies around the world are cutting down on their work force to deal with the economic slowdown. Global accountancy firm KPMG has asked its 11,000 British staff if they would switch to a four-day week or take a long break to help avoid redundancies in the recession. These measures are part of a contingency plan that would help the company cope with the worst economic turmoil.

In this article, we learn more about this worrying trend and how best to conduct a lawful retrenchment exercise.

Definition

Retrenchment means the discharge of surplus labour or staff by an employer for any reason whatsoever otherwise than as a punishment inflicted by way of disciplinary action (*William Jacks & Co (M) Bhd v S Balasingam* [1997] 3 CLJ 235). "Retrenchment" is the expression used to describe what occurs to an employee whose employment is terminated by reason of their job becoming redundant. "Redundancy" is the process of identifying employees who are surplus to the organisation's requirements and the end result is the retrenchment of such employees.

Similarly, on a technical note, it is not the employee who becomes redundant, but their job, thus leaving them unemployed.

What is redundancy?

An employee is said to be "redundant" when their job is no longer available and the employer either cannot offer the employee any alternative position or, any alternative position offered by the employer cannot be accepted by the employee.

Redundancy occurs where the employer's requirements for employees to carry out work of a particular kind has ceased or diminished. Where the same number of employees is no longer required by the employer's business, then that will result in a redundancy. There is redundancy where:

(i) the number of employees required to carry out work of a particular kind is reduced, or is expected to be reduced and this results in dismissals; or

(ii) the work itself ceases or diminishes either permanently or temporarily, or is expected to do so, so that fewer employees are needed and this results in dismissals.

As compensation for leaving employment, the employee is offered "retrenchment benefits", "redundancy pay", or "severance pay". These of course, amount to the same thing – the employer pays the employee to leave.

The Law

Employers are required to treat their employees fairly and in accordance with the law. For example, an employer is not allowed to single out an employee for retrenchment as an easy means of avoiding a process of performance review of the employee or to avoid a claim of unfair dismissal by the employee. The exercise of retrenchment by an employer must be *bona fide*.

> *….an employer is not allowed to single out an employee for retrenchment as an easy means of avoiding a process of performance review of the employee or to avoid a claim of unfair dismissal by the employee.*

Requirements for a retrenchment exercise

In carrying out a retrenchment exercise, the employer must comply with the following requirements:

1. There must be a legal basis and justification to carry out the reorganisation or restructuring.
2. The position of the employee affected must be redundant as a result of the reorganisation.

Notice of Retrenchment and Retrenchment Benefits

For employees within the EA, the minimum length of such notice and termination benefits are as follows:

Length of service	Minimum notice period	Minimum amount of termination benefits
Less than 2 years	4 weeks	10 days' wages for every year of service
2 years or more but less than 5 years	6 weeks	15 days' wages for every year of service
5 years or more	8 weeks	20 days' wages for every year of service

[Per s 12(2), EA; reg 3 and 4 of the *Employment (Termination and Lay-Off Benefits) Regulations 1980*

3. The retrenchment exercise must be in accordance with the principle of Last–In–First–Out (LIFO) or other accepted standards of industrial relations practice.

A redundancy will not be a valid termination if it is either substantively unfair or procedurally unfair.

A redundancy will not be a valid termination if it is either substantively unfair (not economically justified) or procedurally unfair (unfair selection criteria, inadequate notice, etc).

Procedure to Conduct a Retrenchment Exercise

This is covered in Art 20–24 of Code of Conduct for Industrial Harmony, which is reproduced below:

"Redundancy and Retrenchment

Art 20. In circumstances where redundancy is likely an employer should, in consultation with his employees' representatives or their trade union, as appropriate, and in consultation with the Ministry of Labour and Manpower, take positive steps to avert or minimise reductions of workforce by the adoption of appropriate measures such as –
- (i) limitation on recruitment;
- (ii) restriction of overtime work;
- (iii) restriction of work on weekly day of rest;
- (iv) reduction in number of shifts or days worked a week;
- (v) reduction in the number of hours of work;
- (vi) re-training and/or transfer to other department/work.

