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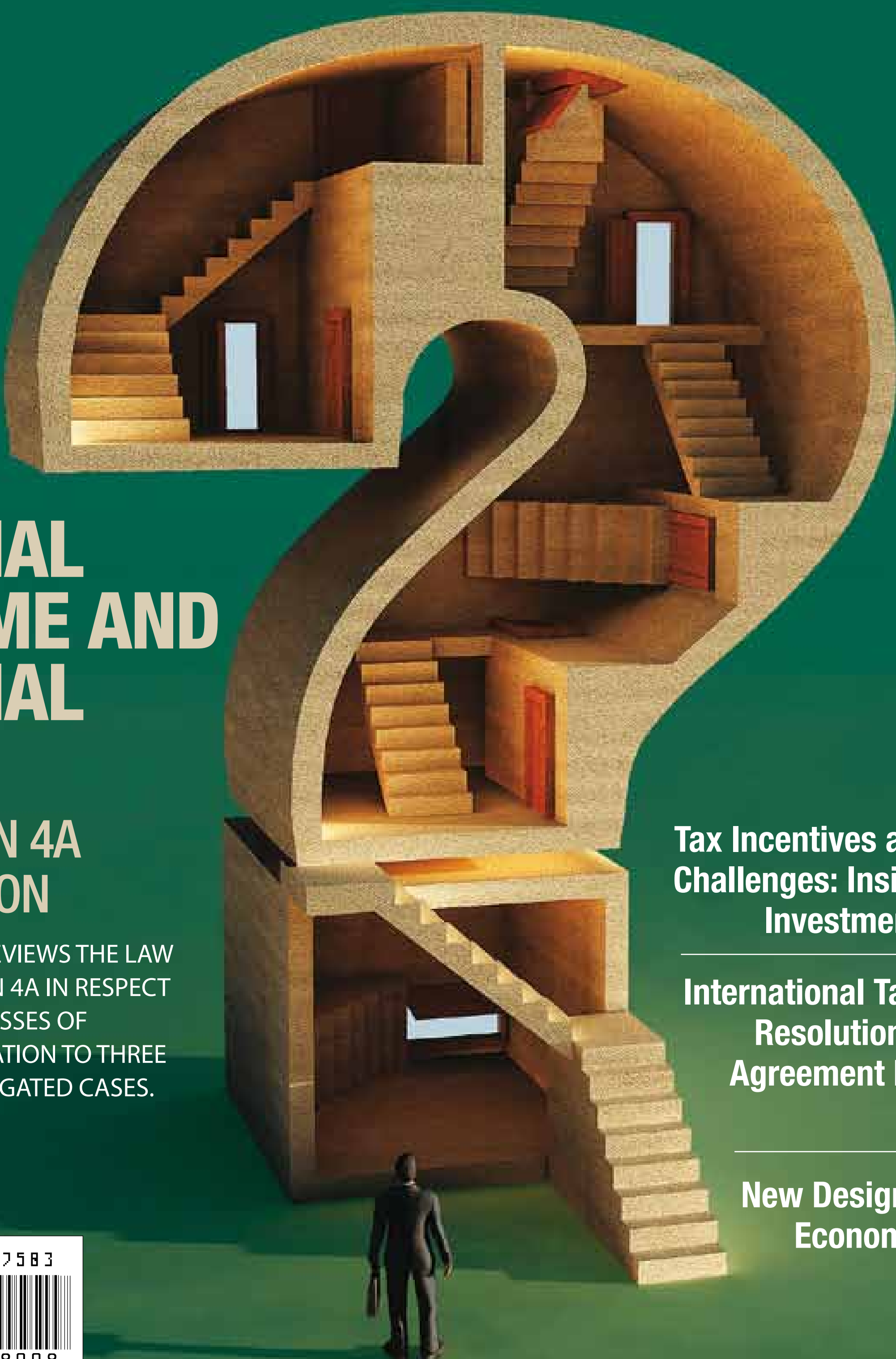

SPECIAL INCOME AND SPECIAL LAWS

- SECTION 4A CONFUSION

THIS ARTICLE REVIEWS THE LAW UNDER SECTION 4A IN RESPECT OF SPECIAL CLASSES OF INCOME IN RELATION TO THREE IMPORTANT LITIGATED CASES.

Tax Incentives and Future Challenges: Inside MIDA's Investment Agenda

International Tax Dispute Resolution – Mutual Agreement Procedure Route

New Design for CTIM Economics Paper

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The Chartered Tax Institute of Malaysia (CTIM) is a company limited by guarantee incorporated on 1 October 1991 under Section 16(4) of the Companies Act 1965. The Institute's mission is to be the premier body providing effective institutional support to members and promoting convergence of interest with government, using taxation as a tool for the nation's economic advancement and to attain the highest standard of technical and professional competency in revenue law and practice supported by an effective Secretariat.

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contents

Tax Guardian

VOL.7/NO.3/2014/Q3
JULY 2014

55

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INVITATION TO WRITE

The Institute welcomes original contributions which are of interest to tax professionals, lawyers, academicians and students. They may cover local or international tax developments. Article contributions should be written in UK English. All articles should be between 2,500 to 3,500 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.

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From the President's Desk

SM THANNEERMALAI

This issue will be the final issue that I will be writing to members as President of the Institute as I will be stepping down during the forthcoming Annual General Meeting (AGM) on 14 June 2014 after serving the Institute as President for three terms. After the AGM, the Council Members will elect a new President and Deputy President to serve the 2014/2015 term of office at the first Council meeting for the year.

On this note, I would like to congratulate in advance the new President and Deputy President on their appointments and wish them all the best and success in carrying out their duties for the Institute. They will have their work cut out for them in serving the members that will require a great deal of personal sacrifice and time.

Since I took over as President, the Institute has grown financially stronger in that accumulated funds have grown to RM5.2 million (2013) from RM3.8 million (2011) with an addition of a new adjacent office space increasing our office space from approximately 3,000 sq ft to 5,000 sq ft. The new office has enabled the Institute to provide a training room for CPD workshops to be held and additional space for new staff to cope with the expansion and a new resource centre.

Taking the profile of our members into consideration, the Institute had increased and improved its technical support to members by issuing almost daily technical eCTIMs with the help of additional technical support staff. The *Tax Guardian*, the only specialised tax journal in Malaysia had its content recently refocused on tax technical areas only with some news on the Institute activities. The *Tax Guardian* has become a tax reference point and authority for many members. We have also varied the range and content of the Institute's CPD activities to take account of current developments. On this aspect, the Institute had arranged for two GST training courses held in 2012/2013 and to date to be held for 2014, four GST training courses with speakers from the Royal Malaysian Customs (RMC). More than 1,000 participants have joined these six GST training courses organised by CTIM. We are planning to have another six GST training courses organised for this year in various locations commencing from August 2014. I would encourage all members to participate in these training courses to give you a working knowledge of the forthcoming implementation of GST. We also recently conducted a one day GST seminar by various CTIM speakers giving participants a flavour and overview of GST and are planning for more such events.

For members who are interested in becoming GST tax agents, we were informed by the authorities that you will have to be a member of a recognised professional body like CTIM, go through this six day GST training course and pass the one day examination. Do note that members have been advised through our recent eCTIM that the GST registration at the RMC Department website has been opened from 1 June 2014. Please advise your clients to register as early as possible to avoid the last minute rush. The registration for GST tax agents will also be opened before the end of June for those who qualify. Let us join the RMC in making the implementation of GST in Malaysia a resounding success.

In May, the Institute organised a one day IRBM CEO Luncheon talk whereby the IRBM CEO Tan Sri Dr. Mohd Shukor Hj. Mahfar gave his presentation on the future direction of IRBM that was attended by almost all his senior IRB officers. Members of the Institute were able to mingle and network with the IRBM senior officers. This event provided the opportunity for CTIM and IRBM to build on their mutual relationship and emphasis that CTIM is a partner to IRBM in nurturing and building the tax profession that plays an important role in nation building. Also in May, I led a CTIM delegation in paying a courtesy visit to the Director-General of Customs, Dato' Sri Khazali Bin Haji Ahmad to strengthen the bond between the RMC and CTIM especially now with the forthcoming implementation of GST. Members may be interested to know that CTIM is the main professional body that had been consistently giving feedback and support to the authorities on the GST Bill and the various guides that have been issued to date. The Institute intends to play a major role in raising the various issues that will arise as the GST regulations and more GST guides are issued in the coming months.

My ability to lead this Institute would not have been possible without the full support of my Deputy President, Mr. Peter Lim Thiam Kee and all the Council Members who gave up their precious time and gave their full committed effort to lead the various Committees and participate in the activities of the Institute. My utmost thanks and appreciation to all the Council Members. My thanks also to the staff of the Secretariat who have had to put up with all my demands and that of my fellow Council Members.

Last but most importantly, I would like to thank all members who have supported the Institute in their own way by participating in activities, responding to requests for feedback and attending the various CPD events. The Institute represents and reflects its membership. I am grateful to have had this opportunity to serve and be part of this esteemed premier body.

Editor'sNote

K. SANDRA SEGARAN

TAX DISPUTES AND DEVELOPMENTS: CROSS BORDER ISSUES STEAL THE LIMELIGHT

By the time this issue goes to print, CTIM will be helmed by a new Council following the AGM on 14 June 2014. For now this issue will reflect the pre-AGM office bearers and sub-committee members. This issue brings a diverse perspective with contributions from IRBM, MIDA, industry and the regular practitioners and academia.

Our regular contributor, Dr. Nakha highlights the highly contentious Section 4A of the Income Tax Act 1967 which has perennially plagued taxpayers who have to act as the government's agent to withhold taxes when making payments to non-residents. He examines issues that were the subject of dispute in three landmark cases that proceeded up to our highest court, ie. the Federal Court. While there are several more cases on this Section, a recent adverse decision of the Court of Appeal delivered on 21 April 2014 – *KPHDN v Teraju Sinar Sdn Bhd [2014] MLJU 392*, not discussed herein has raised cause for concern for resident payers to exercise the statutory duty to deduct withholding tax and leave the question of relief to be advanced by the non-resident service provider.

IRBM will contribute a regular column henceforth. In this issue IRBM's e-Services' are highlighted by the writer. These services have been useful for not only taxpayers, but also tax agents and the public at large. First timers should log on to check the up-to-date status of your ledger (under e-LEJAR) to appreciate the improvements in the e-Services.

A senior officer from MIDA has provided a policy perspective in granting incentives and has elaborated the current challenges faced and the direction in incentivising new investments from abroad as well as on the domestic front. In keeping with current needs, Malaysia is moving towards attracting higher value - add investments and high potential emerging technologies. The strategic direction is also to reduce business dependency on incentives by highlighting Malaysia's other conducive environs.

When cases go on appeal to the higher courts, the decision of the judges are at times not delivered with detailed grounds. In one such instance, lawyers from LHAG have contributed a useful article on a Sales Tax classification issue - in what has been described as a landmark judgement. In the authors' views, this article should serve as a useful historical record of the arguments raised for the sake of posterity. This case also recognised the application of the cardinal principles of taxation law in the realm of indirect tax. Let's hope that coffee lovers continue to enjoy their favourite cuppa at the lower sales tax rate of 5% in consequence of this favourable Court of Appeal decision.

On international tax issues, we have two articles. Venkataraman weighs in on the transfer pricing development in the OECD BEPS project. In this article the author's focus is on Transfer Pricing documentation, which is one of the 15 action points of BEPS. While the author recognises that the new initiatives increase transparency in the global supply chain, it is not without problems. Several areas such as detailed information request can be scaled down while more clarity can be introduced in areas such as imposition of penalty and materiality thresholds, keeping in mind burgeoning compliance costs.

It is not just taxpayers who take aggressive tax positions as revenue authorities globally too pursue such an approach for various reasons. Rihanna Haryanti reflects on this and casts doubts on the MAP clause in double tax treaties as an effective mechanism in solving cross border tax disputes as this emerges as an area of grave problems for Malaysia's multinationals and hopes that the role of competent authorities in disputes with our treaty partners can be stepped up. Failing which, there appears to be a real danger that treaty protection and benefits may be denied and repatriation of our earnings abroad may suffer a shortfall. The effectiveness of the MAP clause in double tax treaties and alternative mechanisms and approaches need greater scrutiny by stakeholders.

Happy reading and we look forward to greater interest on the *Tax Guardian* from members, especially from outside the Klang Valley.

BRANCH NEWS

PERAK BRANCH

The Perak Tax Forum with the theme "Challenges & Opportunities – A Tax Perspective" was successfully organised by the CTIM Perak Branch on 11 April 2014 at the Syuen Hotel, Ipoh.

Four speakers, Mr. Chow Chee Yen, Mr. S. Saravana Kumar, Mr. Fan Kah Seong & Mr. Prabhat Kumar shared their perspectives on various topics. In the evening a gala dinner was held which was attended by officials from the IRBM, speakers, sponsors and CTIM members. It was indeed an evening of fun, sharing, learning and networking among the guests.

EAST COAST BRANCH

CTIM East Coast Branch members paid a courtesy visit to the Kuantan IRB Branch on 10 March 2014. The CTIM delegates led by the President, Mr. SM Thanneermalai included Mr. Wong Seng Chong (East Coast Branch Chairman), Mr. Aruljothi Kanagaretnam (Council Member), East Coast Committee Members and senior tax practitioners. The IRBM Kuantan Branch was represented by En. Ruslan bin Othman (Co-ordination Division Director representing the State Director), En. Hussin bin Mohd (Director of Kuantan Branch), En. Idrus bin Yaacob (Deputy Director of Kuantan Investigation Unit) and all Section Heads in the Kuantan IRB Branch. There was a cordial exchange of ideas and information and local tax issues were also discussed. In the afternoon, the President presented a paper on "Transfer Pricing and Documentation" to tax practitioners at the Zenith Hotel, Kuantan.

On 12 March 2014, the East Coast Branch Chairman met with the CTIM members and tax practitioners at Hotel Grand Continental, Kuala Terengganu. 'GST and Monthly Tax Deductions as Final Tax' were some of the issues that were discussed.

CPD WORKSHOPS

Several events were conducted in the 2nd quarter of 2014:

- IRBM-CTIM Tax Forum 2014
- Common Tax issues Faced By Taxpayers
- Capital Allowances on Plant, Machinery & Buildings
- Goods and Services Tax (GST) Training Course No. 2/2014
- Latest Tax Developments on Employers' Statutory Requirements in 2014
- Latest Developments on Real Property Gains Tax in 2014
- Luncheon Talk by the CEO of IRBM

IRBM & CTIM jointly organised the "IRBM-CTIM Tax Forum 2014" in March and April 2014 at various locations - Kuala Lumpur, Johor Bahru, Kota Bharu, Penang, Kota Kinabalu and Kuching with great success. The forum emerged as an essential platform for the tax professionals and tax authorities to build good working rapport. This Forum was held for the first time in Kota Bharu.

CTIM organised a second seminar on "Common Tax issues Faced by Taxpayers" at the Connexion @ Nexus Bangsar South

on 8 April 2014. The seminar was conducted by distinguished speakers:

- Mr. Ian Clarke (TP Partner, Deloitte Malaysia)
- Mr. Nicholas Crist (Executive Director, KPMG Tax Services Sdn Bhd)
- Dr. Veerinderjeet Singh (Chairman, Taxand Malaysia Sdn Bhd)

Mr. Thenesh Kannaa presented a series of workshops on 'Capital Allowance on Plant, Machinery & Buildings' at several venues in Penang, Ipoh, Melaka & Johor Bahru. These workshops focused on the study of capital allowances and charges, one of the most stimulating areas and a vital area of knowledge for tax practitioners and tax advisers if they were to deal competently for their clients.

Two workshops conducted by Sivaram Nagappan during the months of April and May 2014 were:

- Latest Tax Developments on Employers' Statutory Requirements in 2014
- Latest Developments on Real Property Gains Tax in 2014

The workshop on "Latest Developments on Real Property Gains Tax in 2014" was conducted at all major cities. Among the topics covered were:

- How the RPGT works and its impact.
- Budget 2014 proposals and the implications to 2013 RPGT guideline.
- Tax consideration of revenue and capital gain on disposals of real properties
- Tax planning initiatives including real property shares.

Another exclusive event was organised by CTIM - "Luncheon Talk by the CEO of IRBM" held on 19 May 2014 at the Le Meridien Hotel, Kuala Lumpur. The CEO of IRBM, YBhg Tan Sri Dr. Mohd Shukor Hj. Mahfar presented a talk on "IRBM's Future Direction and Focus". The event was held for CTIM members to network with invited senior officers from IRBM.

SPECIAL INCOME AND SPECIAL LAWS – SECTION 4A CONFUSION

THIS ARTICLE REVIEWS THE LAW UNDER SECTION 4A[1] IN RESPECT OF SPECIAL CLASSES OF INCOME IN RELATION TO THREE IMPORTANT LITIGATED CASES.

Dr. Nakha Ratnam Somasundaram

Once upon a time, there was no Section 4A.

Thus, any payment made to a non-resident would be taxed in Malaysia if it was a business income and the non-resident had a permanent establishment in Malaysia. Other income like royalty would suffer withholding tax if it falls within the definition of 'royalty' as defined in Section 2.

