CHARTERED TAX INSTITUTE OF MALAYSIA (225750 T)
(Institut Percukaian Malaysia)

PROFESSIONAL EXAMINATIONS

FINAL LEVEL

# ADVANCED TAXATION 1

DECEMBER 2016

| | | | |
|---|---|---|---|
| **Student Registration No.** | | **Date** | |
| **Desk No.** | | **Examination Centre** | |

**Time allowed: 3 hours**

## INSTRUCTIONS TO CANDIDATES

1. You may answer this paper **EITHER** in English **OR** in Bahasa Malaysia. Only **ONE** language is to be used.
2. This paper consists of **SIX** questions. **Candidates are ONLY REQUIRED TO ANSWER <u>FIVE</u> QUESTIONS**
3. The Income Tax Act 1967 (as amended) is referred to as ITA.
4. Each answer should begin on a separate answer booklet.
5. All workings **MUST** be shown as marks will be awarded.
6. Answers should be written in either black or blue ink.
7. No question paper or answer booklets are to be removed from the examination hall.

***DO NOT TURN OVER THIS PAGE UNTIL INSTRUCTED BY THE INVIGILATOR***

**Question 1**

HL Sdn Bhd carries on a leasing business and it entered into the following leasing agreements.

A sale and leaseback arrangement for Asset X started in year 2015 for a lease period of 60 months with rental payments of RM2,250 per month. The cost of the asset was RM80,100. The lessee, who has previously used Asset X, incurred balancing charge from the sale of the asset to HL. Finance income for 2016 for this lease is RM15,300. Lease rental received for year 2016 is RM24,750, i.e. the lessee have not paid the lease rental for December 2016 of RM2,250.

HL Sdn Bhd entered into two more leasing arrangements in 2016 for Assets Y and Z. The monthly lease rental for Assets Y and Z are RM2,700 and RM3,150 per month. In 2016, the number of monthly rental for lease of Asset Y is 6 months and the lease for Asset Z is 4 months. The cost for Asset Y is RM115,560 while Asset Z costs RM87,600. Asset Y is installed in the lessee's premises and cannot be used by any other person without altering or dismantling it. The lease of Asset Z is classified as a finance lease by the lessee company under MFRS 117 *Leases*, but this lease is not required by the Regulation to be treated as a sale agreement. The income for this lease (i.e. finance income) amounting to RM10,044 for the year 2016 has been recognized in the profit and loss statement. Finance income from the lease of Asset Y is RM12,510. Lease rentals received in 2016 are RM16,200 and RM12,600 for Assets Y and Z respectively. There were no lease rental accrued for 2016 for both leasing arrangements.

In the year of assessment 2016, HL Sdn Bhd's profit before taxation is RM20,744. Included therein are common expenses (excluding depreciation and donation) of RM4,000, depreciation of RM28,000 and donation of RM500.

The company does not recognize arrears of rental for accounting purposes.

Each leased asset qualifies for annual allowance at 14%. Capital allowance for leasing and non-leasing business for the year of assessment 2016 amounted to RM13,900. Unabsorbed business loss brought forward is RM1,299. There were no unabsorbed capital allowances from prior years.

**Required:**

**(a) Based on the three leasing agreements that HL has entered into above, explain whether these lease agreements are deemed as leasing or non-leasing business for income tax purposes.**

(6 marks)

**(b) Identify the recognition of income for tax purposes and eligibility for HL Sdn Bhd to claim capital allowances for the lease of asset Z.**

(2 marks)

**(c) Calculate the chargeable income for HL Sdn Bhd. Please show all necessary calculations.**

(12 marks)

**[Total: 20 marks]**

**Question 2**

(a) Yamuna Can Manufacturing Sdn Bhd ('the company') manufactures tin cans and closes its accounts to 30 June each year. The company is a resident in Malaysia for the purposes of the Income Tax Act 1967 (as amended) and was incorporated in May 2007 with a paid up capital of RM10 million. It operates from a factory in Bangi, producing a mix of promoted and non-promoted products.

At a recent Board of Directors meeting ('the Board'), the company considered applying for investment tax allowance commencing from the year of assessment 2017 in respect of its promoted products. No decision was made at that meeting but the Board had directed its Financial Controller to look into the matter and advise the Board, at the next meeting to be held in the following month.