Art 21. The ultimate responsibility for deciding on the size of the workforce must rest with the employer, but, before any decision on reduction is taken there should be consultation with the workers or their trade union representatives on the reduction

Art 22. (a) If retrenchment becomes necessary, despite having taken appropriate measures, the employer should take the following measures –
- (i) giving as early a warning, as practicable, to the workers concerned;
- (ii) introducing schemes for voluntary retrenchment and retirement and for payment of redundancy and retirement benefits;
- (iii) retiring workers who are beyond their normal retiring age;
- (iv) assisting in co–operation with the Ministry of Labour and Manpower, the workers to find work outside the undertaking;
- (v) spreading termination of employment over a longer period;
- (vi) ensuring that no such announcement is made before the workers and their representatives or trade unions have been informed.

(b) The employer should select employees to be retrenched in accordance with an objective criterion. Such criteria, which should have been worked out in advance with the employees' representatives or trade union, as appropriate, may include –
- (i) need for the efficient operation of the establishment or undertaking;
- (ii) ability, experience, skill and occupational qualifications of individual workers required by the establishment or undertaking under (i);
- (iii) consideration for length of service and status (non–citizens, casual, temporary, permanent);
- (iv) age;
- (v) family situation;
- (vi) such other criteria as may be formulated in the context of national policies.

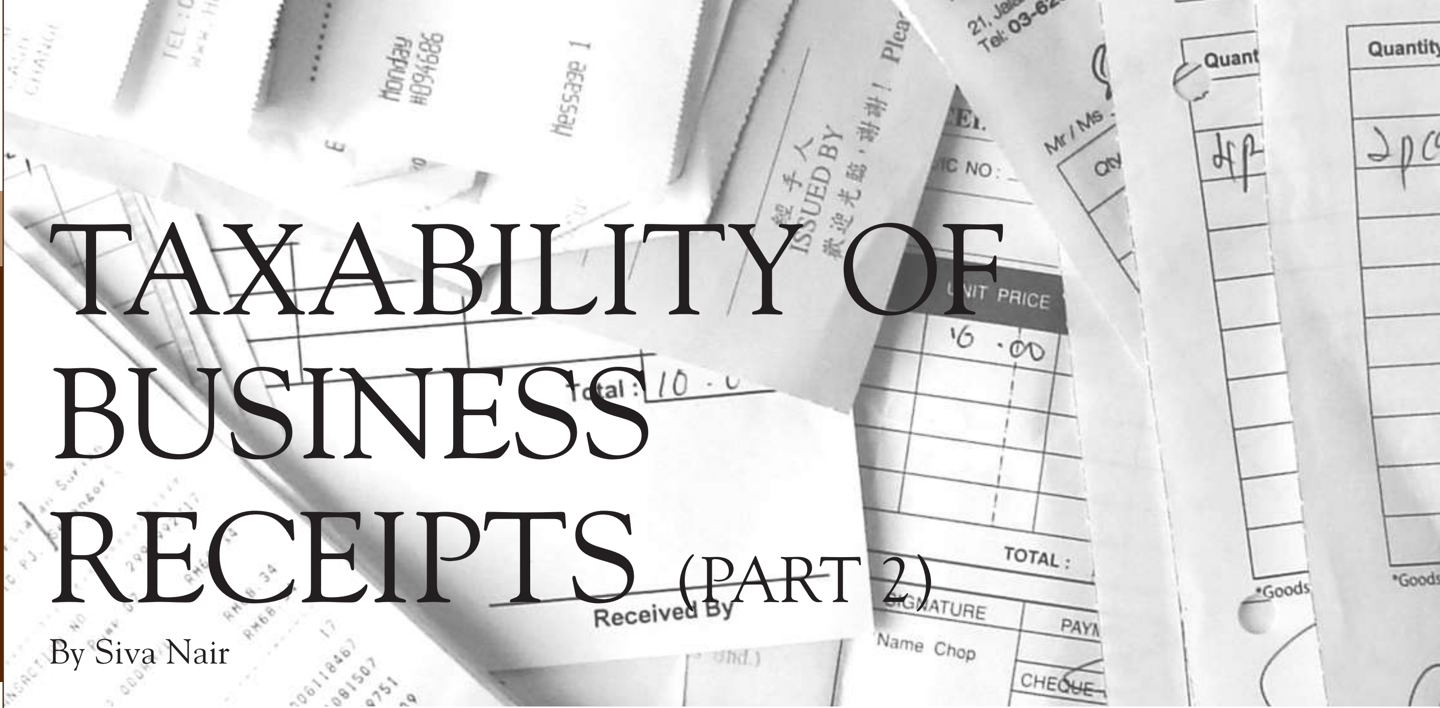
Art 23. Employees who are retrenched should be given priority of engagement/re-engagement, as far as is possible, by the employer when he engages workers.

