



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

PROFESSIONAL EXAMINATIONS

FINAL LEVEL

ADVANCE TAXATION 2

DECEMBER 2015

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 FIVE 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

ABC Sdn Bhd ("ABC"), a shopping mall operator in Malaysia, has recently acquired a plot of land and intends to build a shopping mall on the said land. However, ABC has insufficient funds to construct the mall and has approached SSS Sdn Bhd ("SSS") for financial assistance.

SSS is a company incorporated in Malaysia, with a parent company in Japan, providing leasing and hire purchase services in Malaysia.

One of the viable options which ABC is considering is to have SSS provide property leasing services to ABC as a form of financing.

Under this financing option, ABC will enter into an agreement with SSS where ABC will sublease the land to SSS. SSS will then construct the mall as per ABC's requirements and lease the mall (land and constructed shopping mall) to ABC upon completion of the construction.

Under the agreement between ABC and SSS, the lease term is for 10 years. Upon the completion of the lease term, the land and the mall will be returned to ABC. SSS is agreeable to this as their role in this transaction is merely to provide finance. SSS will only assume the financial risk and rewards relating to the lease payments. SSS will not be assuming any risk pertaining to the property including the construction risk of the building. ABC will bear the risk of construction risk and obsolescence of the building. All the repairs, maintenance costs and the insurance are to be borne by ABC.

From accounting perspective, the lease transaction will be treated as a finance lease. An extract of the forecast annual lease payment and the profit and loss accounts of SSS in relation to the transaction are enclosed below:

Annual lease payment (RM'000)	(Year) Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10	Total
Interest portion	16,000	15,200	14,300	13,400	12,100	10,800	9,300	7,500	5,600	3,500	107,700
Principal portion	10,700	11,500	12,400	16,600	18,800	18,900	23,600	26,000	27,300	34,000	199,800
Lease payment	26,700	26,700	26,700	30,000	30,900	29,700	32,900	33,500	32,900	37,500	307,500

Profit and Loss: Accounting (RM'000)	(Year) Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10	Total
Finance lease charges	16,000	15,200	14,300	13,400	12,100	10,800	9,300	7,500	5,600	3,500	107,700
Expense	13,000	12,000	11,500	10,500	9,500	8,500	7,500	6,000	4,500	2,500	85,500
Profit before tax	29,000	27,200	25,800	23,900	21,600	19,300	16,800	13,500	10,100	6,000	193,200

In order to fund the construction of the mall, a loan will be given by SSS's parent company in Japan to SSS. A loan agreement will be entered into between SSS and the parent company in Malaysia and the monies would be used to construct the mall. SSS's parent company in Japan does not have any presence in Malaysia and is subject to Japan taxation rules.

Required

- (a) **Based on your knowledge of the Income Tax Leasing Regulations 1986 (“ITLR”), state your arguments as to whether the above transaction is a leasing transaction under ITLR. You may refer to the ITLR and section 36 and the Income Tax Act 1967 provided below.**

(2 marks)

INCOME TAX ACT 1967

INCOME TAX LEASING REGULATIONS 1986

In exercise of the powers conferred by section 36(1) of the Income Tax Act 1967, the Director General makes the following regulations:

1. These Regulations may be cited as **Income Tax Leasing Regulations 1986** and shall have effect for the year of assessment 1986 and subsequent years of assessment.
2. In ascertaining the gross income of a person from his business which consists of leasing transactions and other activities, the gross income from the lease transactions shall be deemed to be a separate and distinct business source from other activities of that person :

Provided that this regulation shall not apply to a bank licensed under the Banking Act 1973 or the Islamic Banking Act 1983 or a finance company licensed under the Finance Companies Act 1969, for the years of assessment up to and including the year of assessment 1990.

3. The total sum of rentals of a lease term receivable in respect of a lease shall be deemed to accrue evenly throughout the period of such lease term and the gross income of the lessor in respect of that lease for the basis period for a year of assessment shall be a portion which bears the same proportion to that total sum receivable as the number of days in the basis period for that year assessment that falls within the lease term bears to the total number of days of the lease term :

Provided that the full rentals receivable in the basis period for a year of assessment may be treated as the gross income of the lessor for the basis period for that year of assessment where the Director General considers such treatment to be just and reasonable in the circumstances.

4. For the purpose of these Regulations –

“**lease**” means any kind of agreement or arrangement under which payments are made for the use of an asset.