'Royalty' as it was then, was defined as including:

(a) any sums paid as consideration for the use of, or the right to use—

(i) copyrights, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks or tapes for radio or television broadcasting, motion picture films, films or video tapes or other means of reproduction where such films or tapes have been or are to be used or reproduced in Malaysia or other like property or rights;

(ii) know-how or information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(b) income derived from the alienation of any property, know-how or information mentioned in paragraph (a) of this definition;

(c) amounts paid in consideration of services rendered by a non-resident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such persons; and

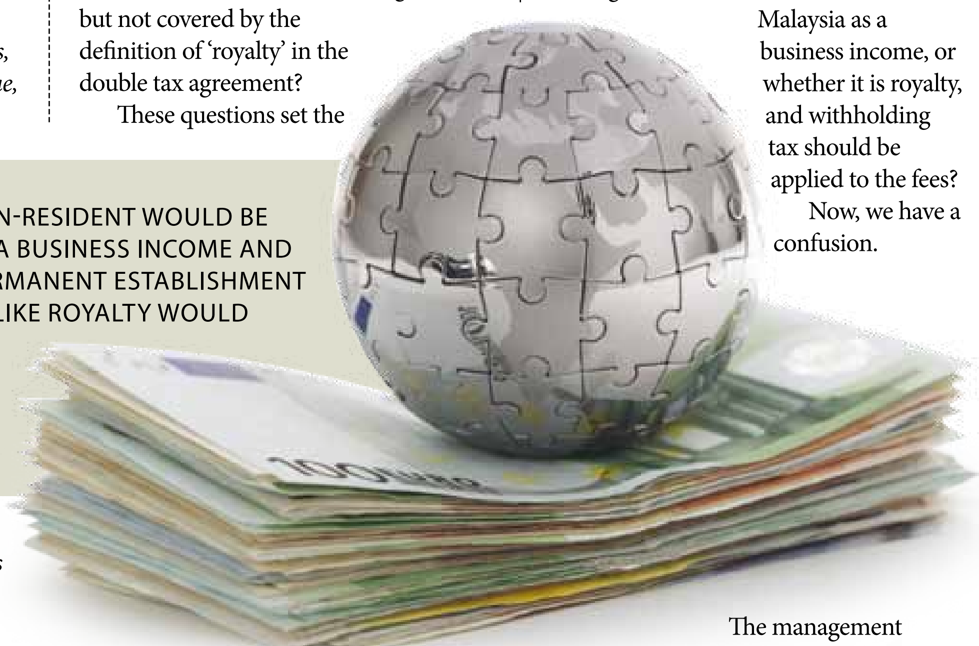
(d) any other amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme.

So, what if the payment constitutes a business income, and the non-resident had no permanent establishment?

Or alternatively, the payment is 'royalty' that falls within the meaning of the definition in the domestic legislation, but not covered by the definition of 'royalty' in the double tax agreement?

These questions set the stage for the Euromedical Industries[2] case to determine what constitutes business income, and what constitutes royalty income - and what happens if there is a confusion[3].

ANY PAYMENT MADE TO A NON-RESIDENT WOULD BE TAXED IN MALAYSIA IF IT WAS A BUSINESS INCOME AND THE NON-RESIDENT HAD A PERMANENT ESTABLISHMENT IN MALAYSIA. OTHER INCOME LIKE ROYALTY WOULD SUFFER WITHHOLDING TAX IF IT FALLS WITHIN THE DEFINITION OF ' ROYALTY' AS DEFINED IN SECTION 2.



EUROMEDICAL INDUSTRIES LTD

Euromedical Industries Ltd was a British company, and a resident of the United Kingdom that signed an agreement with a Malaysian company to manufacture catheters. The agreement further provided for Euromedical Industries Ltd to deliver a series of related services that included managerial, planning, training, technical operations including marketing and development services. For these various services provided, the Malaysian company paid management fees to Euromedical Industries Ltd.

It was accepted that Euromedical Industries Ltd does not have a permanent establishment in Malaysia. It was also accepted that the management fees comes within the definition of 'royalty' in Section 2 as it stood then.

The issue was whether this management fee falls to be taxed in Malaysia as a business income, or whether it is royalty, and withholding tax should be applied to the fees?

Now, we have a confusion.

The management fees paid to Euromedical Industries Ltd came within the definition of 'royalty' in Section 2 because it was a payment for technical advice, assistance or services rendered[4].

However, it did not come within the definition of 'Royalty' under Clause 3

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[1] *All Sections quoted in this article refer to the Income Tax Act 1967 (as amended) unless otherwise specified.*

[2] *DGIR v Euromedical Industries Ltd (1983) 2 MLJ 57.*

[3] *These issues are considered in the context of Section 4A and the provisions of the withholding tax and not in the context of, for example, badges of trade.*

[4] *See footnote 8.*

of the Article XI of the Malaysia-United Kingdom Double Tax Agreement as that definition does not include fees for technical advice, assistance or services rendered.

Under Clause 3 of Article XI of the Malaysia-United Kingdom Double Tax Agreement, the word 'Royalty' was defined as:

> *A payment of any kind received as consideration for the use of, or the right to use any copyrights of literary, artistic or scientific work, any patent, trademark, designs or model, plans, secret formula or process or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning technical, industrial, commercial or scientific experience. The term, however, does not include any royalty or other amount paid in respect of motion picture films or of tapes for radio or television broadcasting, or of the operation of a mine, oil well, quarry or any other place of extraction of natural resources or of timber or forest produce.*

As the domestic law provided for the taxing of the income but the provisions of the Double Tax Agreement did not, there was perceived to be a conflict between the domestic law and the relevant Double Tax Agreement - and certainly, there was plenty of confusion.

In a conflict between the domestic law and the provisions of the Double Tax Agreement, it is generally accepted that the provisions of the Double Tax Agreement take effect[5].

The case went to the courts and in the final judgement at the Federal Court, it was held that pursuant to Section 132 (1) the treaty provisions must prevail – and so the payment received by Euromedical Industries Ltd was not taxed in Malaysia.

Apparently, tax planners get only one blast at a tax planning scheme before it gets shot down by the policy-makers. The decision in the Euromedical Industries Ltd case created a potential loophole and the policy-makers were alerted to amend the domestic law.

And so, about 30 years ago, Section 4A was born[6].

SECTION 4A INCOME

Section 4A reads as follows:

Notwithstanding Section 4 and subject to this Act, the income of a person not resident in Malaysia for the basis year for a year of assessment in respect of—

(i) amounts paid in consideration of services rendered by the person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such persons;

(ii) amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme; or

(iii) rent or other payments made under any agreement or arrangement for the use of any moveable property, which is derived from Malaysia is chargeable to tax under this Act.

One would notice that the Section 4A payments under (i) and (ii) essentially constituted income that were previously charged under the old definition of 'royalty'.

The Inland Revenue Board made it clear that Section 4A income now constitutes a special class of income and therefore the treaty provision does not apply – in other words, the domestic law applies. No two ways about it. No more loopholes.

Fine.

However, this position was not satisfactory to one taxpayer, namely SGS Singapore (Pte) Ltd[7].

SGS SINGAPORE (PTE) LTD.

This was a Singapore incorporated company and resident in Singapore. It was awarded a contract by a Malaysian resident company, Petronas Carigali Sdn Bhd to provide third party inspection, liaison, and co-ordination services. The services were all (except 2%) performed outside Malaysia.

When payments were made for the services rendered, Petronas Carigali Sdn Bhd withheld 15% from the payments.

[5] *United Overseas Bank Ltd v Ketua Pengarah Hasil Dalam Negeri (1977) 3MLJ359; WW(S) Ptd Ltd v DGIR (1990) 1 MSTC 3146.*

[6] *Section 4A came into effect from 21 October 1983.*

[7] *SGSS (Pte) Ltd. v Ketua Pengarah HDN [(2000) 7 MLJ 229].*

SGS Singapore (Pte) Ltd was not agreeable to this and sought to recover the taxes withheld on the grounds that it does not have a permanent establishment in Malaysia and thus the income cannot be taxed.

It was argued that Article IV of the Malaysia-Singapore Agreement ('the old agreement)[8] provided that the 'income or profits of a Singapore enterprise' shall be taxable in Malaysia only if the said enterprise carries on business in Malaysia through a permanent establishment.

As SGS Singapore (Pte) Ltd did not have a permanent establishment in Malaysia it should not be taxed.

The argument of SGS Singapore (Pte) Ltd had a basis in Article 7(1) of the Organization for Economic Co-operation and Development (OECD) Model Tax Convention. The Committee on Fiscal Affairs, in their commentary in Paragraph 11 to Article 7 stated that the first principle underlying Paragraph 1 is that the profits of an enterprise of one contracting State shall not be taxed in the other State unless the enterprise carries on business in that other State through a permanent establishment situated therein.

Generally, OECD takes the stand that until an enterprise of one State has a permanent establishment in the other State, it should not properly be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits.

Tax pundits call this rule the 'No PE, No Tax Rule', and knotty legal complexities aside, this rule provides a convenient rule of the thumb when it comes to taxing cross border transactions.

The case then proceeded to the Special Commissioners of Income Tax (SCIT) who held that the so called 'income or profits' as mentioned in Article II of the 'old agreement' excludes certain type of payments - and among them, remuneration from management, control or supervision of the trade, business or other activity of another enterprise or concern or income from the operation of ships or aircraft.

This 'exclusion' therefore exposed the income received by SGS Singapore (Pte) Ltd to tax under the domestic law as what the company received was treated as not 'income or profits' within the meaning of Article II of the 'old agreement' - which

means, Article IV was not applicable.

The SCIT accordingly held that the payment was chargeable to income tax under Section 4A and the withholding tax deducted from the payments made was in order.

On appeal the High Court held that double tax relief is available under Article IV if the following conditions are satisfied:

- The taxpayer is a Singapore enterprise
- The taxpayer does not carry on a business through a permanent establishment
- The taxpayer derives income or profits from Malaysia.

Under Clause 4 of Article XII, services provided in Malaysia would be liable to Malaysian income tax only if there was a permanent establishment.

As SGS Singapore (Pte) Ltd performed all the services outside Malaysia, and there was no permanent establishment in Malaysia, the High Court held that the income received is not subject to Malaysian tax[9].

That brings us to the case of Alam Maritim (M) Sdn Bhd[10].

ALAM MARITIM (M) SDN BHD

Similar to the SGS Singapore (Pte) Ltd case, Alam Maritim posed a conflict between the application of Section 4A and the provisions in the Malaysia-Singapore Double Tax Agreement (DTA).

Alam Maritim (M) Sdn Bhd was a Malaysian resident company that carried on the business of vessel hire and management. Most of the hiring and managing was provided to a local petroleum company. Between the years 1998 to 2004 the company entered into several contracts with non-resident companies, mostly Singapore based companies, for the supply of ships and crew. Payments by way of charter fees were made to these non-

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[8] *A new agreement between Malaysia and Singapore was signed on 5 October 2004 and this came into effect on 1 January 2007 (henceforth referred to in this article as the 'new agreement'). In the new agreement, Business Profits are covered under Article 7; and Article 13 was added on (which was not in the old agreement) covering Technical Fees.*

[9] *Take note that this decision was made before the law on the exclusion of payment from withholding tax in respect of payment for services performed outside Malaysia under the proviso to Section 15A was introduced. Thus, the argument in the SGS Singapore (Pte) Ltd case was limited to the issue of whether there was a permanent establishment in Malaysia or not.*

[10] *Alam Maritim (M) Sdn Bhd v LHDN Malaysia (2012) MSTC 30-048 (Judicial Review No R1-22- 148-2007).*

resident companies in full because the payments were treated as business income of the non-resident companies, and as there was no permanent establishment in Malaysia, such income is only taxable in the recipient's country of residence.

The Inland Revenue Board took the stand that Article IV of the 'old agreement'[11] applies if there is a permanent establishment in Malaysia (in which case the income will be taxable in Malaysia) and if there is no permanent establishment, then the income would fall within the meaning of Section 4A and withholding tax under Section 109B must be deducted from the payment made.

Since there was no assessment on which to appeal, Alam Maritim (M) Sdn Bhd then resorted to a Judicial Review proceedings seeking an *Order of Certiorari*[12].

The High Court and later, the Court of Appeal held that under the 'old agreement', the charter fees for the vessels paid to the Singapore non-resident companies were business income of the recipients, and as the recipients did not have a permanent establishment in Malaysia, the income is not subject to Malaysian tax - and withholding tax need not be deducted[13].

The Inland Revenue Board appealed to the Federal Court which reversed the decision of the Court of Appeal.[14] The Federal Court adopted the purposive approach to the interpretation of Section 4A and found that it is the intention of the Malaysian government to tax 'the income of non-resident companies derived from certain sources which include rent or other payments made under any agreement or arrangement for the use of movable property derived from Malaysia...'. Accordingly, the Federal Court held that Article VI of the 'old agreement' with Singapore takes prominence over Article IV, thus enabling the Malaysian government to tax the non-resident companies.

Article VI of the 'old agreement' provides that the 'income or profits' of an enterprise [as defined in Article II of that agreement] of one of the Contracting States from the operation of ships or aircraft in international traffic may be taxed in the other Contracting State only if such income or profits are derived from that other Contracting State. Article II, in defining 'income or profits' of a Malaysian enterprise or of a Singapore enterprise, excludes the income derived from the operation of ships or aircraft. The Federal Court therefore held that Article IV, which talks about 'the income or profits...' would be inapplicable in the instant case where the income of the non-resident falls under Section 4A(iii), and is dealt with differently under the

Act – in other words, the DTA does not come into the picture and the ITA now applies.

The Federal Court further found that Section 4A(iii) read together with Article II and VI of the 'old agreement' empowers the Malaysian government to tax the income of non-resident companies categorised as special classes of income 'without the previous fear of the spectre of a permanent establishment having been established in Malaysia'. It also held that Article IV of the 'old agreement' should not be looked at in isolation nor should the issue of a permanent establishment be given undue importance.

In other words, the presence or non-presence of a permanent establishment is irrelevant in respect of the special classes of income falling under Section 4A. In this case, as the payment now falls under Section 4A(iii), Section 109B would be triggered and withholding tax applies.

CONCLUSION

So, what can we learn from these litigated cases?[15]

For one, it is obvious by now that cross border transactions can be very tricky and pretty complex when it comes to income tax.

Based on the court decision in Euromedical Industries Ltd, one cannot read much into Section 4A from this case simply because when this case was decided, there was no Section 4A!

And when the SGS Singapore (Pte) Ltd case was decided, the provision in the Double Tax Agreement in respect of 'income or profits' embodied in the 'old agreement' was slightly different from the new agreement signed on 5 October 2004.

One outstanding fact in the SGS Singapore (Pte) Ltd case was that most of the services performed by the Singapore company were performed

[11] Take note that this is the 'old' Singapore-Malaysia Double Tax Agreement.

[12] An Order of Certiorari is an application to the court to review a point of law. Alam Maritim resorted to an Order of Certiorari because there was no assessment against which to appeal to the Special Commissioners at that time. See amendment to Section 109H with effect from 1 January 2013.

[13] LHDN Malaysia v Alam Maritim (M) Sdn Bhd (2012) MSTC 30-049.

[14] Lembaga Hasil Dalam Negeri v Alam Maritim Sdn Bhd(2013)MSTC 30-068.

[15] The opinions expressed in this article are that of the writer's, and readers are advised to take this with plenty of salt.

outside Malaysia. And it may be noted that with effect from 21 September 2002, Section15A of the Income Tax Act 1967 was amended whereby for the special classes of income only those falling under Section 4A(i) and (ii) and performed in Malaysia would be liable to tax. For services performed outside Malaysia, it would not be taxed, pursuant to the proviso to Section 15A.

In the Alam Maritim (M) Sdn Bhd case[16], the Federal Court stated categorically that ordinary class of income under Section 4 should not be confused with special classes of income under Section 4A. The rules to be applied to the classes of income falling under Section 4 and 4A are different. Further, a DTA does not create or impose any new taxes[17].

For income falling under Section 4 and on which tax is imposed on a non-resident, a relief may be granted under the relevant DTA which provides only a mechanism to eliminate double tax – and relief is granted subject to the non-resident *not* having a permanent establishment in Malaysia.

As for 'permanent establishment', the definitions do not seem to be permanent. For example in the Malaysia-New Zealand Agreement[18] there will be a deemed permanent establishment if a New Zealand enterprise has in Malaysia supervisory activities for more than six months, or if it has substantial equipment in Malaysia being used under contract with the enterprise [What is 'substantial equipment' is not defined or explained and this can lead to potential disputes].

In the Malaysia-Sri Lanka Agreement[19], the time period for supervisory activities is 'more than183 days' [now, some may ask why 'days' and not 'months'?]– but then in the case of furnishing of services, including technical, managerial or consultancy services, a permanent establishment comes into existence when the period or periods aggregate more than 60 days within any twelve month period.

One would note that DTA that Malaysia had signed in recent years usually include a 'Technical Fees' article - for example, Article 13 of the new agreement with Singapore - which to some extent, seem to give extra biting power to Malaysia to impose tax on income treated as falling under Section 4A of the ITA.

But at the end of it, one may want to ASK why payments made in consideration for any services rendered in connection with the use of property or rights, or payment of a technical, managerial or consultancy nature[20] or rent or charter fees paid for a boat, should be special income, and not business income, or even 'industrial or commercial profit',[21] to the non-resident recipient?

Apparently there is no answer. And so, the confusion continues.

[16] As the contracts by Alam Maritim (M) Sdn Bhd with the Singapore companies were entered into during the period 1988 to 2004, the old Malaysia-Singapore Double Tax Agreement applied to the withholding tax dispute. The new agreement, signed on 5 October 2004, came into effect only on 1 January 2007.

[17] Walter Wright (Singapore) Pte Ltd v Director-General of Inland Revenue [(1990) 2 MTC 115].

[18] Signed on 19 March 1976 and effective from 1 January 1976 [P.U. (A) 276/1976]

[19] Signed on 16 September 1997 and effective from 1 January 1997 [P.U. (A) 491/1997]

[20] Clause 2 of Article 13 of the new Malaysia-Singapore Agreement.

[21] Article 5 of the Malaysia-New Zealand Agreement talks about 'industrial or commercial profit' instead of just 'business profits' as in most other Double Tax Agreements.