Art 24. The appropriate measures and objective criteria should comprise part of the establishment's or undertaking's employment policy."

In essence, in a retrenchment exercise, the employer should ensure that:

- Employees to be retrenched are selected fairly.
- Employees (and their trade union, if applicable) should be informed first and be consulted on about the retrenchment.
- Employees should receive all retrenchment benefits due and be given the correct length of notice on the retrenchment.
- The employer should consider any alternatives to redundancy. TG

This article is an excerpt from A-Z Guide to Employment Practice in Malaysia, 2nd edition published by CCH Asia Pte Limited. The article has been adapted for publication in this issue of the Tax Guardian.



TAXABILITY OF BUSINESS RECEIPTS (PART 2)

By Siva Nair

In this article, we are going to look at miscellaneous income, included sometimes as part of operating profits or otherwise as other income in the profit and loss account, and how these income should be reflected in the tax computation.

Firstly, let's revise the format of a tax computation in relation to the position of business and non-business income.

Tax computation for year of assessment 20XX	
Profit before tax	xxx
Adjustments	xxx / (xxx)
Adjusted income	xxx
Less capital allowances	(x)
Statutory income	xxx
Add statutory income from other business sources	xx
Aggregate statutory income from business	xxx
Less b/f business loss	(x)
	xxx
Add: Non – business income	xx
Aggregate income	xxx

Source of income

Any other gains made by a taxable person, as reflected in the profit and loss account, should firstly be analysed to determine whether it is capital or income in nature. Detail tests for ascertaining this have been discussed in the earlier articles. Capital gains are not subject to income tax.

However, if we have confirmed that the gains are income, then we need to determine whether they are:–

- related to or an extension of the main business source of the taxable person;
- a business source, BUT a separate source from the main business source of the taxable person; or
- a non–business source.

The common miscellaneous income items that appear in a profit and loss account for examination purposes are dividends, interest and rental income. We shall discuss these incomes in the light of the sources detailed above.

Dividend income

Dividend income is rarely a business source except for specialised industries such as insurance, banking and investment dealing or investment holding companies. For insurance companies, dividend income is regarded as part of the insurance business for life, general business, inward re–insurance and offshore insurance businesses. This is also true in the case of dividends from short–term investments for the banking industries.

Tax treatment

No adjustment is needed to profit before tax since the dividend is part of the main business source of the company. However candidates (CTIM papers Tax III – V) should note that tax computations for insurance companies usually commence with gross income and ***NOT*** *profit before tax.*

Usually dividend income is a non–business source of income. Under the single tier tax system, companies are not entitled to deduct tax on dividends and the dividends are exempt in the hands of the recipients.

Tax treatment

The dividend income should be deducted from the profit before tax in arriving at the adjusted income; but in arriving at aggregate income dividend income should be indicated as exempt.

However, under the transitional provisions of s 108, taxable dividends can still be paid (as long as it is in respect of ordinary shares and the payment is in cash).

Tax treatment

The dividend income should be deducted from the profit before tax in arriving at the adjusted income but should be added back in arriving at aggregate income. Note that for companies, the dividend income is deemed total income and have to be added back in ascertaining the total income of the company.

Interest income

For banks, finance companies and money lenders interest is regarded as a business source of income. However, even for other businesses, interest charged on late settlement of trade debts is regarded as part of the main business source and not as a separate source of income.

Tax treatment

No adjustment is needed to profit before tax since the interest is incidental to their normal business activity. This is normally indicated by inserting a "Nil" in the (-) column of the tax computation before arriving at adjusted income.

In some cases, the interest income is regarded as a business source BUT not incidental to the main business.

Tax treatment

The interest income should be deducted from the profit before tax in arriving at the adjusted income but should be added back in arriving at aggregate statutory income from business.

Generally, interest from fixed deposits, bonds and etc are regarded as a non-business source

Tax treatment

The interest income should be deducted from the profit before tax in arriving at the adjusted income but should be added back in arriving at aggregate income.