Provided that a lease agreement or arrangement shall be deemed to be a sale agreement where –

- (i) the lessee is given an option to purchase the asset during the lease term or upon expiry;
- (ii) the lessee is given the beneficial ownership of the asset;
- (iii) the lessee during the lease term or upon expiry of the lease term acquires directly or indirectly the asset otherwise than at its market value at the date of

- such acquisition;
- (iv) the asset is a special purpose asset;
 - (v) the lessee has claimed capital allowance in respect of the asset prior to the lease or
 - (vi) the lessee is given the right to sell or dispose of the asset and receives the proceeds or a portion of the proceeds from the sale;

“lease term” means –

- (i) the period for which the lessee has contracted to lease an asset; or
- (ii) where a lease arrangement has been terminated earlier than its expiry the actual period of the lease:

Provided that where the lessee exercises an option to continue to lease the asset such further term shall constitute a new lease term.

“special purpose asset” means a leased asset where no other user can use the same asset without making alterations or dismantling from a structure or land; and such special purpose asset shall be deemed to be a movable property for the purpose of section 36(1) of the Income Tax Act, 1967.

INCOME TAX ACT 1967

SECTION 36 - POWER TO DIRECT SPECIAL TREATMENT IN THE COMPUTATION OF BUSINESS INCOME IN CERTAIN CASES

Section 36(1) of the ITA states –

Notwithstanding any other provision of this Part, where the Director General is satisfied that there is a need for some treatment in computing-

(a) the gross income from a business with respect to-

- i. a hire-purchase transaction;
- ii. a transaction under which a debt is payable by instalments;
- iii. a lease transaction in respect of moveable property;
- iv. any other transaction involving a debt or stock in trade; or
- v. such other transaction as may be prescribed; and

(b) the adjusted income and statutory income from the business, he may give directions and formulate regulations to be published in the gazette for special treatment with respect to any such transaction, either in relation to a particular business or in relation to any business having any such transaction:

Provided that no such directions and regulations shall have effect in relation to a business for any year of assessment with respect to which an assessment wholly or partly relating to income from that business has become final and conclusive or is the subject of an appeal which has been sent forward to the Special Commissioners.

- (b) On the assumption that this lease is an operating lease from a tax perspective, discuss the relevant income tax implications to ABC Sdn Bhd and SSS Sdn Bhd should the lease arrangement occur. Ensure that your discussion includes:
- i. The treatment of the rental payable by ABC Sdn Bhd,
 - ii. Rental income received by SSS Sdn Bhd,
 - iii. Capital allowance claim on the property, and
 - iv. Deductibility of interest payment by SSS on the loan to SSS's parent company.
- (4 marks)
- (c) On the assumption that this transaction is treated as a financing transaction from a tax perspective, discuss the relevant income tax implications to ABC Sdn Bhd and SSS Sdn Bhd should the financing arrangement occur.

Your discussion could include any three of the following;

- i. The treatment of the finance charges payable by ABC Sdn Bhd,
 - ii. Capital allowance claim on the property,
 - iii. Finance income received by SSS Sdn Bhd, and
 - iv. Deductibility of interest payment on the loan to SSS's parent company.
- (3 marks)
- (d) SSS has approached you to be their tax advisor for the transaction above. They would like to explore with the Inland Revenue Board ("IRB") on whether the transaction can be treated as financing for tax purposes.

State which avenue under the Income Tax Act 1967 ("ITA") that this matter can be referred to the IRB and your justifications to the IRB to treat the transaction as a financing for tax purposes.

(4 marks)

- (e) In relation to the loan given by SSS Sdn Bhd's parent company, advise on any transfer pricing rules in which SSS Sdn Bhd needs to be mindful about.

Explain whether the interest paid by SSS to the Japanese parent company would be subject to any taxes in Malaysia.

(4 marks)

- (f) On the assumption that both ABC Sdn Bhd and SSS Sdn Bhd are registered for Goods and Services Tax ("GST") in Malaysia, **explain the GST treatment on the following transactions entered into by the two companies. State your assumptions (if any). You may base your answers in the following format:**

Transaction	GST Implications	
	ABC Sdn Bhd	SSS Sdn Bhd
1. Leasing of mall by SSS Sdn Bhd to ABC Sdn Bhd		
2. Sub-lease of land by ABC Sdn Bhd to SSS Sdn Bhd		
3. Interest paid by SSS Sdn Bhd to the Japanese parent company		

(3 marks)

[Total: 20 marks]

Question 2

- (a) **Discuss briefly the legal status of Double Taxations Agreement (DTA) in relation to the Income Tax Act, 1967 (as amended) for non-residents receiving income from Malaysia.** (5 marks)
- (b) **Explain briefly the objectives of Double Taxations Agreements** (3 marks)
- (c) **Explain briefly the significance of the concept of permanent establishment in relation to the determination of the tax liability on business income derived by a foreign enterprise of a treaty country from Malaysia.** (2 marks)
- (d) ABC Sdn Bhd is seeking technical consultancy support services from Watermark International Pte Ltd (Watermark), an Australian tax resident company. Watermark will send its employees to Malaysia to perform part of the consultancy services for a period of five months. The following payments will be made by ABC Sdn Bhd to Watermark.