The Financial Controller has called you for a discussion and had indicated that based on available information for the basis period for the years of assessment 2017 and 2018, the projected additional capital expenditure on plant and machinery, the adjusted income/(loss) and allowances in respect of the promoted and the non-promoted products are as follows:

**Table 1**
**Yamuna Can Manufacturing Sdn Bhd: Promoted product**

| **Year of assessment** | **2017** | **2018** |
|---|---:|---:|
| **Particulars** | **RM** | **RM** |
| Adjusted Income/(Loss) | (503,316) | 1,661,400 |
| Capital Allowances | 126,641 | 221,520 |
| Capital expenditure qualifying for Investment Tax Allowance | 799,500 | 1,105,000 |

**Table 2**
**Yamuna Can Manufacturing Sdn Bhd: Non-promoted product**

| **Year of assessment** | **2017** | **2018** |
|---|---:|---:|
| **Particulars** | **RM** | **RM** |
| Adjusted Income/(loss) | 1,136,520 | (166,140) |
| Capital Allowances | 194,832 | 92,300 |
| Unabsorbed business loss b/f | (243,540) | 0 |

**Required:**

**(i) The Financial Controller has requested you to determine the chargeable income of Yamuna Can Manufacturing Sdn Bhd for the years of assessment 2017 and 2018 on the assumption that Investment Tax Allowance is claimed for the said years of assessment.**

**Note:** The investment tax allowance is 60% of the qualifying capital expenditure to be allowed against 70% of the statutory income.

(10 marks)

(b) Ravi Manufacturing Sdn Bhd ('the company') is a Malaysian resident company incorporated in 2009, and closes its accounts to 31 December each year. The company plans to obtain pioneer status for the manufacture of an approved product in Petaling Jaya for a period of 5 years starting from 1 January 2017. The company's projected adjusted income/(loss), capital expenditure and capital allowance information are as follows:

| Year Ended 31 Dec | Land | Factory | Plant and Machinery | Furniture | Capital allowance | Adjusted income /(loss) |
|---|---|---|---|---|---|---|
| | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 | RM'000 |
| 2017 | 11,470 | 11,470 | 17,205 | 570 | 8,000 | (14,900) |
| 2018 | 0 | 12,000 | 11,400 | 3,400 | 8,000 | (8,000) |
| 2019 | 0 | 2,300 | 0 | 0 | 12,600 | 24,000 |
| 2020 | 0 | 0 | 6,900 | 3,500 | 14,900 | 51,000 |
| 2021 | 0 | 0 | 0 | 0 | 12,700 | 32,000 |

**Required:**

**Compute the statutory income, chargeable income, capital allowance and the pioneer exempt account for the relevant years of assessment.**

**Note:**

a) Assume that there will be no change in the tax law during the relevant years of assessment; and

b) The income to be exempted under the pioneer status is 70% of the statutory income derived from the production of the approved product.

(10 marks)

**[Total: 20 marks]**

**Question 3**

**(a)** **State the income tax provisions and briefly explain how the residence status of a club is determined under the Income Tax Act 1967.**

(3 marks)

**(b)** One Damansara Recreation Club (ODRC) was primarily formed for social, recreational, sports and leisure pursuits for the benefit of its members. ODRC submitted to the tax authorities the following income and expenditure accounts for year ended 31 December 2016:

| **Total Receipts** | **RM** | **Total Expenditure** | **RM** |
|---|---|---|---|
| Member's subscription fees | 214,000 | Rental of hall (seminars) | 72,000 |
| Seminar fees for non-members | 124,000 | Salaries to staff | 306,000 |
| Interest Income (fixed deposits) | 94,000 | Administration and stationery items | 24,000 |
| | | Utilities | 8,000 |
| Sales of souvenirs | 15,000 | Cost of souvenirs | 9,000 |
| | | Transport for workers | 11,000 |
| | | Repairs | 12,000 |
| | | Excess of income over expenditure | 5,000 |
| **Total** | **447,000** | **Total** | **447,000** |