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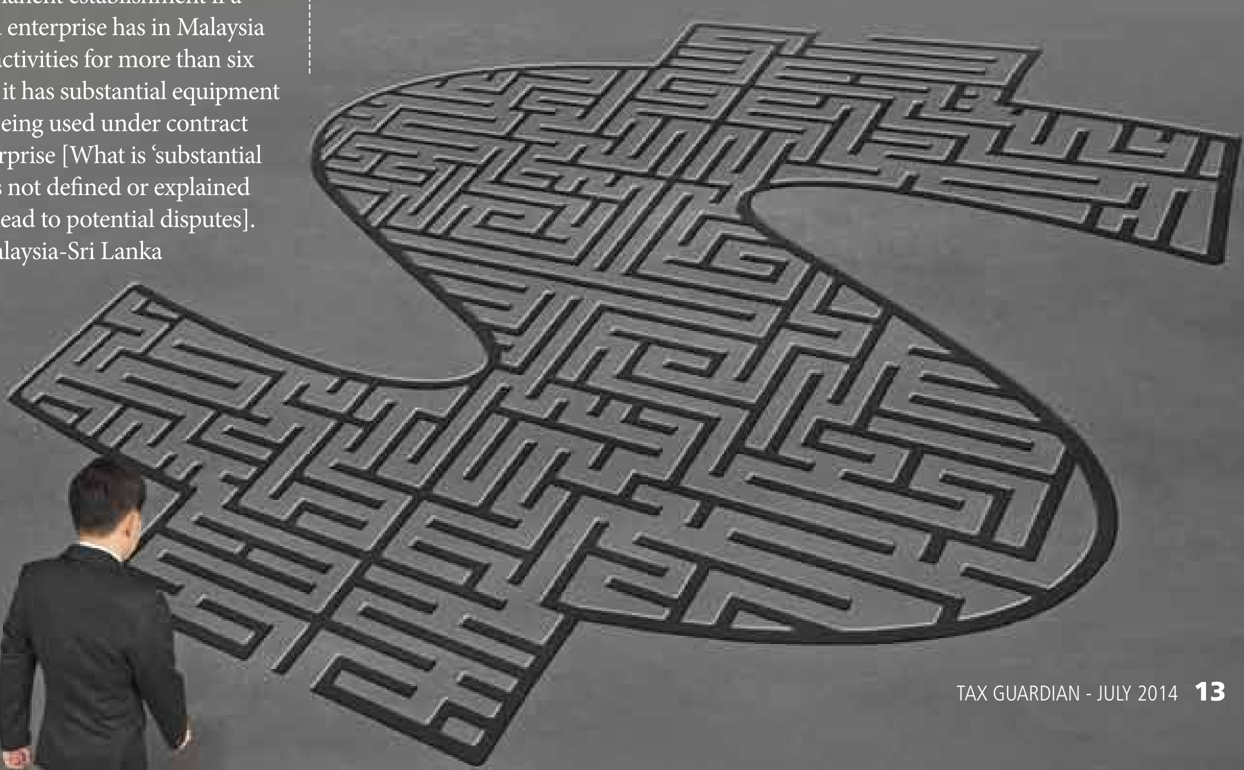


THE IRBM'S e-SERVICES

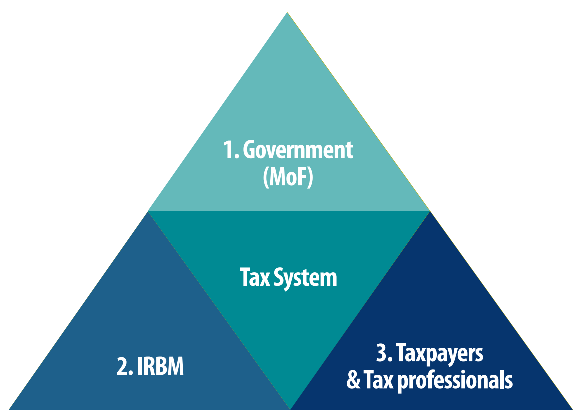
Muhamad Mustafa Said

The IRBM uses a triangle as a logo to symbolise a mountain peak, which signifies strength in an organisation that strives to achieve peak performance.

The triangle is also used to denote the three components in the tax system in Malaysia, first the Government represented by the Ministry of Finance, second the IRB and the third component, taxpayers and the tax professionals. All the components in the tax system play crucial roles to ensure efficient tax collection for the nation.

The government through the MoF plans and develops policies to enhance the collection of tax revenue.

The IRBM which forms the second component is



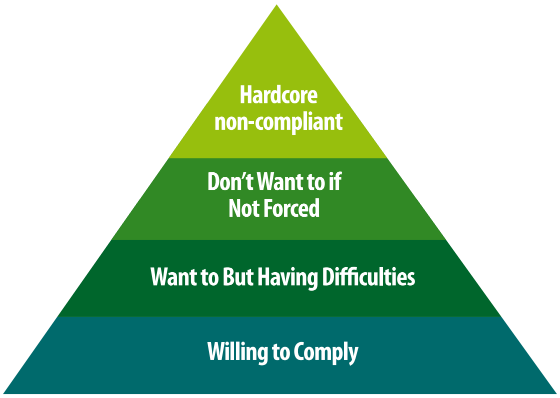


Table 1

FOUR CATEGORIES OF TAXPAYERS	STRATEGIES
Willing to comply	Providing facilities and infrastructure for those willing to comply.
Want to comply but having difficulties	Help those who want to comply but having difficulties by providing services to ease their difficulties.
Do not want to comply if not forced to	Use certain provisions of the tax laws to make sure that they toe the line.
Hardcore non-compliant	The full force of the law is used

responsible in enforcing rules and regulations, ensuring it is fair to the taxpayer and at the same time observes the rules of professionalism and impartiality in carrying out its duties and responsibilities. The triangle above shows that while a vast majority of taxpayers fall within a category of 'willing to comply' there are various degree of non-compliance.

The IRBM adopts various strategies to enable compliance. **Table 1** shows the categories of taxpayers and strategies it employs.

The taxpayers and tax professionals who form the third component are expected to be law abiding citizens and do their duty of paying the right amount of tax.

With these three components working in harmony, the tax system is expected to perform in the most efficient manner. A slight glitch however by any of the components would bring about disequilibrium to the system and the objective of the nation as a whole will not materialise.

The IRBM hopes to build a respected tax community that has an efficient tax collection system. It further expects that the MoF, IRBM, the taxpayers and tax professionals would not only complement each other but also synergise the tax system.

HOW IS THE RELATIONSHIP BETWEEN THE COMPONENTS PERCEIVED TO BE?

When I first joined IRBM (IRD at that time) almost 30 years ago, the system was not well perceived. There

seemed to be a bit of mistrust among the components. The taxpayers were deemed to be on the opposite side of the fence and treated like enemies by the IRBM officers. The impression was that the taxpayers will always try to cheat and not declare the true amount of income. The perception that the taxpayers were cheaters were supported by the low compliance rate of around 50% in submission of returns and also the existence of a wide tax gap collected during visits by the IRBM officers.

That situation has improved over the years with the relationship warming up and more engagement between IRBM and the taxpayers. Collaboration with tax bodies provides a good platform for better understanding between IRBM and the tax professionals who represent the taxpayers. Cooperation between IRBM and CTIM has improved tremendously with the co-organising of the National Tax Conference (NTC) already into its 14th year. In addition to that, new partnerships in organising tax seminars and other smaller projects have been instituted.

The IRBM with its new open policy has supported many other tax seminars and programmes organised by other professional bodies and organisations. Even though the situation has improved tremendously, the compliance rate has not shown similar improvement over the period. This phenomena is something to be pondered by all; be it the MoF, the IRBM or the tax professionals.

The IRBM has since the late eighties embarked on customer oriented services. We started with the Taxpayers' Service Week programme where the IRBM opened counters outside the office to cater for the need of the taxpayers. Initially it was viewed with extreme caution by the public. The programme was later expanded to a month long programme called Tax Payers' Service Month and later renamed Hasil4U.

During the Hasil4U programme, IRBM officers assist the taxpayers in solving their tax issues and also help them to file their returns either electronically or manually. This programme has helped to narrow the trust gap between the taxpayer and the IRBM. The atmosphere has now changed to be more relaxed and cordial. Nevertheless, there are occurrences of displeasure when at times the issues are not solved amicably.

The IRBM has spent a great deal of resources to enhance its services to the taxpayers. Many new electronic service products were introduced to help taxpayers with their tax issues. It is quite

disheartening when the taxpayers do not make use of the services provided.

Even with lots of promotions done, the usage is still limited. Most of the time, the excuse is that the information did not reach the taxpayers.

When I was approached by CTIM to contribute articles to the *Tax Guardian*, I welcomed the opportunity with gusto. This article and hopefully the future articles in this column will reach a good number of readers, thus enabling the *Tax Guardian* to act as a bridge between the IRBM and the taxpayers as well as tax professionals.

I would like to begin with an introduction and also familiarisation of the electronic services provided by the IRBM in its effort to assist the taxpayers to comply. There are currently twelve (12) electronic services being provided to the taxpayers and the general public, which are:

E-DAFTAR

e-Daftar is an application via internet for the registration of income tax files for individuals and companies.

This application facilitates the registration of income tax files for:

- Individuals who have income which is liable to tax
- Employees who are subject to Monthly Tax Deduction (MTD)
- Companies which commence business
- Individuals/companies who wish to claim tax credits repayment arising from deductions against dividend income.

Supporting documents required:

CATEGORY	SUPPORTING DOCUMENTS
Individual without business income	Identification Card (New Identification Card, Armed Forces, Police or Passport)
Individual with business income	Identification Card (New Identification Card, Armed Forces, Police or Passport) Business Registration Certificate
Company	Form 9 & Form 49 (Companies Commission of Malaysia)

Documents can be sent via email to *edaftar@hasil.gov.my* or via Fax to 03-77136363.

Tax reference number will be available within three working days after completing an online application.

E-FILING

An application on filing of income tax return form (ITRF) electronically through internet for the following forms:

Form B/BT (e-B/e-BT)	Resident Who Carries on a Business/ Knowledge/Expert Worker
Form BE (e-BE)	Resident Who Does Not Carry on a Business
Form P (e-P)	Partnership Return Form
Form M/MT (e-M/e-MT)	Return Form of a Non-Resident Individual/Knowledge Worker
Form E (e-E)	Return Form of an Employer
Form C (e-C)	Return Form of a Company
Form R (e-R)	Statement of Revised 108 Balance
e-Estimated (e-CP204) For Company/Co-operative Society/ Trust Body	Company Tax Estimate Form (CP204)/ Company Tax Estimate Form-Amendment - 6 (CP204A-Amendment 6)/Company Tax Estimate Form-Amendment - 9(CP204A-Amendment 9)

E-FILING BY TAX AGENTS

This application facilitates tax agents to file-in their clients' income tax return form electronically. The tax agent must have the permission of their clients first before filing can be done. The clients can authorise their tax agent by completing the form CP55 (Authorisation to File Return Electronically).

ByrHASIL

ByrHASIL is an application that allows income tax payments through appointed banks. This service enables tax payments to be made through the FPX gateway. In order to do this, a user is required to have an internet banking account with the FPX associates. With this application, payment of tax can be made at any time of the day.

The following are the FPX associates:

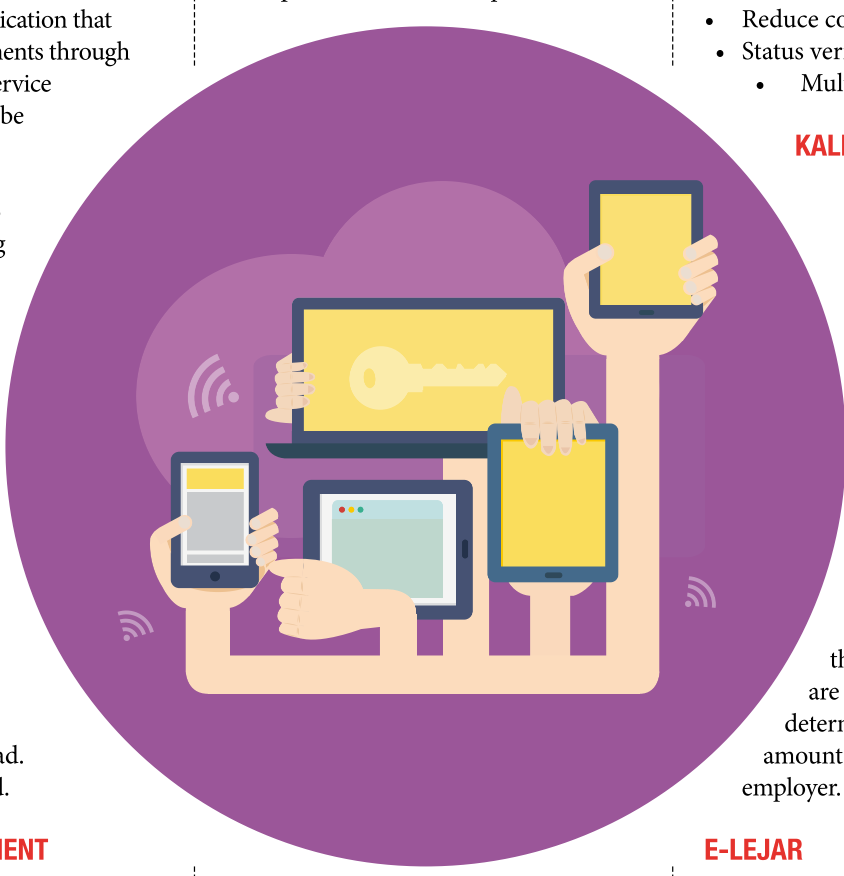
- - Bank Islam Malaysia Berhad
- - CIMB Bank Berhad
- - Hong Leong Bank Berhad
- - Maybank2e and Maybank2U
- - Public Bank Berhad.
- - RHB Bank Berhad.

E-SPC (TAX SETTLEMENT LETTER SYSTEM)

e-SPC is an application that facilitates the submission of documents pertaining to cessation of employment which requires an employer to withhold monies due to the employee. This system allows employers to submit Form CP22A / CP22B - notification of employees employment cessation and Form CP21 - notification of departure from the country of an employee.

STAMPS

STAMPS is an Electronic Stamp Duty Assessment and Payment System via internet. This method replaces the manual system in IRBM's counter which uses the Franking Machine and Revenue Stamp. The receipt/stamp certificate generated by STAMPS replaces revenue stamps and franked stamps. Individuals, companies and



agents may start using this facility to endorse the documents below:-

- Real Properties Transfer
- Share Transfer
- Business Transfer
- Rental/Lease
- Security
- Selling of Annuity
- General Stamping
- Section 15/15A relief
- Compound Duty payment
- Replica
- Repayment
- Appeal

STAMPS have the following benefits as compared to the manual stamping of documents:

- Easy to retrieve anywhere and anytime
- Save time in processing instruments/documents
- Systematic and expedites processing
- Data safety guaranteed
- Reduce costs
- Status verification at any time
- Multi-payment mode

KALKULATOR PCB

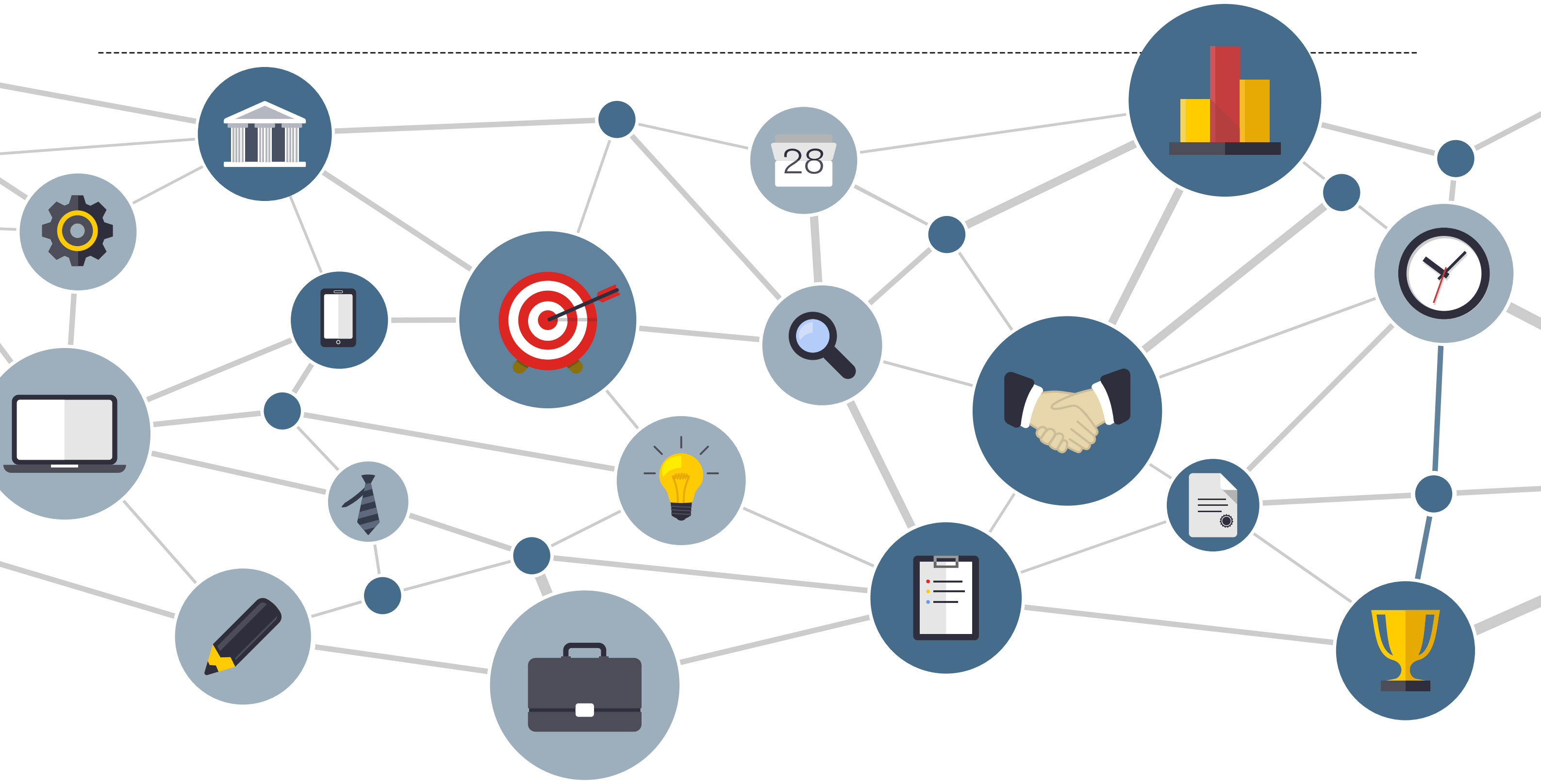
Kalkulator PCB is an electronic support system to calculate MTD of employees. This application is easy to use, fast, time saving and accurate. If all information is taken into account, then there should not be any under or over payment of tax. The schedule for monthly tax deduction will be redundant. With this application, employees are able to check and determine the correctness of the amount of tax deduction by the employer.

E-LEJAR

e-Lejar is an application that enables taxpayers to check for their personal details, updated ledger transactions and to know their current tax position.