Types of expenses	RM'000
Supply of parts	315
Consultancy services in Malaysia	400
Training in Malaysia	75

Required

- (i) **Explain whether Watermark International Pte Ltd has a permanent establishment in Malaysia** (4 marks)
- (ii) **Explain whether the three payments made are subject to withholding tax, and if so, state the withholding tax rate (Ignore the effect of double taxation agreement on the withholding tax rate)** (6 marks)

You are encouraged to use the excerpt from the **Australia and Malaysia DTA** that is provided in the next page, to answer Questions (d)(i) and (ii).

[Total: 20 marks]

Question 2 (Excerpt)

Excerpt from the Australia and Malaysia DTA on Article 5 Permanent establishment:

1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term "permanent establishment" shall include especially –
 - a) a place of management;
 - b) a branch;
 - c) an office;
 - d) a factory;
 - e) a workshop;
 - f) a mine, oil or gas well, quarry or any other place of extraction of natural resources including timber or other forest produce;
 - g) an agricultural, pastoral or forestry property;
 - h) A building site or construction, installation or assembly project which exists for more than six months.
3. An enterprise shall not be deemed to have a permanent establishment merely by reason of –
 - a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
 - b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
 - c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
 - d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;
 - e) The maintenance of a fixed place of business solely for the purpose of activities which have a preparatory or auxiliary character for the enterprise, such as advertising or scientific research.
4. An enterprise of one of the Contracting States shall be deemed to have a permanent establishment in the other Contracting State and to carry on business through that permanent establishment if –
 - a) it carries on supervisory activities in that other State for more than six months in connection with a building site, or a construction, installation or assembly project which is being undertaken in that other State;
 - b) substantial equipment is in that other State being used or installed by, for or under contract with, the enterprise; or

- c) it furnishes services, including consultancy services, in that other State through employees or other personnel engaged by the enterprise for such purpose, but only where those activities continue (for the same or a connected project) within the other State for a period or periods aggregating more than three months within any twelve-month period.
- 5. A person acting in one of the Contracting States on behalf of an enterprise of the other Contracting State (other than an agent of an independent status to whom paragraph 6 applies) shall be deemed to be a permanent establishment of that enterprise in the first-mentioned State if –
 - a) he has, and habitually exercises in that first-mentioned State, an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise; or
 - b) there is maintained in that first-mentioned State a stock of goods or merchandise belonging to the enterprise from which he habitually fills orders on behalf of the enterprise; or
 - c) In so acting, he manufactures or processes in that first-mentioned State for the enterprise goods or merchandise belonging to the enterprise.
- 6. An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where that person is acting in the ordinary course of his business as such a broker or agent

Question 3

Maju Technologies Sdn Bhd ('the company') is a Malaysian resident company engaged in the manufacture of diesel engine components for earth moving machines. The engine components qualify as a 'promoted product' for the purposes of the Promotion of Investments Act 1986 (as amended). The company closes the accounts to 31 December each year.

The company has provided the following information in respect of the years of assessment 2015-2019:

(i) **Estimates of capital expenditure:**

Year of assessment	2015	2016	2017	2018	2019
	RM'000	RM'000	RM'000	RM'000	RM'000
Land	2,100	0			
Factory and building	1,680	1,400			
Manufacturing staff quarters	2,240	0			
Plant and machinery	980	840	700	560	420

(ii) **Projected adjusted pioneer income:**

Year of assessment	2015	2016	2017	2018	2019
	RM'000	RM'000	RM'000	RM'000	RM'000
Projected adjusted pioneer income	420	700	980	1,260	1,400

The company's accountant has informed you that the company could qualify for either of two incentives: a pioneer status at 70% of the statutory income for five (5) years; or alternatively qualify for an investment tax allowance at 60% of the qualifying capital expenditure restricted to 70% of the statutory income of the relevant year of assessment commencing from the year of assessment 2015. He has further informed you that the capital allowance rates available are as follows:

Capital allowance rates	Initial Allowance (%)	Annual Allowance (%)
Plant and machinery	20	20
Factory and buildings	10	3

The company's Board of Directors are meeting next week and would like to know which of the two incentives to choose.

Required:

- Compute and determine the tax exempt income available to the company under the pioneer status incentive and the investment tax allowance incentive; and
- Based on your computation in (a) above, which incentive would you recommend to the company and why?

Note: Your computations should be rounded to the nearest RM1.00

[Total: 20 marks]

Question 4

Mr. T together with his family, owns 100% of A Bhd. A Bhd owns 100% of Two Sdn Bhd. Two Sdn Bhd owns a factory which it leases to Three Sdn Bhd. Three Sdn Bhd is a manufacturing company and is wholly owned by A Bhd.