ODRC's expenditure records related to transactions with members, non-members and common expenses during the year ended 31 December 2016 are:

| **Expenditure** | **Expenses in relation to transactions with members** | **Expenses in relation to transactions with non-members** | **Expenses common to both members and non-members** |
|---|---|---|---|
| | **RM** | **RM** | **RM** |
| Salaries to staff | Nil | Nil | 306,000 |
| Rental of hall (seminars) | Nil | 72,000 | Nil |
| Administration and stationery items | Nil | Nil | 24,000 |
| Transport for workers | Nil | Nil | 11,000 |
| Utilities | Nil | Nil | 8,000 |
| Repairs | Nil | Nil | 12,000 |
| Cost of souvenirs | Nil | Nil | 9,000 |
| **Total** | **Nil** | **72,000** | **370,000** |

The gross receipts of ODRC are as follows:

| **Receipts** | **Mutual Receipts RM** | **Non-Mutual Receipts RM** |
|---|---|---|
| Members' subscription fees | 214,000 | Nil |
| Seminar fees (Non-members) | Nil | 124,000 |
| Interest income (fixed deposits) | Nil | 94,000 |
| Sale of souvenirs | 8,000 | 7,000 |
| **Total** | **222,000** | **225,000** |

**Required:**

**Compute the taxable income of ODRC for the year of assessment 2016.**

(13 marks)

(c) The income and expenditure accounts of AS Club for the year ended 31.12.2016 shows the expenditure exceeds the receipts from mutual transactions resulting in members' of AS Club incurring a loss of RM12,000. However, the receipts of AS Club exceeded expenses from non-mutual transactions with non-members resulting in a surplus of RM18,000. The club has a net profit of RM6,000.

**Required:**

**In respect of the above income and expenditure accounts of AS Club, outline the tax treatment of the losses incurred by AS Club as a result of transactions with members under the Income Tax Act 1967.**

(4 marks)

**[Total: 20 marks]**

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**Question 4**

(a) Mr Ravi and Mr Song are partners in a plastic manufacturing firm, RS Plastic Manufacturing Enterprise. The firm was registered on 1 January 2007 and was actively engaged in the manufacturing of plastic bins. In June 2012, Mr Song decided to follow his children and settled down in Singapore. The partnership was accordingly dissolved on 10 August 2012, and Mr Ravi received the land and the factory upon the dissolution. The land and the factory were originally acquired by the partnership on 1 October 2007 for RM800,000.

Mr Ravi continued with the manufacturing business but on 10 November 2013, on the advice of his accountant, he transferred the land and the building to a limited company, Ravi Corporation Sdn Bhd ('the company') in which he had a controlling interest, for RM3 million which was accepted as the market value for the purposes of the transaction. The consideration was satisfied by the issue for 2.6 million shares of RM1.00 each and the balance of RM400,000 was settled in cash.

The company extended the factory building at a cost of RM1 million after its acquisition. In August 2015 Mr Ravi sold off his shares in the company that was received for the transfer of the land and building, for RM6 million to a third party.

The company continued the manufacturing business until its sale to another unrelated company for RM8 million on 15 November 2015. In disposing the land and building, the company incurred RM150,000 valuation fees and RM70,000 legal fees.

**Required:**

**Compute the real property gains tax payable under the Real Property Gains Tax Act 1976 (as amended) in respect of the following:**

**(i) Disposal by Mr Ravi**
**(ii) Disposal by Ravi Corporation Sdn Bhd**

(14 marks)

(b) Mr Anand has two properties. The first property, a double storey house, was acquired on 1 May 2002 for RM200,000. A year after the acquisition Mr Anand extended the porch for RM30,000 to park an additional car.

In 2014 Mr Anand purchased the second property, a condominium for RM400,000 and spent RM100,000 to renovate the balcony and the hall.

In October 2016 he decided to give the properties to his two children: the first child received the double storey house (which is now valued at RM600,000 in the market), and the second child received the condominium (which is now valued at RM700,000 in the market).

**Required:**

**For the purposes of the Real Property Gains Tax 1976 (as amended), what is the implication of the gift for Mr Anand and his two children?**

(6 marks)
**[Total: 20 marks]**

**Question 5**

(a) With references made to the Income Tax Act 1967 (as amended) and the Inland Revenue Board's guidelines, explain the taxability of charitable institutions in Malaysia.