E-KEMASKINI

e-Kemaskini is an application to enable taxpayers to update their tax



information as follows:

PERSONAL	
- **Phone Number** - **E-mail address** - **Mailing Address** - **Residential Address** - **Address of Business** ***(if any)***	Rebate and Relief claims can be updated and will be prefilled in the respective e-Forms for that year of assessment.

Taxpayers will be able to check whether their personal details such as address and bank account number are correct. If there is any error, they should inform the IRBM immediately.

The ledger will display all tax transactions including assessments, payments and repayments. The taxpayers can thus check whether their tax transaction has been updated. As an example, taxpayers can check whether their MTD payments deducted by the employer have been received and credited by the IRBM or whether their e-Filing has been duly posted in the ledger.

The taxpayer can know whether he/she has a debit or credit balance by looking at the tax balance position in the ledger. Debit balance means an amount of tax is still outstanding while credit balance means tax overpaid by the taxpayer.

E-PCB

e-PCB is an electronic system that is available for employers who do not have a computerised payroll system to calculate and verify MTD calculation. The system helps employers to store employees' information and submit MTD payment data to the IRBM online. This time saving system ensures correct and accurate STD calculation.

E-DATA PCB

e-Data PCB allows employers to check the format and upload the text file of CP39 online. This system helps employers to send data that meets the specifications.

E-DATAPRAISI

To facilitate taxpayers use of e-Filing in line with current technological developments, IRBM is reinforcing its e-Filing system by obtaining remuneration particulars of taxpayers direct from their employers. The data obtained will be filled in their respective e-Filing forms. This will ease the burden of taxpayers in filling their income particulars when submitting their return form. Prior to signing and sending the forms electronically, taxpayers using e-Filing may alter the prefilled particulars if there's a change.

Muhamad Mustafa Said *is the Director, Corporate Planning Division, Corporate Services Department of the Inland Revenue Board of Malaysia.*

COFFEE OR NON-ALCOHOLIC BEVERAGE?

An Analysis of the Power Root Case

S. Saravana Kumar & Jason Tan Jia Xin

On 2 April 2012, the Court of Appeal gave its decision on a sales tax classification issue in *Ketua Pengarah Kastam v Power Root (M) Sdn Bhd & Lain-Lain (Rayuan Sivil No. W-01(1M)-441-10).* In the best knowledge of the authors, this landmark decision has the distinction of being the first case of its kind in Malaysia that has reached the appellate court.

In its unanimous decision, the Court of Appeal ruled in favour of the taxpayers and dismissed with costs the appeal mounted by the Director-General of Customs ("Customs"). Unfortunately, the Court of Appeal did not provide its written grounds of judgement.

For posterity's sake, this article records the arguments raised by the parties before the Court of Appeal.

THE BRIEF FACTS

The taxpayers are the manufacturer of various popular coffee based products, namely:

- Alicafe Premium Gold with Oligofructose;
- Alicafe with Tongkat Ali;
- Per'l Cafe Kacip Fatimah; and
- Alicafe with Ginseng.

It was undisputed that the above products attract sales tax. The rate of the sales tax payable is determined based on the harmonised system tariff code ("Tariff Code"). It is an internationally standardised system of names and numbers to classify traded products which includes the general rules of interpretation. Our domestic law has adopted both the system and the general rules of interpretation.

THE ISSUE

The single issue in the Power Root case was under which category of the Tariff Code do the products fall? The taxpayers classified the products under Tariff Code 2101.12.900 i.e. preparation with a basis of extracts, essences or concentrates or with a basis of coffee. This Tariff Code attracted sales tax at the rate of 5%.

The Customs, however, disagreed with the taxpayers' classification. The Customs classified the products under Tariff Code 2202.90.900 as "other non-alcoholic beverages", which attracted sales tax at the rate of 10%. The Customs reassessed the sales tax paid by the taxpayers and raised additional sales tax with penalty.

The taxpayers being aggrieved by the decision of the Customs, appealed to the Customs Appeal Tribunal ("Tribunal"). The Tribunal ruled in favour of the Customs. The taxpayers appealed further to the High Court, which reversed the Tribunal's decision. The High Court ruled in favour of the taxpayers that the above products ought to have been classified under Tariff Code 2101.12.900. The decision of the High Court was unanimously affirmed by the Court of Appeal.

THE TARIFF CODE & THE RULES OF INTERPRETATION

The Tariff Code 2101.12.900 under Chapter 21 reads as follows:

21.01

Extracts, essences and concentrate, of coffee, tea or mate and preparations with a basis of these products or with a basis of coffee, tea or mate; roasted coffee substitutes, and extracts, essences and concentrates thereof.

Extracts, essences and concentrates, of coffee, and preparations with a basis of these extracts, essences or concentrates or with a basis of coffee:

....

2101. .12

Preparation with a basis of extracts, essences or concentrates or with a basis of coffee:

...

900 *Other"*

Meanwhile, Tariff Code 2202.90.900 under Chapter 22 reads as follows:

22.02

Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavoured, and other non-alcoholic beverages, not including fruit or vegetable juices of heading 20.09.

...

2202.90 Other

...

900 Other"

In determining which Tariff Code is to be applied, one must apply the rules of the interpretation. In this

regard, paragraph 4 of the Customs Duties Order ("Customs Order 2007") states that the classification of goods is to be determined according to the various principles set out as below:

(a) Paragraph 4 Rule (1) of the Customs Order 2007 which reads:

"The titles of Sections, Chapters and sub-Chapters are provided for ease of reference only; for legal purposes, classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes and provided such headings or Notes do not otherwise require, according to Rules (2) to (7) below. "

(b) Paragraph 4 Rule (3)(a) and (b) of the Customs Order 2007 which reads:

"When by application of Rule 2(b or for any other reason, goods are prima facie, classifiable under two or more headings, classification shall be effected as follows:

(a) the heading which provides the most specific description shall be preferred to headings providing a more general description. However, when two or more headings each refer to part only of the materials or substances contained in mixed or composite goods or to part only of the items in a set put up for retail sale, those headings are to be regarded as equally specific in relation to those goods, even if one of them gives a more complete or precise description of the goods.

(b) mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, which cannot be classified by reference to (3)(a), shall be classified as if they consisted of the material or component which gives them their essential character, insofar as this criterion is applicable."

DECISION OF THE HIGH COURT

As in most appeals of this nature, the finding of facts is the function of the Tribunal, which is unassailable on appeal unless the finding of facts is so unreasonable or erroneous. Bearing in mind this principle, the High Court took cognisance of the following facts found by the Tribunal:

(a) the products do not contain any alcohol and contain water of at least 78%;
(b) the products had coffee powder;
(c) the quantity of coffee in the products ranges from 3% to 4.5%;
(d) Alicafe Premium Gold with Oligofructose contains coffee powder and oligofructose;
(e) Alicafe with Tongkat Ali contains coffee powder and tongkat ali extract;
(f) Per'l Cafe Kacip Fatimah contains coffee powder and kacip fatimah extract;
(g) Alicafe with Ginseng contains coffee powder and ginseng extract;
(h) the drinks were pleasant to consume;
(i) all the drinks contain sugar and milk powder is added to enhance the taste;
(j) ginseng, tongkat ali and kacip fatimah have effects on the body;
(k) the expectation of the consumer is that the drinks containing those herbs are tonics;
(l) the drinks are not intended as thirst quenchers;
(m) a normal person can consume more than one can at any one time;

(n) there is no indication that the products containing tongkat ali should be consumed by men only;
(o) there is no indication that the drinks containing kacip fatimah should be consumed by women only;
(p) there is no warning on the cans that the products containing tongkat ali, kacip fatimah or ginseng should not be consumed by children or pregnant women;

(q) the drinks are sold in high traffic areas such as at petrol stations and easily available to consumers travelling by road;
(r) the goods with the same ingredients but in powder form had been classified as 'extracts or concentrates of coffee' by the Customs;
(s) the Explanatory Notes to the Heading 21.01 states in paragraph 1 that the extracts or concentrates of coffee may be in liquid or powder form, usually highly concentrated;
(t) the addition of water and carbon dioxide had changed the physical properties;
(u) the quantity of water added is substantial and the ingredients including the coffee were no longer in a concentrate form;
(v) the dilution of the ingredients changed the character of the products substantially resulting in beverages; and
(w) the products containing ginseng, tongkat ali and kacip fatimah were tonic beverages.

Based on the finding of facts by the Tribunal, among others, the High Court ruled the following:

(a) The Tribunal erred in not considering the **second limb** of Heading 2101.12 of Chapter 21 of the Schedules to the Customs Order 2007.
(b) The Tribunal failed to consider Paragraph 4 Rule 3(a) that where goods are prima facie classifiable under two or more headings, the heading that provides the **most specific description** shall be preferred.
(c) The Tribunal also failed to consider whether the description under Heading 21.01 which is *"Extracts, essences and concentrates, of coffee, and preparations with a basis of these extracts, essences or concentrates or with a basis of coffee"* and whether ***"preparations with a basis of coffee"*** under Heading 2101.12.900 aptly describes the products.
(d) The products of the Taxpayers/ Respondents is more appropriate

THE CUSTOMS' ARGUMENTS

The arguments advanced by the Customs before the Court of Appeal were that the High Court had erred in allowing the taxpayers' appeal. The Customs' arguments could be summarised as follows:
(a) The High Court did not conclude that products are "beverages".
(b) The High Court failed to consider that Tariff Code 2101.12.900 does not mention about mixing with water.
(c) The High Court failed to consider that Tariff Code 2202.90.900 is more appropriate when compared with Tariff Code 2101.12.900 as contended by the taxpayers as it mentions about mixing water with flavour materials.

to be classified as *"preparation with a basis of coffee"* as it describes **specifically** the products.

(e) The Tribunal **failed to consider** paragraph 4 Rule (3)(b) of the Customs Order 2007 that provides that mixtures, composite goods consisting of different materials shall be classified as if they consisted of the material or component which gives them their essential character. Thus, to the consumer the **essential character of the products** is that it is a **<u>coffee drink with traditional herbs</u>** whether purchased in powder form or in the ready-to-drink liquid form sold in cans.

(f) The Tribunal having described the products as "tonic" and having found that the expectation of the consumer is that the drinks containing the herbs are "tonics" and **not intended as thirst quenchers** and is consumed for **nutritional and health benefits,** ought to have arrived at the reasonable conclusion that the **products are not "beverages".**

(g) The amount of moisture content is not the only criteria in deciding whether or not the product is a "beverage". Items like essence of chicken which contained 93.2% and 92.9% water were not classified as beverages by the Customs. The chemist report showed that the third product and fourth product respectively contained 85.1% and 86.3% water. The Tribunal ought to have considered the chemist's report which was tendered.

(h) That the Tribunal's finding that the addition of water and carbon dioxide had changed the physical properties of the products is **not supported** by any evidence.

The authors are of the humble opinion that the passages above clearly illustrate that the High Court had applied the law accordingly in exercising its appellate jurisdiction.

THE TAXPAYERS' SUBMISSION

In responding to the Customs' argument, the taxpayers highlighted two important points to the Court of Appeal's attention.

First, the High Court in the present appeal **<u>did not disturb</u>** the finding of facts made by the Tribunal. The High Court upheld the facts found by the Tribunal and arrived at the correct conclusion in ruling that the products fall under Tariff Code 2101.12.900 as "preparation with a basis of coffee".

Second, in interpreting the relevant instrument in relation to the

Tariff Code, one must note that the words in a taxing instrument are to be given its ordinary meaning. One has to look merely at what is clearly said. There is no room for any intendment or presumption so to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used (see *National Land Finance Co-operative Society Ltd v Director General of Inland Revenue [1993] 4 CLJ 339)*. The principle that a provision in a taxing statute must be read strictly is one that is to be applied against the taxing authority and not in its favour. The maxim in revenue law is this: no clear provision; no tax (see *Exxon Chemical (Malaysia) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2005] 4 CLJ 810).*

In these circumstances, the issue before the Court of Appeal was simply whether the learned High Court Judge's decision is wrong in law?

The following is the summary of the legal arguments advanced by the taxpayers in support of the classification of the products as **"preparation with a basis of coffee"**, which was accepted by the Court of Appeal:

1. Are the products beverages?

In ruling that the products are not beverages coming well within the description under Tariff Code 2202.90.900, the High Court considered the following cases:

(a) *Re Forever Living Products Australia Pty Ltd v Collector of Customs 9 ALD 271*, which held that beverages are generally consumed for refreshment and to quench thirst. In Re Forever Living, the issue was whether aloe vera juice and aloe vera gel, which were in liquid form, were "medicaments" under Chapter 30.03 or "beverages" under Chapter 22. The following passage is instructive:

"In our view, this is too literal an interpretation of an incidental word found in the company of many other words. It could not be said, for example, that poison is a beverage, although it is in liquid form and can be taken orally. One simply cannot ignore all the other words in the item. In Bourne v. Norwich Crematorium Ltd. (1967) 1 WLR 691 at 696 Stamp J. put it in these words:

"Sentences are not mere collections of words to be taken out of the sentence, defined separately by reference to the dictionary or decided cases, and then put back again into the sentence with the meaning which one has assigned to them as separate words, so as to give the sentence or phrase a meaning which as a sentence or phrase it cannot bear without distortion of the English language".

The meaning of a word or phrase is to be derived from its context. This is akin to the ejusdem generis rule. Here the genus or family of objects consists of drinks which (however difficult to define in exact terms) are generally considered to be pleasant and are generally drunk for refreshment. Aloe vera juice is in no way akin to lemonade or any of the other nominated drinks. They (like the goods in chapter 20) are usually to be found on household tables.

The subject goods are not generally considered pleasant and are not generally drunk for refreshment. The fact that they have a small dosage indicated on the packaging indicates that the seller of the substances does not expect them to be consumed for refreshment. It is true that the applicant's own selling brochure described the juice as "a delightfully smooth lemon/lime flavoured nectar made from aloe vera gel 100% stablised". When closely analysed this statement is probably literally

true, although it certainly leaves an inference as to taste and use which could not be supported. On the balance of the evidence before us, it must be regarded as mere puffery, perhaps to be condemned in another context, but not to affect the classification of the goods for Customs Tariff purposes. The evidence does not support the submission that the goods should be classified as a beverage as that word is used in item 22.02 of the Tariff."

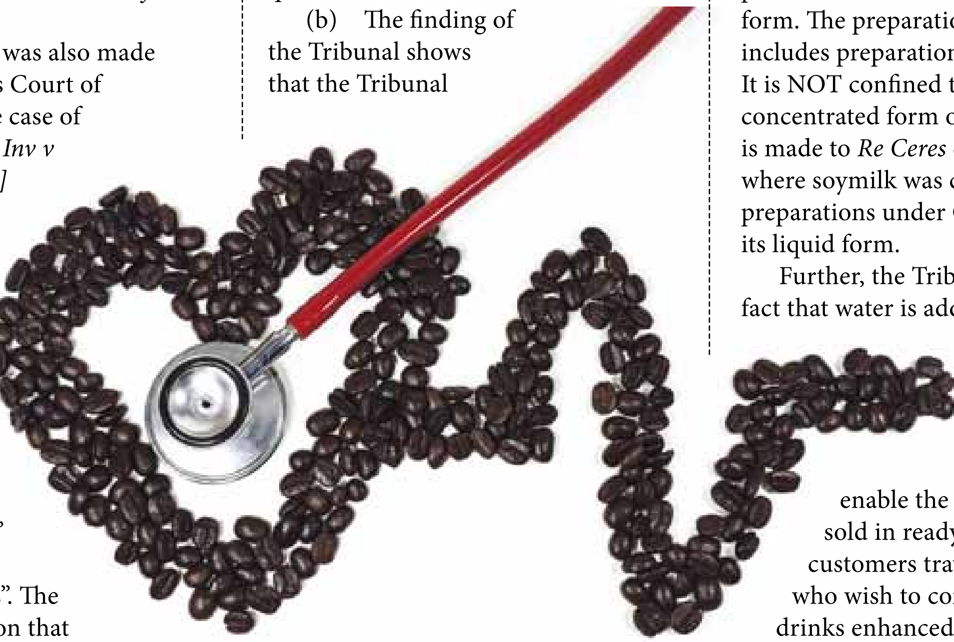
(b) Reference was also made to the United States Court of International Trade case of *Maxcell Bioscience, Inv v United States [2007] Ct. Intl. Trade LEXIS 182.* The taxpayer imported two liquid dietary supplements which were classified by the government as "food preparations" rather than "non-alcoholic beverages". The taxpayer's contention that the products were beverages because they were drinkable was not accepted by the Court. In this case, the Court held that the products could not be classified as beverage as it was not designed to be flavourful and refreshing or to quench thirst. The products were not intended for consumption in significant and non-measured quantities and the products were purchased for health and nutritional purposes.

(c) *Re Ceres Natural Foods Pty Ltd v Controller of Customs 10 ALN N81,* where the Australian Court held that soy milk, a product containing soybeans with water and corn oil, barley malt, salt and flavourings which is nutritious should be classified under Chapter 21 as "food preparations" and NOT as "non-alcoholic beverages" under Chapter 22.

Additionally, the High Court also relied on the following facts found by the Tribunal itself which supported the taxpayers' contention that the products were not beverages:

(a) The Tribunal found that the expectation of the consumer is that the drinks containing the herbs are 'tonics' and not intended as thirst quenchers.

(b) The finding of the Tribunal shows that the Tribunal



accepted that the expectation of the consumer is that these products, coffee drinks enhanced with herbs, are 'tonics' not generally consumed as thirst quenchers but consumed for nutritional and health benefits.

(c) Hence the products are sold at high traffic areas like petrol stations so that they are easily available to consumers who travel by road.

2. The More Appropriate Code: Tariff Code 2101.12.900 or 2202.90.900

Tariff Code 2101.12.900 covers preparation with a basis of extracts, essences or concentrates of coffee" **OR** "preparation with a basis or coffee". Both items are to be read disjunctively. The word "OR" clearly supports this submission. The taxpayers submitted that the products fall under item (ii) above. It must be noted that Parliament does not act in vain and it is incumbent on our Courts to give effect to every word used by Parliament. To be classified under the latter part of the said code, the products need not be in concentrated form. The preparation under the latter includes preparation in liquid form. It is NOT confined to products in a concentrated form only. Reference is made to *Re Ceres* case (supra) where soymilk was classified as food preparations under Chapter 21 despite its liquid form.