Rental income

The Inland Revenue Board has issued **Public Ruling 1/2004** on **INCOME FROM LETTING OF REAL PROPERTY** which sheds some light on:

- the treatment of rent as a non-business source of income under s 4(d) of the Income Tax Act 1967;
- the situations or circumstances where rent or income from the letting of property can be treated as business income of a person under s 4(a) of the Act; and
- how all properties of a person are to be grouped in several categories in computing the statutory income under s 4(d) of the Act.

Guidance on when rental income can be construed to be part of the main business source can be obtained from the ruling which states that:

"Where a building is used for the purpose of a business and part of the building is sublet, the rent arising from the subletting is treated as part of the existing business source."

Tax treatment

No adjustment is needed to profit before tax

Example
Summer College, which is involved in the education business, usually has excess space during its semester breaks and frequently rents them out for short periods to trainers requiring a suitable venue for conducting their courses.

The rental received would be deemed to be part of the education business of the college.

The main purpose of the Ruling was to clarify the circumstances when rental income can be construed to be business income. It states:

"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 s 4(a)."

A person includes a company, co-operative society, partnership, club, association, Hindu joint family, trust, estate and individual, but excludes a unit trust.

The Ruling defines "ancillary or support services/facilities" to mean the inclusion of some or all of the following:
- security guard service;
- air-conditioning (centralised or split units);
- supply of hot water; escalators and/or lifts;

- recreational facilities (clubhouse, gymnasium, tennis/squash/badminton courts, swimming pool, etc.);
- cleaning or housekeeping (including garbage disposal);
- maintenance of common property, garden, landscaping, exterior lighting and other external fixtures.

However, it also clarifies that 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.

This is illustrated through an example in the Ruling as reproduced below:

Example
An individual owns an apartment complex consisting of 24 units (located in 2 blocks of 3 storeys each) and lets out individual units to tenants on both short and long term tenancies. The lifts that are provided for access to the upper floors are maintained by the owner. Security is provided on a 24-hour basis by a security firm hired by the owner. Housekeeping service is provided optionally at an additional charge; a maid is employed by the owner for this purpose.

The letting of the apartment units can be treated as a business source of the individual since the services and facilities are actively provided.

However, for companies (excluding investment holding companies and companies limited by guarantee which is taxed as a club or association) the Ruling provides a special "quantitative test" to determine whether the rental income is a business source. This is summarised as follows:

• Commercial complex • Office complex • Shopping complex • Factory or • warehouse	1 unit

• Commercial unit
  • Unit in office complex
  • Floor / unit in shophouse with separate strata title
• Shophouse
• Residential property
• Mixture of properties
	4 unit

For companies, to ensure that the letting of property to or occupation of property by, related or connected person can be taken into account for determining eligibility under the quantitative test, the following conditions must be fulfilled:

- there is payment of rent by the related or connected person(s); and
- the amount of that rent is not significantly less than the market rate.

Market rate is defined as 70% of the economic rent or the rent payable if the lease or tenancy or occupation of the premise had been negotiated by independent parties.
Example

Winter Sdn Bhd owns 4 bungalows, 3 of which is rented out to unrelated parties for RM4,000 per month and the fourth is rented to the Managing Director of the company. The rental is regarded as a business source for Winter Sdn Bhd if the Managing Director pays a monthly rental of at least RM2,800 (i.e. 70% of RM4,000).

Tax treatment

The rental income should be deducted from the profit before tax in arriving at the adjusted income but the statutory income from the rental business should be added back in arriving at aggregate statutory income from business.

Candidates should be able to download a copy of the Ruling from the IRB website.

Where the conditions for rental income to qualify as business income is NOT fulfilled, it will be regarded as a non–business source

Tax treatment
The rental income should be deducted from the profit before tax in arriving at the adjusted income but should be added back in arriving at aggregate income.