(4 marks)

(b) Yayasan Harapan Malaysia is a company limited by guarantee incorporated in Malaysia, focusing on providing deaf and hearing impaired individuals in Malaysia to reach their listening and speech potential and help them to integrate into their local community. This organization is exempted under Section 44(6) of the Income Tax Act 1967 (as amended).

**Statement of Profit or Loss for the financial year ended 31 September 2016**

| **Income** | **Note** | **RM** | **RM** |
|---|---|---|---|
| Interest received from fixed deposits with licensed Malaysian banks | | 3,000 | |
| Donations and contributions | | 12,000 | |
| Malaysian dividends | | 2,000 | |
| Sale of goods | 1 | 1,500 | |
| Profit from coffee shop | 2 | 1,700 | 20,200 |
| | | | |
| **Expenditure:** | | | |
| Administrative expenses | | 4,000 | |
| Grants to support projects | | 10,000 | |
| Cost of buying equipment, furniture& fittings for coffee shop | 2 | 4,000 | 18,000 |
| Surplus/(Deficit) | | | 2,200 |
| | | | |
| Accumulated funds at the beginning of the year | | | 47,200 |
| Accumulated funds at the end of the year | | | 49,400 |

**Notes:**

1) Sale of artwork are related to artwork that was produced by deaf individuals in the Yayasan.
2) The Coffee shop is run by the organisation and was open to the public in February 2016. The coffee shop plans to employ hearing impaired employees in the near future.

**Required:**

**By making specific references to the relevant sections in the Income Tax Act, explain the tax treatment for all of the income received by Yayasan Harapan Malaysia.**

(16 marks)

**[Total: 20 marks]**

**Question 6**

The Raintree Property Trust is a Malaysian Security Commission approved real estate investment trust (REIT) and closes its accounts to 30th June annually. It was incorporated in 2013 with a paid up capital of RM5 million. For the year ended 30 June 2016, the company's accountant has produced the following statement of accounts:

| **Raintree Property Trust<br>Statement of income for year ended 30 June 2016** | | |
|---|---|---|
| **Income** | | **RM'000** |
| Rent | | 493,423 |
| Dividends (single tier) | | 14,513 |
| Dividends (exempted) | | 8,708 |
| Interest from debentures (not exempted) | | 2,903 |
| Gains from realization of shares | | 28,300 |
| | **(a)** | 547,847 |
| **Expenses** | | |
| Interest charges | | |
| For acquisition of real property | | 50,794 |
| For acquisition of shares | | 6,241 |
| Quit rent and assessment | | 25,034 |
| Repairs and maintenance of property | | 40,780 |
| Depreciation | | 33,305 |
| Manager's fee - property management | | 24,765 |
| Entertainment | | 24,672 |
| Fire insurance on property | | 12,290 |
| Staff salaries | | 25,078 |
| Manager's remuneration | | 9,070 |
| Advertising | | 31,201 |
| Secretarial fee | | 2,903 |
| Maintenance of shareholder register | | 2,542 |
| Audit and accounting fees | | 5,804 |
| Tax agent fees | | 1,452 |
| Telephone, printing, stationery and postage | | 8,708 |
| Donation to an approved institution | | 5,000 |
| | **(b)** | 309,639 |
| **Net profits** | **(a-b)** | **238,208** |

The accountant has informed you that for the year of assessment 2016 the REIT is claiming a capital allowance of RM22,869. The Board of Directors is meeting shortly and is considering distributing to the unit holders the following amounts:

a) RM200,000 or
b) RM150,000.

This decision will be very much dependent on the company's cash flow position at the end of the financial year.

**Required:**

**Compute the chargeable income and the tax payable, if any, of the Raintree Property Trust for the year of assessment 2016, assuming the following situations:**

**(i)** **The amount distributed to the unit holders was RM200,000**

**(ii)** **The amount distributed to the unit holders was RM150,000**

**Note:** The applicable tax rate for the year of assessment 2016 is 24%.

**[Total: 20 marks]**

**(END OF QUESTION PAPER)**