Further, the Tribunal found as a fact that water is added as a soluble agent since the drinks were sold in liquid form in cans. This was to enable the products to be sold in ready to drink cans to customers travelling by road who wish to consume coffee drinks enhanced with herbs not as thirst quenchers but consumed for nutritional and health benefits to sustain them during their journey.

The Tribunal acknowledged that the amount of moisture content is not the only criteria in deciding whether or not liquid is a 'beverage'. Despite this, it appears that the Tribunal's decision was solely based on the amount of moisture content in the products.

Interestingly, the chemist reports on Brands Essence of Chicken and Eu Yang Sang's Essence of Chicken referred to by the Tribunal show that Brands Essence of Chicken contains 92.3% water and Eu Yang Sang's Essence of Chicken contains 91.9% water. Yet the Customs did not classify both products as beverages.

The Customs did not rebut this evidence led by the taxpayers before the Tribunal. Further, the Customs failed to explain as to why the chicken essence which contained a higher water content than the products were not classified as beverages. Clearly, public interest demands that a statutory power must be exercised reasonably and with due consideration. In these circumstances, the Customs cannot act arbitrarily (see *Alcatel-Lucent Malaysia Sdn Bhd & Anor v Ketua Pengarah Hasil Dalam Negeri (No: R1-25-166-2008)*.

Additionally, the Customs' argument that Tariff Code 2101.12.900 does not include products mixed with water clearly tantamount to reading in an additional requirement. The words in a taxing instrument are to be given ordinary meaning. One has to look merely at what is clearly said. Nothing is to be read in, nothing is to be implied. If one were to accept the argument of the Customs, then one would not be promoting the purpose or object of the 2007 instrument but be defeating it. For, in such event one would, through unauthorised legislative power, be re-writing statute (*see: Palm Oil Research and Development Board Malaysia & Anor v Premium Vegetable Oils Sdn Bhd [2004] 2 CLJ 265*).

In fact, if Parliament had intended Tariff Code 2101.12.900 to exclude products mixed with water, then Parliament would have surely specified this clearly to the Chapter Notes for Tariff Code 2101.12.900. The United Kingdom tax authority's attempt to impose an additional condition in determining the taxpayer's eligibility for industrial building allowance was rejected by the House of Lords in *Inland Revenue Commissioners v Saxone, Lilley & Skinner (Holdings) Ltd [1967] 1 All ER 756*. Lord Reid commented "The Crown's main argument was that 'in use for the purposes of a trade' or of a part of a trade means wholly or mainly in use for such purposes. But that involves writing in words which are not there, and I can see nothing in the context to make that necessary. Moreover, it requires no feat of imagination in a draftsman to see that cases may arise where the same building or the same part of it is being used for two purposes, and if it were intended to exclude such cases I would expect that to be made clear…".

CONCLUSION

The decision of the Court of Appeal in the Power Root case provided the much needed certainty with regard to the manner in which one should apply the rules of interpretation in determining which Tariff Code is to be applied. This case also recognised the application of the cardinal principles of taxation law in the realm of indirect tax. More importantly, this decision now settles the matter once and for all that coffee products in the form of liquid are indeed coffee preparation and not non-alcoholic beverages. Thanks to this decision, coffee lovers may continue to enjoy their favourite cuppa at the lower sales tax rate of 5%.

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Datuk D.P. Naban *and* ***Mr. S. Saravana Kumar*** *of Lee Hishammuddin Allen & Gledhill represented the taxpayer in the Power Root case before the Court of Appeal.*

Tax incentives and future challenges: Inside MIDA's investment agenda

Dato' Azman Mahmud

IN ITS ROLE AS AN ENABLER FOR BUSINESS, MALAYSIAN INVESTMENT DEVELOPMENT AUTHORITY (MIDA) MANAGES TAX INCENTIVE APPROVALS WHILE TACKLING THE CHALLENGES OF THE FUTURE.

Two years after its rebranding from Malaysian Industrial Development Authority to Malaysian Investment Development Authority in 2012 , MIDA has discovered in itself a revitalised spirit.

The change of name and reorganisation have done much to clarify the agency's role in light of the country's transforming business landscape. MIDA's new name befits its importance in promoting the national investment agenda on a broader scale, as the country is no longer just a manufacturing hub, but has also grown to become a hub for services.

MIDA's broader role has empowered the agency to spearhead the national investment agenda. The attraction of quality investments, particularly in high value-added projects related to research and development (R&D), creativity and innovation, will enable the nation to achieve its targets under the Tenth Malaysia Plan (10MP) and the Economic Transformation Programme (ETP). Today, the agency engages with investors in targeted areas of manufacturing and services, and processes and approves tax incentives in real time. The agency's expanded role also covers policy advocacy and total solutions for the entire business ecosystem, including technology acquisition, funding, training, business development and transformation.

Tax incentives in Malaysia

MIDA is responsible for the approval of standard tax incentives in Malaysia, which comprise Pioneer Status and Investment Tax Allowance (see sidebar 1). Depending on the merits of each case and requests from companies, customised incentive packages may be provided if the project has a high impact on the

Types of Incentives

In Malaysia, tax incentives, both direct and indirect, are provided for in the Promotion of Investments Act 1986, Income Tax Act 1967, Customs Act 1967, Sales Tax Act 1972, Excise Act 1976 and Free Zones Act 1990. These Acts cover investments in the manufacturing, agriculture, tourism (including hotel) and approved services sectors as well as R&D, training and environmental protection activities.

The major tax incentives for companies investing in the manufacturing and services sector are the Pioneer Status and the Investment Tax Allowance (ITA). A company granted Pioneer status enjoys a five year 70% to 100% exemption from the payment of income tax under the Promotions of Investments Act 1986. A company granted ITA is entitled to an allowance of 60% to 100% on its qualifying capital expenditure incurred within five years from the date the first qualifying capital expenditure is incurred.

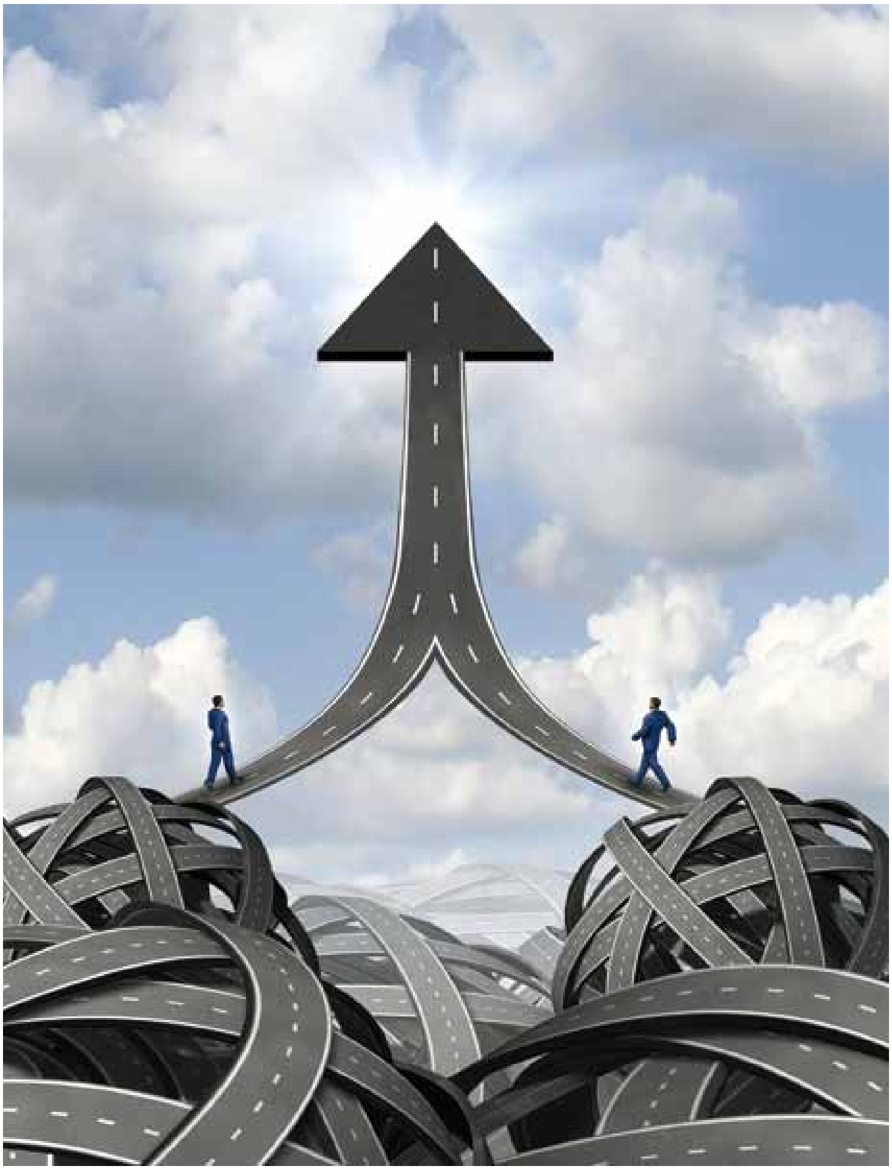
Malaysian economy.

Incentives are usually aimed at developing new growth areas that can generate high-income, high-skilled jobs and cultivate supporting industries in the same cluster. The entry of a strategic project can move industries up the value chain, driving Malaysia's transformation towards developed nation status. Past examples of successful pioneer projects include Intel (M) Sdn. Bhd, First Solar (M) Sdn. Bhd, Western Digital (M) Sdn. Bhd, Infineon Technologies (Malaysia) Sdn. Bhd. as well as home-spun heroes such as SapuraKencana and Vitrox Technologies Sdn. Bhd.

MIDA leads the National Committee on Investment (NCI), which provides a balanced consensus from members who represent several government Ministries and relevant agencies. Through the NCI, MIDA evaluates and decides upon applications for incentives.

MIDA's industry experts evaluate each application, taking into consideration national policies, implications to the business landscape and expected spin-offs. In the interest of transparency, Malaysia makes the list of promoted activities for incentives available to the public (see sidebar 2). Companies involved in high value-added activities incorporating innovation, creativity and R&D stand to get better incentives than those in labour-intensive industries, as they will support the nation's shift up the value chain.

While MIDA assists existing industries in establishing their operations, the agency is also looking beyond tomorrow. By taking a broad view to assess future business models and the possible changes in each industry's landscape, MIDA hopes to seize upon high-potential emerging technologies that can be tapped for Malaysia's benefit. Industries such as advanced electronics, medical devices, renewable energy, aerospace



and information and communication technology (ICT) evolve at a rapid rate and therefore require careful and calculated tax treatments.

Achieving a perception shift

MIDA faces several ongoing challenges in managing the national effort to incentivise and attract investments. First is the perception challenge. In the early years of the nation's economic growth, investors saw Malaysia as a production base first and foremost. But the years of Malaysia's low-cost advantage are long past, as the country has evolved towards higher value-added and knowledge-centric industries.

Any sampling of high-income economies makes it clear that R&D, creativity and innovation are essential for moving economies up the value chain, especially in the case of high value-added activities and front-end manufacturing. Companies that are able to inject creativity and innovation in their products will be able to increase productivity, earn a premium from their products, and gain a competitive edge in the market. For this reason, Malaysia's tax incentives are designed to attract greater investments in science and technology, particularly in the promoted sectors. MIDA is focused on changing investors' perception of Malaysia to highlight the availability of advanced infrastructure, competitive talent and supporting industries that can undergird high-technology projects.

Another common misconception faced by MIDA concerns its focus on foreign investments. While the media has often spotlighted high-profile projects involving foreign direct investments (FDIs), the agency has not actually neglected domestic investments, and in fact continues to strengthen its domestic initiatives.

Malaysia's private savings-investment gap (11.9% of GNI in 2010) is proof that domestic investment has room to grow. Under the ETP, the Government has set a target of RM1.4 trillion in investments by 2020, of which 92 per cent will comprise private investments. Out of the total private investments, the contribution of domestic investments is set at 73 per cent.

Seeking to further promote domestic investment growth, the government has established a Domestic Investment Strategic Fund of RM1 billion. Managed by MIDA, the Fund will provide assistance to Malaysian-owned companies under the Customised Incentive Scheme, the details of which will depend on the merits of each case and requests from companies. The Fund aims to leverage on outsourcing opportunities created by multinationals operating in Malaysia, intensify technology acquisition by Malaysian-owned companies, and enable Malaysian-owned companies to obtain international standards and certifications in strategic industries.

The Promoted List

The list of promoted activities and products which are eligible for consideration of Pioneer Status and Investment Tax Allowance have been gazetted under the Promotion of Investments Act 1986. This list covers a range of agriculture, forestry and wood products; chemical and petrochemical products; oil palm products; iron and steel products; components for machinery; electrical and electronic products; manufacturing-related services and hotel and tourism services.

The promoted list also includes activities and products for high technology projects, small-scale companies, selected industries (machinery and equipment, oil palm biomass, renewable energy and conservation of energy) as well as activities and products for reinvestment.

A future without dependencies

MIDA is well aware that tax incentives are just another tool to provide a tipping point for investment attraction. Incentives alone are no substitute for inherently strong competitive advantages, such as a vibrant talent pool, a knowledge-based economy, robust investor protection, healthy interconnected upstream and downstream industries, and other factors conducive to investment. With these unique strengths, Malaysia is well on its way to creating such a conducive business landscape.

To reduce business dependency on incentives, MIDA's challenge is twofold: The agency needs to identify the strengths and opportunities in the various business ecosystems. Then, it has to showcase these advantages to investors. As MIDA continues to educate investors about the benefits of the cluster-based ecosystem approach, these attraction factors will overshadow tax incentives in importance, thus reducing the need for such incentives.

MIDA also plays an important part in the government's drive to reduce industries' dependence on foreign labour. Malaysia's economic growth and the development of its educational institutions has led to a flowering of home grown skilled talent, particularly in science and technology.

In its role in managing tax incentive approvals, MIDA is in a prime position to reduce industries' dependency on foreign labour through a phased approach. The agency has launched initiatives to facilitate the human capital needs of investors, including a dedicated division for providing human capital services to investors, a comprehensive database on local graduates, a structured MIDA-Academia-Industry collaboration, and a comprehensive database on talent development programmes. MIDA also intends to continue its partnership with TalentCorp to identify sectors in sore need of skilled manpower.

Many roles, one mission

Going forward, the new MIDA will continue to fill the role it has played for decades, serving as the bridge between public sector bodies and private sector investors. To accomplish its mission, the agency has learned to sit on both sides of the table, acting as the representative of the business community when dealing with other government agencies, and functioning as a government body when negotiating with investors.

The emergence of Malaysia's Investment Promotion Agencies (IPAs) such as the regional economic corridors and industry-specific promotion agencies heralds new opportunities for wooing investors. However, the government is well aware of the need for greater national coordination between the IPAs in order to avoid duplication of promotional and marketing efforts. MIDA has been assigned as the Central Agency for coordinating and streamlining approvals of the various agencies to ensure a smooth and unified process for investment attraction.

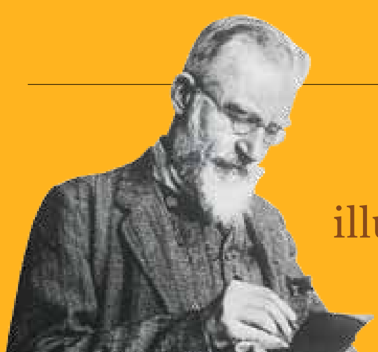
Dato' Azman Mahmud *started his career with the Malaysian Investment Development Authority (MIDA), the Government's principal agency for the promotion of manufacturing and services sectors in Malaysia since 1989 and currently serves as the CEO of the organisation. He has extensive experience in international business as well as a broad understanding of the development of the manufacturing and services sectors in Malaysia.*

INTERNATIONAL TAX DISPUTE RESOLUTION

MUTUAL AGREEMENT PROCEDURE ROUTE

Rihanna Haryanti Mohd Ramli

The combination of global uncertainties from the financial crisis to political upheavals in certain parts of the world, has also spurred governments in increasing their revenue collection and widening the tax base. This has resulted in an increased focus on tax audits and tax controversies / disputes between the governments and the international investors. Revenue authorities are increasingly seen to take aggressive approaches against the international tax norms on the basis of populist or political sentiments within their local jurisdictions. Tax assessments are seen to be a tool of the current political governments to demonstrate to their own nationals of good government governance where the multinational companies are depicted as parties "defrauding" the countries' resources and not paying their "fair share of taxes" in their respective countries.



> The problem with communication is the illusion that it has occurred.
>
> *- George Bernard Shaw*

Behind this background, tax positions undertaken by multinational companies in a certain country due to the availability of provisions within the Double Taxation Agreements ("DTA") between countries are increasingly being challenged or denied. This could be in the form of total denial that the treaty is applicable to the transaction to whether the company has sufficient "substance" to be accorded treaty benefits despite the fact that the treaty country has accorded tax residency status to the company.

As such, multinationals are relying on the traditional Mutual Agreement Procedures (MAP) as provided in Article 25 of the OECD Model Convention 2011 to resolve the tax disputes encountered when investing in a foreign country. However, the issue is how effective is the MAP in resolving a cross border tax dispute and whether there are other alternative techniques available to provide more effective and timely financial resolutions for a company.

MUTUAL AGREEMENT PROCEDURE – "ONLY TALK, NO ACTION"?

The MAP statistics for 2012 of the OECD members are reflected in **Exhibit 1** – New reported MAP cases initiated in the reporting year and **Exhibit 2** – Inventories of MAP cases by the end of the reporting year[1].