This concludes the discussion of business receipts. The next article, shall dicuss on business deductions. TG

Further Reading

- Choong, K.F. Malaysian Taxation Principles and Practice, (Latest Edition) Infoworld,
- Kasipillai, J. (2009) "A Comprehensive Guide to Malaysian Taxation under Self Assessment", (Latest 4th Edition), McGraw Hill.
- Malaysian Master Tax Guide, (2008) CCH Asia Pte. Ltd
- Singh, Veerinderjeet; Veerinder on Taxation (latest edition) Arah Pendidikan Sdn Bhd
- Thornton, Richard. Thornton's Malaysian Tax Commentaries, (Latest Edition) Sweet & Maxwell, Asia.
- Thornton, Richard. Richard Thornton: 100 Ways to Save Tax in Malaysia for Small Businesses (latest edition) Sweet & Maxwell Asia
- Yeo, Miow Cheng Alan. Malaysian Taxation, (Latest Edition), PAAC Sdn Bhd

__Siva Subramanian__ Nair is a freelance lecturer preparing students for the professional examinations of the ACCA, MICPA and AIA and undergraduates of degree programmes in both local and foreign universities. He is an examiner for one of the professional bodies in Malaysia and a member of the marking team for the Advanced Taxation paper for the ACCA examination. He can be contacted at sivanair@tm.net.my.

Notice Board

Extension of time for submission of 2008/2009 income tax returns

The deadline for the submission of Form C and Form R have been extended to companies in the following financial year end:

Year of assessment	Financial year end	Extended deadline
2008	31 December 2008	14 August 2009
2009	31 January 2009	14 September 2009

Any balance of tax payable in respect of the above year of assessment must be paid by the extended deadline.

Extension of time for submission of 2008 employers' returns

Employers are allowed time up to 31 March 2009 to submit the 2008 employers' return (Form E).

Note that an employer who has received the Form E must complete and file the Form on or before the due date, even if it is dormant, under liquidation or has no employees. Employers must inform the IRB if they are no longer active or are under liquidation so that the IRB can update its records accordingly.

Filing of tax returns in PDF format

Thee IRB has notified that with effect from YA 2008, tax agents are **not** allowed to use tax return Forms **B, BE, M, E, P, TP, TF** and **TJ** in PDF format for filing purposes.

For **Forms C, R, C1, TA** and **TC,** filing in PDF format is still acceptable for YA 2008. However, tax agents are advised to use e-filing or manual filing through original printed tax return forms as far as possible. This is because many of the PDF forms returned cannot be scanned by the IRB and this has created an administration burden at the IRB. Note with effect from YA 2009, the filing of these forms in PDF format will not be accepted by the IRB. Members are advised to prepare themselves for this change.

New Revenue Stamp

A new revenue stamp has been introduced effective from 1 February 2009 for the purpose of stamp duty payment. The old revenue stamp may still be used until 31 July 2009.

2009 Schedular Tax Deductions (STD) and "Kalkulator PCB"

Pursuant to the 2009 Budget proposals, the IRB has issued a new STD schedule, which is applicable to 2009 remuneration. Bonus and directors' fees paid in 2009 must also be based on the new 2009 schedule.
For prior year remuneration paid in 2009, the old STD tables (issued in 2004) should be used.

As a concession, employers with a large number of employees and/or using computerised payroll systems, may apply in writing to the relevant IRB branches handling their files, to continue using the old STD tables until March 2009.

In developing the new STD schedule, efforts have been taken to ensure a more accurate deduction to closely reflect the actual tax liability. Various reliefs enjoyed by the individual are now included as a factor in arriving at the deduction. Consequently, the new computation formulae may appear to be more complicated. Members are advised to read the explanatory notes carefully and familiarise themselves with the new STD rules. The explanatory notes are available at the IRB website (http://eapps.hasil.gov.mypcbcalc/nota_penerangan_jadual_PCB_2009.PDF).

To assist employers and tax practitioners in computing the deduction, the IRB has made available the "Kalkulator PCB" on its website (http://eapps.hasil.gov.my/pcbcalc/).