A Bhd also owns 100% of Four Sdn Bhd. Four Sdn Bhd owns an office building which is used by the A Bhd group. Four Bhd also owns 90% of Five Sdn Bhd which has been awarded Multimedia Corridor Status (MSC). The remaining 10% of Five Sdn Bhd is owned directly by Mr. T.

Required:

- (a) (i) Mr. T informs you that in order to bring about greater efficiency, it is proposed that A Bhd will transfer the shares in Two Sdn Bhd to Three Sdn Bhd. The consideration for the transfer of shares remain as amount owing by Three Sdn Bhd to A Bhd.

Mr. T asks you to advise on the Income Tax, Real Property Gains Tax and Stamp Duty implications of this proposal. If there are reliefs or exemptions that might reduce any tax costs, you are required to identify these.

(10 marks)

- (ii) In relation to 1(a) above, Mr. T asks you to consider whether it would make any difference if Two Sdn Bhd transferred its factory building to Three Sdn Bhd rather than A Bhd transferring the shares in Two Sdn Bhd

(4 marks)

- (b) A Bhd has made a loan to Four Sdn Bhd. The proceeds are used by Four Sdn Bhd to make improvements to its office building and to subscribe for shares in Five Sdn Bhd. The loan is interest bearing.

Mr. T seeks your views on whether Four Sdn Bhd can claim a tax deduction for the interest expense.

(3 marks)

- (c) Three Sdn Bhd pays royalty and also technical fees to a related company incorporated and tax resident in Japan

Mr. T seeks your advise on whether the above amounts are subject to withholding tax. Mr. T also requires your advise on any Goods and Services Tax issues in relation to the above amounts.

(3 marks)

[Total: 20 marks]

Question 5

- (a) Mr Ray Ken was a qualified Malaysian lawyer practising in UK. He is a criminal law expert, but unfortunately he was charged and convicted for the murder of one of his prominent clients. He was jailed in UK for 25 years and was released in late 2013.

Upon his release on return to Malaysia, a UK newspaper offered him RM2 million for a series of newspaper articles for the events led him to involved in the murder. He will be paid RM500,000 upon signing the contract for the story, RM1 million upon completion of the draft and the balance RM500,000 upon the first publication of the serial. The newspaper will provide Ray with all the guidance to write the story.

All the payments were made during the year 2014. Ray had not been engaged in any literary venture before this particular deal and does not plan to engage in any writing effort in the future. He has no copyright interest in the deal and the newspaper company is free to use the story in any way they want.

The IRB of Malaysia had issued an assessment to Ray taxing the sums received. Ray is contemplating to appeal.

Required:

Provide an argument for the IRB of Malaysia for taxing the sum of RM2 million; and provide an alternative argument for Mr Ray that the sum is not liable under the ITA 1967 (as amended). You should quote relevant provisions of the law and cite cases where appropriate.

(8 marks)

- (b) There are many instances where Malaysian taxation taxpayers in general will want to pay less tax if an opportunity arise.

Required:

- (i) **Briefly explain the difference between tax evasion, tax avoidance, tax planning, and tax mitigation, while providing one clear example for each activity.**

(8 marks)

- (ii) **With reference to the general anti-avoidance provisions in the Income Tax Act in Malaysia, discuss the relevant provisions and principles with regards to the above issues.**

(4 marks)

[Total: 20 marks]

Question 6

- (a) **What are the conditions required for a business entity to be registered under the Goods and Services Tax (“GST”) Act 2015 in Malaysia?**
(4 marks)
- (b) **What is the GST standard rate for taxable supplies of goods and services in Malaysia?**
(1 mark)
- (c) **State the GST treatment for each of the following supplies as to whether it is standard rated, zero rated, exempt or out of scope.**
- (i) Tuition fees charged by a university
 - (ii) Sale of new motorcar by an authorised dealer
 - (iii) Rental of space in a shopping complex
 - (iv) Sale of chocolates to a tourist in Langkawi
 - (v) Accountancy fees charged by you to a company
 - (vi) Loan processing fee charged by a bank
 - (vii) Toll charges
 - (viii) Sale of fresh vegetables to a hypermarket
 - (ix) Manufacturer of dining tables sending two tables to its directors’ homes
 - (x) Export of goods
- (10 marks)
- (d) **What is the maximum amount of input tax that can be claimed as input tax credit, if a registered person holds a simplified tax invoice?**
(2 marks)
- (e) **Describe two (2) powers of a customs officer with regards to ascertaining the customs duty leviable on dutiable goods.**
(2 marks)
- (f) **An audit by a customs officer revealed that the payment of customs duties was insufficient. State the time limit available for the Customs department to demand payment from the person who is liable to pay the deficiency.**
(1 mark)

[Total: 20 marks]

(END OF QUESTION PAPER)