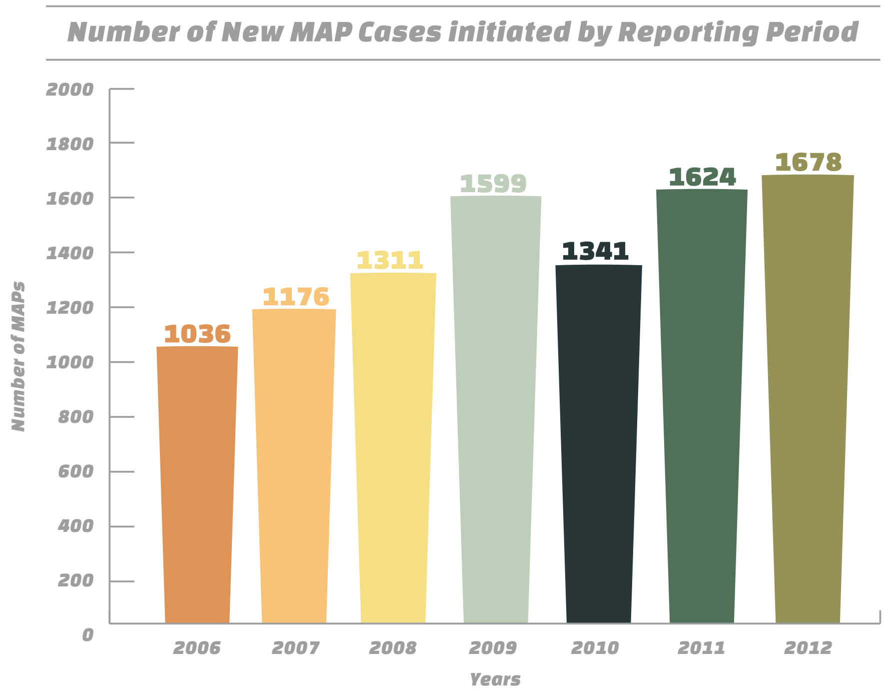
Based on the OECD MAP statistics, there has been an increase of 62% of cases initiated within the OECD member community from year 2006 to 2012. Within OECD's statistics and its member countries, it is officially reported that the average cycle for the MAP cases to be completed, closed or withdrawn in 2012 is approximately 25.46 months or a two year period[2].

Although the statistic only reflects OECD members, it is consistent with the growing trend of the MAPs instituted or initiated. The worrying part for any foreign investor with the growing trend is the increase in uncertainty of any DTAs executed between governments being honoured by each Contracting State and the dispute resolution timeline to resolve a particular MAP which could have an impact to the business and financial decisions undertaken on the investment.

The general dispute resolution mechanism within a DTA is provided in the MAP - Article 25(1) to (4) of the OECD Model Convention, which is adopted by Malaysia for all its DTAs executed:

1. Where a person considers that the actions of one or both of the Contracting States results or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the

EXHIBIT 1: NEW REPORTED MAP CASES INITIATED



[1] *http://www.oecd.org/ctp/dispute/2012mapstatisticsreleased.htm*

[2] *http://www.oecd.org/ctp/dispute/2012mapstatisticsreleased.htm*

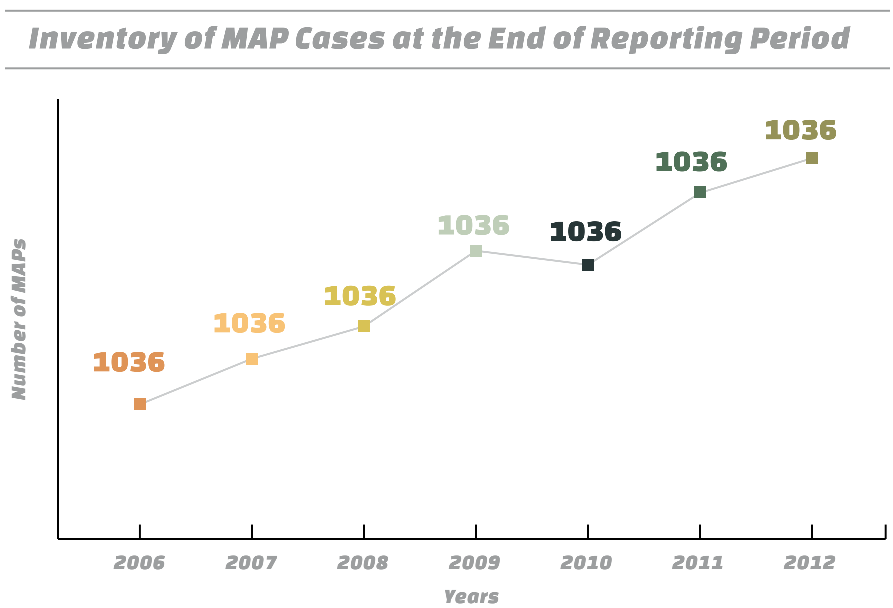


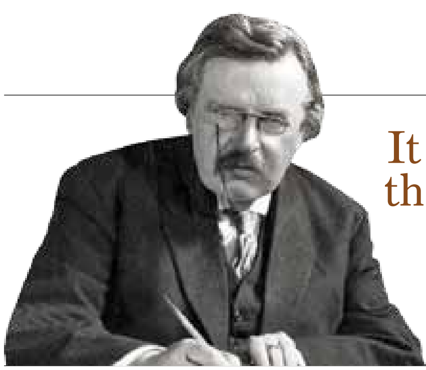
EXHIBIT 2: INVENTORIES OF MAP CASES

Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not by itself able to arrive at an appropriate solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.
3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.
4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.

Based on Article 25(1) to (4), the following observations can be made:

a. The competent authorities are not obliged to resolve a MAP initiated by a taxpayer as the requirement agreed between the Contracting States are that the competent authorities will only endeavour to resolve the case. The current OECD Model Convention does not provide any specific timeline nor procedure that both Contracting States must reach an agreement to remove the double taxation or any matter that is not in accordance with the DTA. In pursuing a MAP, there is a need to "persuade" a competent authority that the matter merits the invocation of Article 25(2) of the Convention. Upon successfully persuading your competent authority of the merits of the case, it is imperative that the other competent authority of the Contracting State involved also agrees to bring the matter for MAP discussions. Again, there is currently nothing within Article 25 to compel both competent authorities to even commence a MAP on behalf of the taxpayer.
b. There is a lack of active involvement of the taxpayer in the MAP process. The taxpayer is at the mercy of both competent authorities. Article 25(1) of the OECD Model Convention does not provide that the taxpayer has the right to initiate the MAP if the taxpayer considers that the actions of the Contracting State or States is not in accordance with the provisions of the MAP. The taxpayer may be updated by its own competent authority on the status of the proceedings but the negotiations and details of the arguments may not be shared by the competent authority.
c. Due to lack of clarity on the timeframe to complete a MAP, domestic legal actions are also undertaken by the taxpayer against the revenue authorities. This is because under normal circumstances the disputes



It isn't that they can't see the solution. It's that they can't see the problem.

- G.K. Chesterton

would result in additional taxes to be paid and additional assessments issued by the relevant revenue authorities. The additional taxes would be paid and legal domestic action is then taken to compel the local revenue authorities to review their positions. In these circumstances, especially when it involves cross border transactions – even the local judiciary may agree with the local revenue authorities and do not want to create a precedent which may be detrimental to the local economy or if the disputed value is too large for the local authorities to forego a substantial amount of revenue for their respective countries.

d. A dilemma would also occur if a taxpayer institutes both domestic legal and MAP action at the same time and should the decisions that come out differ from each other, which decision is binding on the local revenue authority. In certain jurisdictions, e.g. Indonesia, where a taxpayer decides to pursue both actions and the local court system issues a judgement first before the MAP is decided, any decision of the MAP which is contrary to the Indonesian court system cannot or would not be enforced by the local revenue authority and this renders the MAP decision and effort null and void.

In Malaysia, the newly introduced Section 102(1A) provides that when a taxpayer has already invoked a MAP, a similar appeal will not be submitted to SCIT until the MAP has been determined. This effectively denies the taxpayer's rights to also pursue its appeal options under the Income Tax Act 1967 and it would delay any appeal process as it is dependent on the outcome of the MAP.

In the meantime, the taxpayer may be in a conundrum as to whether any action has been taken by the competent authorities and what tax position should be taken for the future tax years. The process creates uncertainties in terms of outcome and timing of the decision to a taxpayer in doing business in a particular country. This could also effectively have an impact to the internal rate of return of the investor or the profiling of a country when decisions are made globally by a multinational to continue investing in a particular country or otherwise.

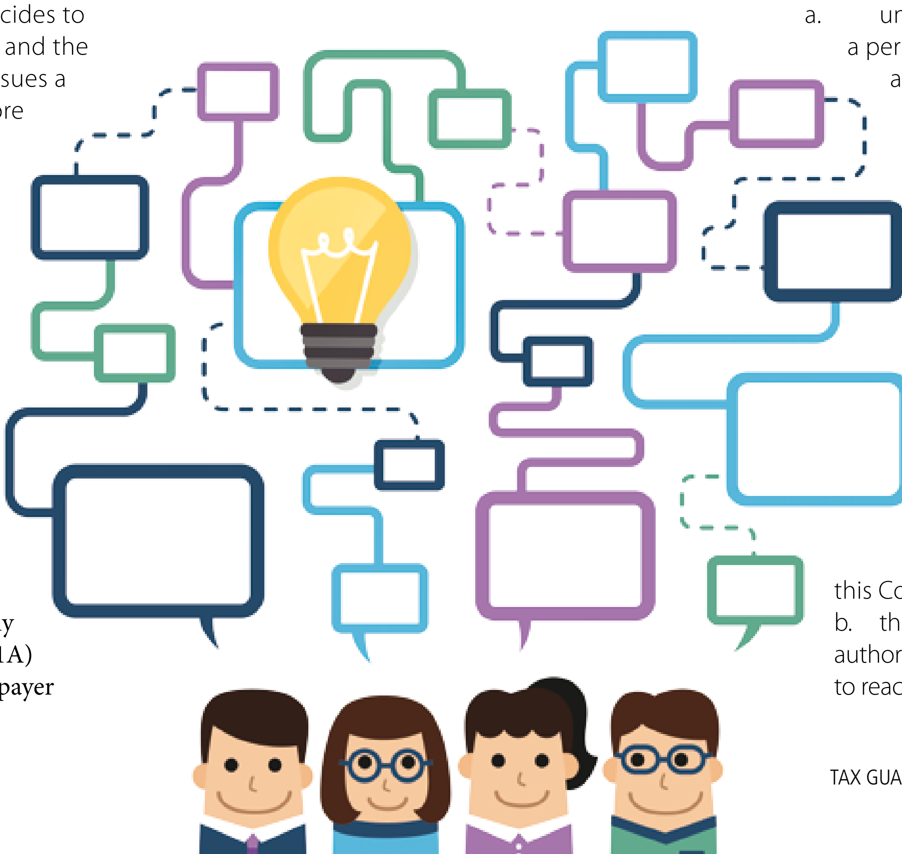
With this increased need to reduce uncertainty and timing, both the OECD Model Convention and the UN Model Double Taxation Convention recognises the need to introduce a mandatory arbitration provision within the current framework of Article 25.

INTERNATIONAL ARBITRATION – AN ALTERNATIVE MECHANISM TO RESOLVE TAX DISPUTES OR CONTROVERSIES?

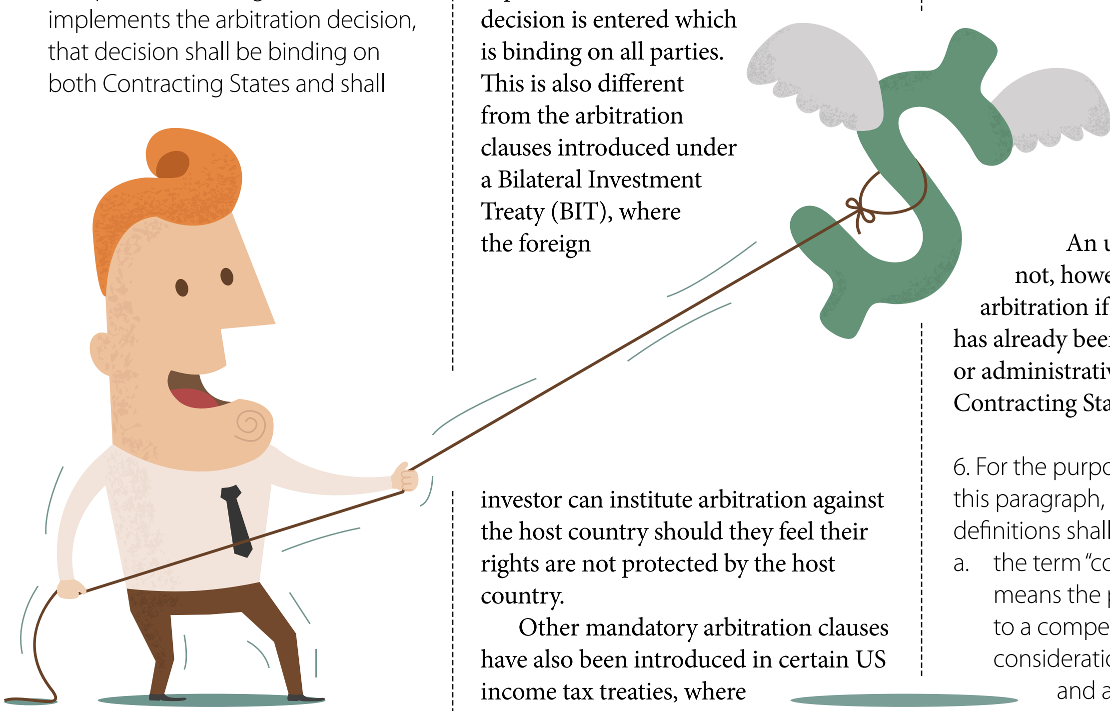
Arbitration is a formal dispute resolution by one or more impartial parties for final and binding determination. The decisions issued by the arbitrators are final and can be executed as provided in the Convention of the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) as issued by the United Nations Conference of International Commercial Arbitration (UNCITRAL). If the seat of arbitration is in a country which is also a signatory of the New York Convention, the award by the arbitrators will be recognised by all other signatory countries.

Article 25 was expanded on 17 July 2008 via "The 2008 Update to the Model Tax Convention" by the introduction of Para 5, which provides:

> Where,
> a. under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and
> b. the competent authorities are unable to reach an agreement



to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall



be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

The OECD Commentary for Article 25(5) provides that this process is not an alternative or additional recourse, it is merely an extension of the MAP that is to enhance the effectiveness of the procedure. The arbitration procedure is merely on the disputed issues rather than the case itself. The decision of the case still lies with the relevant competent authorities. As such, after the arbitration decision on the unresolved issues, the competent authorities will reconvene and decide the case on the basis as determined by the arbitrators' on the disputed issues. This limitation within the "tax treaty arbitration system" introduced in the OECD Model Convention is unlike the other commercial arbitrations provided where the arbitrators' powers are expanded to resolve the entire case and decision is entered which is binding on all parties. This is also different from the arbitration clauses introduced under a Bilateral Investment Treaty (BIT), where the foreign investor can institute arbitration against the host country should they feel their rights are not protected by the host country.

Other mandatory arbitration clauses have also been introduced in certain US income tax treaties, where Article 25 again provides a mandatory binding arbitration clause that enables the designated representatives and competent authorities to communicate with the intent to resolve international tax disputes. A sample of Article 25(5) per the US-France DTA:

5. Where, pursuant to a mutual agreement procedure under this Article, the competent authorities have endeavoured but are unable to reach a complete agreement, the case shall be resolved through arbitration conducted in the manner prescribed by, and subject to, the requirements of paragraph 6 and any rules or procedures agreed upon by the Contracting States, if:

a. tax returns have been filed with at least one of the Contracting States with respect to the taxable years at issue in the case;
b. the case is not a particular case that both competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration; and
c. all concerned persons agree according to the provisions of subparagraph (d) of paragraph 6.

An unresolved case shall not, however, be submitted for arbitration if a decision on such case has already been rendered by a court or administrative tribunal of either Contracting State.

6. For the purposes of paragraph 5 and this paragraph, the following rules and definitions shall apply:

a. the term "concerned person" means the presenter of a case to a competent authority for consideration under this Article and all other persons, if any, whose tax liability to either Contracting State may be directly affected by a mutual agreement arising from that consideration;
b. the "commencement date" for a case is the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities;
c. arbitration proceedings in a case shall begin on the later of:
   i. two years after the

commencement date of that case, unless both competent authorities have previously agreed to a different date, and

ii. the earliest date upon which the agreement required by subparagraph (d) has been received by both competent authorities;

d. the concerned person (s), and their authorised representatives or agents, must agree prior to the beginning of arbitration proceedings not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration panel, other than the determination of such panel;

e. unless any concerned person does not accept the determination of an arbitration panel, the determination shall constitute a resolution by mutual agreement under this Article and shall be binding on both Contracting States with respect to that case only; and

f. for purposes of an arbitration proceeding under paragraph 5 and this paragraph, the members of the arbitration panel and their staffs shall be considered "persons or authorities" to whom information may be disclosed under Article 27 (Exchange of Information) of the Convention."

The mandatory arbitration clause adopted by US is different from the OECD or UN Model Conventions, where the arbitration is entered to resolve the case itself. The arbitrators' are required to choose a proposal from one side of the dispute and not create its own conclusion on the case.

ARBITRATION VS MAP?

In 2011, world merchandise trade was valued at USD18.2 trillion and world commercial services exports valued at USD4.2 trillion. With the high volume of cross border transactions, governments are heavily impacted as they try to also ensure that the taxes from the income and gains that is earned from the transactions are properly captured.

In 2011, world merchandise trade was valued at USD18.2 trillion and world commercial services exports valued at USD4.2 trillion[3]. With the high volume of cross border transactions, governments are heavily impacted as they try to also ensure that the taxes from the income and gains that is earned from the transactions are properly captured. With this, international disputes may arise where disagreements between countries on the interpretation and application of a DTA or when there is total denial of treaty benefits.

For taxpayers, it is important that any tax disputes or controversies are resolved and the resolution is achieved as promptly as possible as the issues may be huge and costly for the taxpayer.

The introduction of arbitration articles within DTAs is to further assist the respective competent authorities in their effort to reduce the inventories of MAP and prompt the governments to act more quickly to resolve CA cases. It provides some expediency to the taxpayers to resolve its issues or proceed by way of arbitration and the timeline could move from a typical 4-year MAP method to a 1-year completion via the arbitration mechanism. Despite the current "tax arbitration system" being not a perfect system for tax controversies nor is it similar to the usual commercial international arbitration system, it is still a step towards a mind shift by governments on the need to look into other tax dispute resolution mechanism.