Employers who agree with an employee's request to claim allowable deductions and rebates under the ITA should use the Kalkulator PCB to ascertain the amount of STD. Employers using their own computerised payroll systems must obtain specification of the STD computerised calculation method and approval from the IRB. TG

CTIM Professional Examination Question & Answer Booklet Order Form

CHARTERED TAX INSTITUTE OF MALAYSIA

Unit B-13-2, Block B, 13th Floor, Megan Avenue II, No.12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur Tel: 03-2162 8989 Fax: 03-2162 8990
Email: examination@mit.org.my Website: www.mit.org.my

Full Name Mr/Mrs/Ms : ______________________ Contact No.: ______________________

Student Registration No./Membership No. ______________________ Email: ______________________

Mailing Address : ______________________
(Please do not use P.O.Box address)

____

MIT REGISTERED STUDENTS & CTIM MEMBERS ONLY

Year	Cost/Level		
	Level 1	Level II	Level III
2008 Examination Booklet	RM10.00	RM12.00	RM15.00
2007 Examination Booklet	RM10.00	RM12.00	RM15.00
2006 Examination Booklet	RM10.00	RM12.00	RM15.00
2005 Examination Booklet	RM10.00	RM12.00	RM15.00
2004 Examination Booklet	RM10.00	RM12.00	RM15.00
2003 Examination Booklet	RM10.00	RM12.00	RM15.00
2002 Examination Booklet	RM10.00	RM12.00	RM15.00
2001 Examination Booklet	RM10.00	RM12.00	RM15.00
2000 Examination Booklet	RM10.00	RM12.00	RM15.00
1999 Examination Booklet	RM10.00	RM12.00	RM15.00
1998 Examination Booklet	RM10.00	RM12.00	RM15.00
1997 Examination Booklet	RM10.00	RM12.00	RM15.00
1996 Examination Booklet	RM10.00	RM12.00	RM15.00
1995 Examination Booklet	RM10.00	RM12.00	RM15.00
Pilot Papers Booklet	RM10.00	RM12.00	RM15.00

NON-MIT REGISTERED STUDENTS & NON-CTIM MEMBERS ONLY

Year	Cost/Level		
	Level 1	Level II	Level III
2008 Examination Booklet	RM14.00	RM15.00	RM22.00
2007 Examination Booklet	RM14.00	RM15.00	RM22.00
2006 Examination Booklet	RM14.00	RM15.00	RM22.00
2005 Examination Booklet	RM14.00	RM15.00	RM22.00
2004 Examination Booklet	RM14.00	RM15.00	RM22.00
2003 Examination Booklet	RM14.00	RM15.00	RM22.00
2002 Examination Booklet	RM14.00	RM15.00	RM22.00
2001 Examination Booklet	RM14.00	RM15.00	RM22.00
2000 Examination Booklet	RM14.00	RM15.00	RM22.00
1999 Examination Booklet	RM14.00	RM15.00	RM22.00
1998 Examination Booklet	RM14.00	RM15.00	RM22.00
1997 Examination Booklet	RM14.00	RM15.00	RM22.00
1996 Examination Booklet	RM14.00	RM15.00	RM22.00
1995 Examination Booklet	RM14.00	RM15.00	RM22.00
Pilot Papers Booklet	RM14.00	RM15.00	RM22.00

I enclose Cheque/Draft/PO/MO no.____________ Bank ____________for RM ____________ payable to **Chartered Tax Institute of Malaysia.**
(Please include bank charges of RM0.50 for outstation cheque)

Please tick one only: To be collected by hand at MIT office ☐ Delivery by courier ☐
(Please include courier charges : West Malaysia - RM15.00, East Malaysia - RM20.00)

Signature: ______________________ Date: ______________________

de Little Studio

from concept to production

Welcome to the world of de Little Studio. We have over 6 years of experience in innovative and customised design and printing solutions.

Every idea & concept can be actualised as a vehicle to express an organisation's purpose, identity or to show the world what it is capable of.

Working with us, you can be assured that the initial process of listening and capturing our clients' words and thoughts is of utmost importance. An effective design is one that actualises your business objectives while fulfilling its purpose and application.

There is much power in imagination. Allow us to actualise your dreams and ideas, to empower your business.

Our areas of design & printing solutions:

- brochure
- booklet
- flyer
- annual report
- letterhead
- logo
- banner
- backdrop
- name card
- booklet
- poster
- lettershopping

Special promotion for MIT members, call us now to enjoy 15% discount on your first design & printing order now!

Promotion valid until 30th June 2009

de Little Studio (001546342-A)

49A, 1st Floor, Jalan USJ 10/1G, 47620 Subang Jaya Selangor.
direct 03.5632.4310 fax 03.5632.4310
jess 012.316.0632 tommy 012.570.7700
de.littlestudio@gmail.com