Despite the potential increase in disposal of MAP cases via the introduction of arbitration clauses within the DTA, as at June 2012 only 17% of the treaties and protocols concluded by OECD member countries has included arbitration provisions.[4]

[3] *World Trade Organisation, "World Trade figures for 2011, prospects for 2012", PRESS/658/Rev.1 (press release dated 10 May 2012).*

[4] *Ruiter, M. a. (2012, June). World Commerce Review. Retrieved from www.worldcommercereview.com.*

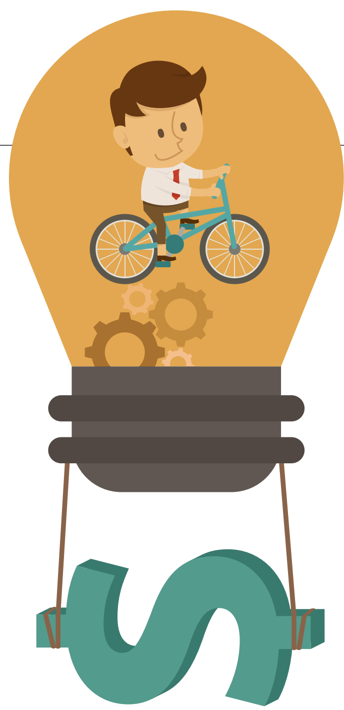
Malaysia has adopted Alternative A of Article 25 of the United Nations Model Convention which excludes arbitration as provided for in paragraph 5 of the OECD Model Convention in its DTAs executed.

Within the commentary of the UN Model Convention, countries that are in favour of Alternative A are the developing countries, as arbitration is not included. The developing countries lack the relevant expertise to manage arbitration matters. Thus, it creates an unfair situation when a dispute occurs with more experienced countries and the interests of developing countries especially on tax matters would hardly be safeguarded by private arbitrators. Further, the cost of mandatory arbitration is costly and therefore making it unsuitable for developing countries[5].

Governments should realise in a world where diplomacy sometimes does not work when there are issues or differences between governments, there is a need to strengthen the dispute resolution mechanisms available with the DTAs which essentially provides better protection to the individual investor. The international tax systems and governments are still playing catch up to the ever changing world of global business and economy where every single minute counts.

5 Para 4, Article 25 Commentary of the Model Double Taxation Convention between Developed and Developing Countries, United Nations

CONCLUSION



It is timely for Malaysia to relook at its position. With the country increasingly trying to shift its position from a developing country status to a developed country status by 2020, more Malaysian companies are venturing and investing outside of Malaysian shores. They would rely on the wisdom of its competent authorities to negotiate treaties which not only looks into protecting Malaysia's sovereign rights but to also ensure that investments done by Malaysian companies are similarly protected. With the increase in trade transactions outside of Malaysia, increased tax controversies would also have an impact on Malaysian companies when investing outside of Malaysia and as such, any alternative dispute resolution mechanism would be a definite relief to Malaysian investors. Having proper best practices adopted by Malaysia's competent authorities (example: issuance of administrative guidelines etc.), would also assist in a more transparent method of applying the MAP.

While taxpayers are expected or demanded to pay their fair share of taxes, it is also important for competent authorities to show their willingness to resolve the tax controversies that may lead to taxpayers paying more than their fair share. As Plato said, "When there is an income tax, the just man will pay more and the unjust less on the same amount of income", the governments need to stop evaluating all taxpayers with the same creed. There are "just" taxpayers who expect the governments to also be "just" in their implementation of swift and effective dispute resolution processes that are fit for purpose in a time when international disputes are expected to increase significantly.

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BEPS AND TRANSFER PRICING

Disclose or Perish OR Disclose and Perish – A Conundrum

Venkataraman Ganesan

As part of the Base Erosion Profit Shifting (BEPS), the Organisation for Economic Co-operation and Development (OECD), on 19 July 2013 issued under Action 13, a Discussion Draft on Transfer Pricing Documentation and Country by Country Reporting calling for a review of the existing transfer pricing documentation rules and the development of a template for country-by-country (CbC) reporting of income, taxes and economic activity for tax administrations.[1] This document (a Public Consultation Draft) received comments from various stakeholders, in response to which the OECD issued a revised Discussion Draft on 30 January 2014. This document also called for comments from the concerned stakeholders and the last date for the submission of comments was 23 February 2014.

> "The wisdom of man never yet contrived a system of taxation that would operate with perfect equality."
>
> – Andrew Jackson

This Article is restricted to and focused on the revised discussion draft issued by the OECD on Transfer Pricing documentation and country by country reporting. Throughout this discussion, the term CbC reporting would be employed to be consistent with, and in conjunction with the terminology employed by the OECD.

This article is divided into three parts. While Part A elucidates the key recommendations made by the OECD in the proposed discussion draft on Transfer Pricing and CbC reporting, Part B provides a vantage viewpoint regarding the various practical concerns that would be faced by taxpayers in complying with the recommendations as elucidated in Part A. Finally Part C concludes by providing logical solutions to bridge the divide between concerns of the taxpayer and the expectations fostered by the OECD.

PART A

Key Features underlying the draft discussion on CbC reporting

A. Two Tiered Approach to Transfer Pricing documentation

The quintessential feature underlying this draft discussion document (as has been with the earlier one), is the emphasis on a 'two tiered approach to transfer pricing documentation. This two

[1] *The BEPS initiative embeds 15 Action Points with stipulated deadlines for complying with the same. The details regarding the Action Points and the completion deadlines may be accessed at the OECD Official Webpage: http://www.oecd.org/ctp/discussiondrafts.htm.*

tier structure basically comprises of:

- A Master File; and
- A Local file

The OECD also elucidates the exact nature of a Master File and a Local file, in addition to identifying the various facets of information to be embedded in both the files. The gist of the OECD articulations is laid down in the succeeding paragraphs:

Master File

A Master File is one that encompasses common standardised information relevant for all the entities constituting a Multinational Enterprise (MNE). According to the OECD the primary intent underlying the preparation and maintenance of a Master File is the disclosure of a reasonably complete picture of the global business, financial reporting, debt structure, tax situation and the allocation of the MNE's income, economic activity and tax payments. Such a disclosure would enable tax administrations across jurisdictions to evaluate potential and significant transfer pricing risks. The OECD in the draft discussion document postulates that taxpayers "should be able to prepare the Master File either for the MNE group as a whole or by line of business, depending on which would provide the most relevant transfer pricing information to tax administrations".[2]

Contents of a Master File

The OECD provides the following details to be encompassed within the confines of a Master File:[3]

1. Chart illustrating the MNE's legal and ownership structure and geographical location of operating entities;
2. Important drivers of business profit;
3. Chart showing supply chain for material products and services;
4. Chart showing important service arrangements between members of the MNE group other than R&D services;
5. A description of the main geographic markets for material products and services;
6. A written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used;
7. A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year;
8. The title and country of the principal office of each of the 25 most highly compensated employees in the business line (note: names of such individuals should not be included);
9. A description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management;
10. A list of material intangibles or groups of intangibles of the MNE group and which entities own them;
11. A list of important related party agreements related to intangibles, including cost contribution arrangements, principal research service agreements and license agreements;
12. A description of the group's transfer pricing policies related to R&D and intangibles;
13. A description of any material transfers of interests in intangibles among associated enterprises during the fiscal year concerned, including the entities, countries, and compensation involved;
14. A description of how the group is financed, including identification of important financing;
15. The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws the entity is organised and place of effective management of such entities;
16. A description of the MNE's general transfer pricing policies related to financing arrangements between associated enterprises;
17. MNE's annual consolidated financial statement for the fiscal year concerned;
18. A list and brief description of the MNE group's applicable unilateral and bilateral/multilateral APAs and Advance rulings;
19. A list and brief description of other relevant tax rulings related to the allocation of income to particular jurisdictions;
20. A list and brief description of transfer pricing matters pending under treaty MAP or resolved via MAP during the last two years; and
21. Country-by-country reporting template according to Annex III.

[2] *Heading C.1. Paragraph 18 of the Discussion Draft on Transfer Pricing Documentation and CbC Reporting.*

[3] *Annex I to Chapter V: Transfer pricing documentation - Master File.*

Note:** The information requirement as stipulated under points 2 – 8 above are required to be furnished with respect to **each line of the MNE's business (emphasis supplied).

Local file

The Discussion Draft on Transfer Pricing Documentation and CbC Reporting expostulates that a local file ought to embed such information so as to supplement the information contained within the confines of a Master File.[4]

A Local File provides assurance or evidence regarding the compliance of the arm's length principle by the taxpayer situated in a particular tax jurisdiction. Hence a Local File predominantly sets its sight upon the transfer pricing analysis related to transactions taking place between a local country affiliate and associated enterprises in different countries and which is material in the context of the local country's tax system. Examples of information of the kind referred to above would be comparability/ benchmarking analysis and the selection and application of the most appropriate transfer pricing method for the fiscal year in question.

Contents of a Local File

The OECD provides the following details to be encompassed within the confines of a Local File[5]

1. Details regarding the management structure of the local entity (including an organisation chart);
2. Description of the individuals to whom local management reports and the country/(ies) in which such individuals maintain their principal offices;
3. Details regarding the involvement of the local entity (wherever appropriate), in business restructurings or intangibles transfers in the present or immediate past year;
4. Description of the related party transactions entered into by the local entity relating to procurement and sale of tangible goods/services and also transactions involving intangibles and financial services;
5. Total sum of intercompany charges for each category of transactions;
6. Identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them.
7. A detailed function asset and risk analysis of the local entity as well as of the relevant associated enterprises with respect to each documented category of controlled transactions, i.e. functions performed, assets used and/or contributed (including intangibles) and risks borne, including any changes compared to prior years.
8. Identification and description of other controlled transactions of the taxpayer that can directly or indirectly affect the pricing of the controlled transaction being documented.
9. Indicate the most appropriate transfer pricing method with regard to the category of transaction and the reasons for selecting that method.
10. Indicate which associated enterprise is selected as the tested party, if applicable, and explain why.
11. Summarise the important assumptions made in applying the transfer pricing methodology.
12. If relevant, explain the reasons for performing a multi-year analysis.
13. List and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information.
14. Describe any comparability adjustments performed, and indicate whether adjustments have been made to the results of the tested party, the comparable uncontrolled transactions, or both.
15. Describe the reasons for concluding that relevant transactions were conducted on an arm's length basis based on the application of the selected transfer pricing method.

B. Contemporaneous Documentation

The Discussion Draft also requires that taxpayers determine their transfer pricing in accordance with the arm's length principle, based upon information reasonably available at the time of the determination.[6] This in effect means that a taxpayer ought to consider whether a transfer pricing policy that is adopted is relevant and appropriate for tax purposes, prior to the establishment of such transfer pricing. The OECD also requires a taxpayer to confirm the arm's length nature of his financial results at the time of filing a tax return.

C. Time Frame

The OECD recognises that practices regarding the timing of the preparation of the documentation differ among countries. The OECD also recognises that such differences in the timing requirements can add to taxpayers' difficulties in setting priorities and in providing the right information to the tax administrations at the right time. The suggestion provided by the Discussion Draft is to require both the Master File and the Local File to be prepared no later than the due date for the filing of the tax return for the fiscal year in question. However in all those cases where final statutory financial statements and other financial information relevant

[4] Heading C.2. Paragraph 23 of the Discussion Draft on Transfer Pricing Documentation and CbC Reporting.

[5] Annex II to Chapter V: Transfer Pricing Documentation - Local File.

[6] Heading D.1 Paragraph 25 of the Discussion Draft on Transfer Pricing Documentation and CbC Reporting.

for the CbC reporting requirements are not finalised until the due date for tax returns, the best practice would extend the date for completion of the template to one year following the last day of the fiscal year of the ultimate parent entity of the MNE group.

D. Penalties

The Discussion Draft document states that *"it would be unfair to impose sizable documentation-related penalties on taxpayers that make a reasonable effort, in good faith, to demonstrate through reliable documentation that their controlled transactions satisfy the arm's length principle"*.[7] The Discussion Draft also states that imposition of penalties must be avoided in situations where the data in question is beyond the access of an MNE.

E. Materiality

The Discussion Draft postulates the inclusion of materiality thresholds in Transfer Pricing documentation requirements with a view to obviate the expending of unnecessary efforts in both collecting and scrutinising non-essential information and data.[8] Such materiality thresholds, as per the Discussion Draft, should take into consideration factors such as the size and the nature of the local economy, the importance of the MNE group in that economy, and the size and nature of local operating entities, in addition to the overall size and nature of the MNE group.

F. Confidentiality

The Discussion Draft particularly lays emphasis on the fact that *"tax administrations should ensure that there is no public disclosure of trade secrets, scientific secrets, or other confidential information"*.[9] The draft also goes on to add: *"tax administrations therefore should use discretion in requesting this type of information and assure taxpayers that the information presented in documentation will remain confidential. In cases where disclosure is required in public court proceedings or judicial decisions, every effort should be made to ensure that confidentiality is maintained and that information is disclosed only to the extent needed"*.[10]

Part B

While the CbC reporting initiative is one to be lauded in so far as striving for transparency and curbing Transfer Pricing abuse are concerned, there is no denying that in its present Avatar, it poses some extenuating practical difficulties for the taxpayer. Some of the critical niggles are as expounded in the following paragraphs:

Information Overload

Albert Einstein once famously remarked *"Information is not knowledge"*. One might be forgiven for assuming that this world famous physicist although known to grapple hard with the nuances of Taxation, had a prescience regarding the introduction of the CbC reporting requirements! While there is no denying the fact that with a view to conducting and completing a Transfer Pricing audit in a methodical and meticulous manner, tax administrations should not be starved of crucial taxpayer information, a slew of information on the contrary would have an adverse and undesirable effect on a Transfer Pricing audit. The following information as prescribed in the Discussion Draft might not be essential or to put in a different manner, the lack of the following information ought not to act as an impediment of any sort for a tax administration in the discharge of its duties:

- A list and brief description of the MNE group's applicable unilateral and bilateral/multilateral APAs and Advance rulings;
- A list and brief description of transfer pricing matters pending under treaty MAP or resolved in a MAP during the last two years;
- The title and country of the principal office of each of the 25 most highly compensated employees in the business line;
- A list of restructurings and intangible transfers during the year (which presumably do not include the local country, which would be included in the local country report if the local company was a counterparty)

Disclosure of such information would only go on to add to the enhancement of a risk perception on the part of the tax administration and unduly prolong the process of an audit/ assessment related to a taxpayer without any tangible or intangible benefits to either party.

Cost of Compliance

While transparency without a semblance of a doubt should be the *sine qua non* characterising the interactions between taxpayers and tax administrations, the search for the best means to achieve transparency must not under any circumstances have the effect of obfuscating cost efficiencies. The information which a taxpayer is expected to furnish under both the Master as well as Local File requirements is so myriad that there would undoubtedly be a significant upsurge in the cost of compliance necessitating a substantial cash outflow.

Penalties

While the Discussion Draft rightly opines that it would be unfair to impose sizable documentation-related penalties

[7] *Heading D.7 Paragraph 38 of the Discussion Draft on Transfer Pricing Documentation and CbC Reporting.*

[8] *Heading D.3 Paragraph 29 of the Discussion Draft on Transfer Pricing Documentation and CbC Reporting.*

[9] *Heading D.8 Paragraph 41 of the Discussion Draft on Transfer Pricing Documentation and CbC Reporting.*

[10] *Ibid.*

on taxpayers that make a reasonable effort, in good faith, to demonstrate through reliable documentation that their controlled transactions satisfy the arm's length principle, it does not explicitly go on to recommend that in the event of an interpretative difference in view point between the taxpayer and the tax administration and also in cases of subjective differences in assumptions between the taxpayer and tax administration, the imposition of penalties ought to be avoided unless a prima facie case for imposition can be made against the taxpayer. In the realms of Transfer Pricing, where the proverbial Science vs Art argument fails to hold water as the Art clearly emerges triumphant, the aspect of penalties is indeed an unavoidable thorn in the flesh.

Reporting of Income Taxes

The Discussion Draft requires the taxpayer to report cash payments of tax instead of reporting tax accruals. There is a genuine possibility that the amount of cash income tax may not be readily identifiable in the books and records maintained by the taxpayer. Moreover, cash income taxes usually do not correspond to current year's profits because there is usually a timing difference between cash taxes paid and earnings subject to tax, which includes the overlapping periods when making estimated tax payments and/or payments upon finalisation and filing of income tax returns from previous periods.

Preparation of Master File

The OECD requires taxpayers to prepare the Master File either for the MNE group as a whole or by line of business, depending on which would provide the most relevant transfer pricing information to tax administrations. A requirement of consolidation at each and every individual country level is likely to be a cumbersome and tedious process for many MNEs. This exercise would also have the effect of substantially increasing the compliance burden for these MNEs.

PART C

CONCLUSION

The initiative of the OECD in issuing the original as well as the revised Discussion Draft on Transfer Pricing Documentation and CbC Reporting strengthens the hope of ushering in a new era of transparency and also co-operation between taxpayers and tax administrations spanning the globe. However if the efforts of the pioneering draftsmen are not to be a mere exercise in futility, the relevant Working Committee of the OECD would do well to have a relook into the Discussion Draft as it stands currently and make some much wanted changes.

Some of the more urgent revisions which the OECD could do with are as set out below:

Less Aggressive Information Request

The information requirement proposed to be part of the Master File may be reviewed so as to seriously consider the possibility of excluding information such as concluded APAs and MAPs; details regarding the title and country of the principal office of each of the 25 most highly compensated employees in the business line; and a list of restructurings and intangible transfers during the year (which presumably do not include the local country, which would be included in the local country report if the local company was a counterparty), from the ambit of disclosure requirements

Position on Penalties

A more firm and conclusive stance regarding the circumstances under which penalties may and may not be imposed would be a welcome measure.

Materiality

A more clear and precise definition of materiality thresholds, possibly in conjunction with Safe Harbours might be a relieving mechanism and a reformist measure in so far as both taxpayers and tax administrations are concerned. This would also go a long way in mitigating the concerns regarding burgeoning compliance costs.

Reporting on Income Taxes

The OECD can mull about the possibility of disclosing taxes paid in line with that reflected in the income tax return instead of disclosing cash income tax.

At the time of writing, we stand at the crossroads in so far as the realm of tax justice is concerned. Tales of rampant tax evasion and shell structures compete with truant and incomprehensible taxation mechanisms. The conduct of both the taxpayers as well as tax administrations seem to echo the famous lament courtesy of the immortal philosopher Plato "when there is an income tax, the just man will pay more and the unjust less on the same amount of income". The time is now ripe for setting right the scales of justice so as to protect the just man and prosecute the unjust. BEPS proposes to do just that. However, there cannot be a wide chasm between an intent that is noble and the method adopted for its execution. Thus, the OECD cannot afford the CbC documentation to be perceived by the taxpayers as a CbC decimation instead. So it's:

"Over to the OECD!"

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Disclaimer:
The views expressed in this article are solely that of the author and do not represent either the views or the opinions of the firm of which he is a part.

International Issues

The column only covers selected developments from countries identified by the CTIM and relates to the period 16 February 2014 to 15 May 2014.

CHINA (PEOPLE'S REP.)

Beneficial ownership clarified

The SAT issued SAT Announcement [2014] No. 24 on 21 April 2014 on beneficial ownership where the investment of a non-resident is managed by an overseas professional institution. Announcement No. 24 applies from 1 June 2014 and is summarised below:

(a) Definitions - "investment managed by an overseas professional

institution" is where a non-resident directly assigns his assets to an overseas professional institution for the purposes of investing in Chinese resident enterprises. An overseas professional institution is defined as a foreign-licensed financial institution such as a security company, asset management institution, or fund management institution. During the investment period, the financial institution is assigned to manage the segregated assets of the non-resident.

(b) Application of treaty benefits - A non-resident who intends to claim tax treaty benefits for income received through a trust investment is required to provide the tax authority with the following information:

– Contracts or agreements signed by the parties involved in each tier of investment, i.e. where one financial institution assigns another financial institution to manage the investment of the non-resident (including a non-resident investor, investment or asset manager, security company, and trustees of different levels), and other information such as the source of the invested amount, the composition of the investment and the agreed charges and investment income to be received.

– Information and evidence on how the investment income and other income have been remitted to the original non-resident investor and the classification of such income, e.g. as dividend or interest.

– Investment income which does not fall within the ambit of the beneficial ownership rules ought to be treated according to the relevant provisions of the tax treaty.

(c) Granting the beneficial ownership status -The non-resident (whose investment is managed by the overseas financial institution) will be deemed the beneficial owner and be entitled to treaty benefits if the investment income qualifies as dividend or interest and, it is proven that the nature of the income has not been altered when remitted to the non-resident. The fees and remunerations on the investment charged and received by the financial institutions in the different layers are not eligible to treaty benefits as the non-resident is not the beneficial owner of such income.

(d) Related parties - In cases where the non-resident investor is related to one of the parties involved in the investment, the information on the transfer pricing principle and method used and other relevant information must be provided to the tax authorities.

(e) Review of the status - Once the beneficial ownership status is granted to the non-resident investor, the status is valid for three calendar years if:

– the investment structure (through the different tiers) remains the same;

– the parties involved in the different tiers remain the same (except the invested Chinese enterprises); and

– the contracts and agreements between the different parties involved (except the invested Chinese enterprises) remain the same.

Enterprise income tax incentive for Hengqin, Pingtan and Qianhai published

The MoF and the SAT, jointly issued Cai Shui [2014] No. 26 on 25 March 2014, reducing the enterprise income tax for the Hengqin New Area of Guangdong province (Hengqin), the Pingtan Comprehensive Pilot Zone of Fujian Province (Pingtan) and the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (Qianhai). The notice retroactively applies from 1 January 2014 and will end on 31 December 2020.

Enterprises established in the abovementioned areas and engaged in the (prescribed) encouraged categories of industries, are subject to enterprise income tax at a reduced rate of 15% (the standard rate is 25%).

The reduced tax rate of this notice is not exclusive from other tax incentives provided under the Enterprise Income Tax Law - a qualified enterprise may take advantage of them all, i.e. if another tax incentive provides for a more favourable tax rate, the enterprise may apply the more favourable rate. Enterprises which are eligible for the reduction of 50% of the tax rate shall calculate the incentive as half of 25% (not half of the reduced rate).

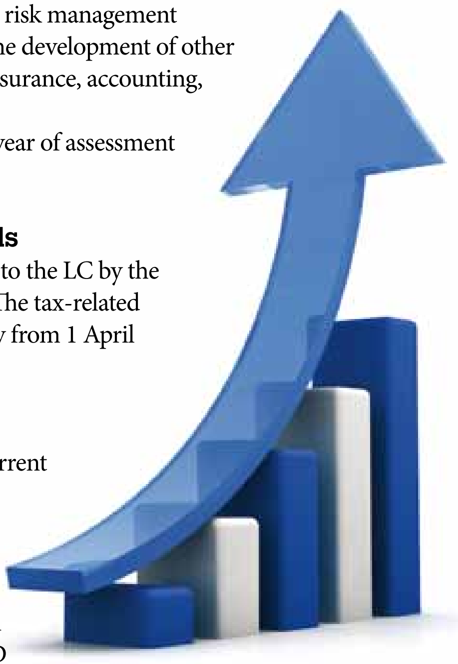
HONG KONG

Inland Revenue (Amendment) (No. 3) Bill 2013 passed

The Inland Revenue (Amendment) (No. 3) Bill 2013 was passed by the Legislative Council (LC) on 19 March 2014.

The Bill seeks to provide a tax concession for captive insurers to enjoy a 50% reduction of the profits tax on offshore risk insurance business. It is expected that the development of captive insurance would reinforce Hong Kong's status as a regional insurance hub, while making Hong Kong's risk management services more diversified and promoting the development of other related professional services including reinsurance, accounting, actuarial and legal services.

The amendment takes effect from the year of assessment 2013/14 onwards.



Budget for 2014/2015 – details

The Budget for 2014/15 was presented to the LC by the Financial Secretary on 26 February 2014. The tax-related proposals will, once they are enacted, apply from 1 April 2014 and are as follows:

Direct taxation

(a) Corporate taxation

– A one-off reduction of 75% of the current profits tax, subject to a maximum of HKD 10,000

(b) Personal taxation

– A one-off reduction of 75% of the current salaries tax and tax under personal assessment, subject to a maximum of HKD 10,000 per case.

– An increase in dependent parent/grandparent allowance

– The maximum amount of deduction for elderly residential care expenses to be increased from HKD76,000 to HKD80,000.

Indirect taxation

Stamp duty on the trading of all exchange traded funds to be waived.

INDIA

Instructions on withholding tax on payments made to non-residents issued

The India Central Board of Direct Taxes (CBDT) released Instruction No. 02/2014 dated 26 February 2014 on the deduction of tax at source (i.e. withholding tax) on payments made to non-residents. The CBDT released the above instruction pursuant to inquiries on whether the withholding tax is to be applied on the whole sum being remitted to a non-resident or on the portion representing the sum chargeable to tax, particularly when no application has been made under the ITA.

In Instruction No. 2/2014, the CBDT has stated that in cases where the taxpayer fails to deduct tax at source on payments made to non-residents under the ITA, the Assessing Officer shall determine the appropriate proportion of the sum chargeable to tax and ascertain the tax liability on which the deductor shall be deemed to be a "taxpayer-in-default". Further, the appropriate portion of the sum will depend on the facts and circumstances of each case taking into account nature of remittances, income component therein or any other fact relevant to determine such appropriate proportion.

Interim Budget for 2014/15

The interim Budget for 2014-15 was presented by the government on 17 February 2014. The new government which was sworn in after elections will present the final Budget.

The interim Budget did not contain any major proposals, however, the government urged the parliament to pass the Goods and Services Tax law and the Direct Tax Code. The Finance Minister also clarified that the government has succeeded in obtaining information on illegal offshore accounts and further prosecution for tax evasion has been launched in 17 other cases. Further, the excise duty has been reduced from 12% to 8% on small cars, two-wheelers and commercial vehicles. The excise duty on sports utility vehicles has been reduced from 30% to 24%.

INDONESIA

Sales tax for luxury cars increased

The government has increased the rate of sales tax on luxury goods from 75% to 125% for certain luxury vehicles. The increased rate is pursuant to Government Regulation No. 22 of 2014 dated 19 March 2014, which is effective 30 days after the issuance date.

SINGAPORE

IRAS issues e-Tax Guide on GST Advance Ruling System

The Inland Revenue Authority of Singapore (IRAS) issued an e-Tax Guide on 21 March 2014 to explain the features of the Goods and Services Tax (GST) advance ruling system and the application procedures. This Guide replaces the e-Tax Guide “GST: Advance Ruling System” that was published earlier on 2 April 2012.

The full Guide is available on the IRAS website.

Income tax treatment of limited partnerships

The IRAS issued an e-Tax Guide that provides details on the income tax treatment of limited partnerships (LPs) on 1 March 2014. Further details can be obtained from the IRAS’ website.

Income tax treatment of limited liability partnerships

The IRAS issued the second edition of the e-Tax Guide on the Income Tax Treatment of Limited Liability Partnerships (LLPs) on 1 March 2014 (first edition was issued on 29 June 2012). This e-Tax Guide is a consolidation of the e-Tax Guides issued previously: (i) Income Tax Treatment of LLPs published on 15 July 2004 ; and (ii) Income Tax Treatment of LLPs (Supplementary Circular) published on 10 June 2005.

This guide explains the tax transparency treatment of an LLP, i.e. income is not taxed at the LLP level, but is instead taxed in the hands of each partner of the LLP as the partner’s share of income from the LLP at his relevant income tax rate.

Budget for 2014 – details

The Budget for 2014 was presented to Parliament by the Finance Minister on 21 February 2014. Details of the Budget, which unless otherwise indicated will apply from the year of assessment (YA) 2015, are summarised below.

Direct taxation

(a) Corporate taxation

– Basel III Additional Tier 1 instruments (other than shares) issued by Singapore-incorporated banks will be treated as debt for tax purposes, i.e. distributions will be deductible for the issuer and taxable for investors

(b) Personal taxation

– The amount of parent and handicapped parent relief will be increased to SGD9,000 and SGD14,000 for individuals staying with the dependant, and to SGD5,500 and SGD10,000 for individuals not staying with the dependant. The claimants will be able to share the relief according to the claimants’ agreed proportion.

– The amount of handicapped spouse, handicapped sibling and handicapped child reliefs will be increased by SGD 2,000 for each relief.

– With effect from the YA 2016, married couples can no longer transfer qualifying deductions and deficits between each other (including under the loss carry-back scheme). As a transitional concession, a deduction will still be allowed for inter-spousal transfers up to YA 2017, subject to existing rules. Any unutilised donations can also be carried forward up to a maximum of five years.

– With effect from YA 2016, the non-resident relief under Section 40 will be removed.

(c) Tax incentives

– The Productivity and Innovation Credit (PIC) scheme will be enhanced as follows:

– the scheme will be extended until YA 2018, and the qualifying expenditure cap of SGD400,000 per qualifying activity per YA will now be combined across YAs 2016 to 2018 (i.e. SGD1.2 million per qualifying activity);

– a new PIC+ scheme will be introduced to provide support to small and medium enterprises (SMEs), with a qualifying expenditure cap of SGD600,000 per qualifying activity per YA. PIC+ will take effect for expenditure incurred in YAs 2015 to 2018, and the combined qualifying expenditure cap will be as follows:

- up to SGD1.4 million for YA 2015; and

- up to SGD1.8 million for YAs 2016 to 2018;

– with effect from the YA 2014, the PIC scheme will be enhanced to allow businesses to claim PIC benefits on training expenses incurred in respect of individuals hired under centralised hiring arrangements;

– with effect from the YA 2016, businesses applying for the PIC cash payout will have to meet the three-local-

employees condition for a consecutive period of at least three months prior to claiming the cash payout; and

– with effect from the YA 2015, the tax deferral option under the PIC scheme will lapse.

– The additional 50% tax deduction under Section 14DA(1) of the ITA on qualifying expenditure incurred on qualifying research and development (R&D) activities will be extended for 10 years until YA 2025. Further tax deduction under Section 14E will be extended for another five years until 31 March 2020.

– writing down allowance (WDA) scheme under Section 19B of the ITA will be extended for five years to YA 2020. The accelerated WDA for media and digital entertainment companies will be extended for three years to YA 2018.

– The 100% tax deduction for registration costs of intellectual property under section 14A of the ITA will be extended for five years to YA 2020.

– The Land Intensification Allowance (LIA) scheme will be extended for five years to 30 June 2020, and will be extended to the logistics sector and to businesses carrying out qualifying activities on airport and port land. A new condition requiring buildings to meet a minimum incremental gross plot ratio of 10% will be introduced. The enhancements are effective for LIA approvals granted and capital expenditure incurred on or after 22 February 2014. Implementation details will be released by the EDB in May 2014.

– With effect from 21 February 2014, payers will no longer need to withhold tax on interest and royalty payments made to permanent establishments that are Singapore branches of non-resident companies.

– The Approved Building Project scheme will be periodically reviewed and the next review date will take place on 31 March 2017.

– The tax incentive schemes for funds managed by Singapore-based fund managers (Sections 13CA, 13R and 13X of the ITA) will be extended for five years to 31 March 2019 and refined, while the Section 13C scheme (trust funds with resident trustee) will be allowed to lapse after 31 March 2014.

– The concession for recovery of GST by qualifying funds managed by prescribed fund managers in Singapore will be extended for five years to 31 March 2019.

– The foreign-sourced income exemption scheme for listed infrastructure registered business trusts will be expanded to cover dividend income originating from foreign-sourced interest income so long as it relates to the qualifying offshore project infrastructure/asset, and interest income derived from a qualifying offshore project infrastructure/asset will automatically qualify for exemption provided certain conditions are met.

– The Designated Unit Trust Scheme will be limited to unit trusts offered to retail investors with effect from 21 February 2014, and from 1 September 2014, unit trusts do not have to apply for the scheme to enjoy its benefits, subject to the fulfilment of conditions. The scheme will be reviewed on 31 March 2019 and MAS will release further details of changes in May 2014.

Indirect taxation

(a) Stamp duty

– The stamp duty rates for transactions executed on or after 22 Feb 2014 will be as follows:

Leases

Lease period	Stamp duty rate
Up to four years	0.4% of the total rent for the entire period of the lease
Exceeding four years or for any indefinite term	0.4% of four times of the average annual rent for the entire period of the lease

Land premiums and purchase of property

Purchase price or market value (whichever is higher)	Buyer's stamp duty rates
First SGD180,000	1%
Next SGD180,000	2%
Remainder	3%

Share transfers and mortgages

Types of instruments	Stamp duty rates
Transfer of stock or shares	0.2% of the purchase price or market value of the stocks or shares transferred, whichever is higher
Mortgage instruments	0.2% or 0.4% of the relevant amount (depending on the type of mortgage instrument) subject to a maximum duty of SGD500

(b) Betting duties: from 1 July 2014, the rate of duty on totalisators, pari-mutuel betting (excluding horse racing) and other system or method of cash or credit betting will be increased from 25% to 30%.

(c) Vehicle tax: the Carbon Emissions-based Vehicle and the Green Vehicle Rebate schemes will both be extended by six months to 30 June 2015 from their original expiry date of 31 December 2014.

(d) Excise duty: from 21 February 2014, the excise duties will be increased by 10% for cigarettes and other manufactured tobacco products and by 25% for all liquor categories other than shandy (which will be reduced to be consistent with the excise duty for beer).

Budget 2014: Changes in relation to Central Provident Fund

During the 2014 Budget speech, the Minister of Finance also announced initiatives relating to the Central Provident Fund (CPF). Details of the changes, which unless otherwise indicated will take effect from 1 January 2015, are summarised below.

Increase in contribution rates

(a) Medisave contribution rates - The employer contribution rates to the Medisave Account (MA) will be increased by 1%. The MA contribution rates for self-employed persons with annual net trade income of SGD18,000 and above will also increase by 1%. As such, their new MA contribution rates will range from 8% to 10.5%.

(b) Contribution rates for older workers - The employer CPF contribution rates for workers aged 50-55 years and aged above 55-65 years will increase by 1% and 0.5% respectively. The increased contribution rates will be allocated to the Special Account. The employee contribution rate for workers aged 50-55 years old will increase by 0.5%. The increased contribution rates will be allocated to the Ordinary Account.

The new CPF contribution rates for employees (i.e. not including self-employed persons), after taking into account the increases to the MA and rate for older workers, are (see **Table 1**).

Enhancements to the Special Employment Credit (SEC)

Employers who hire Singaporeans aged above 50 years earning up to SGD 4,000 per month will receive SEC of up to 8.5% of the employees' monthly wages in the year 2015. Further information on SEC is available at *www.sec.gov.sg.*

Temporary Employment Credit (TEC)

The TEC is introduced to alleviate employers' rising business costs with the increase in MA contribution rates effective from the year 2015. Employers will receive a one year offset of 0.5% of wages for Singaporean and permanent resident employees earning up to SGD 5,000 per month. TEC payments will be

Employee age (years)	Contribution rate-employer (% of wage)	Contribution rate-employee (% of wage)
50 and below	17.0	20.0
above 50 to 55	16.0	19.0
above 55 to 60	12.0	13.0
above 60 to 65	8.5	7.5
above 65	7.5	5.0

Table 1

made based on employees' income paid in the year 2015.

Further details on the above changes are available on the CPF Board's website: *www.cpf.gov.sg.*

Budget 2014: Streamlining the stamp duty rate structure

On 21 February 2014, the IRAS issued an e-Tax Guide to provide guidance on the stamp duty changes as announced during the 2014 Budget speech on the same date. The changes are applicable to instruments executed on or after 22 Feb 2014. Full details of the e-Tax Guide are available on IRAS' website.

IRAS issues guidance on GST and income tax treatment of virtual currencies

The IRAS issued guidance on the GST treatment for the sale of virtual currencies and the income tax treatment of virtual currencies on 23 January 2014 and 27 January 2014 respectively.

GST treatment for sale of virtual currencies

For GST purposes, virtual currencies (e.g. bitcoins) will be treated as a supply of services, which does not qualify for GST exemption.

VIETNAM

Circular 219 on VAT

On 31 December 2013, the MoF issued Circular No. 219/2013/TT-BTC ("Circular 219") as a guideline on VAT in light of the amended VAT law that came into effect on 1 January 2014. The key points of Circular 219 are summarised below.

(i)Taxpayer -Branches of export processing enterprises (which are set up to implement the trading rights such as importing goods for domestic sale or export) will be considered VAT payers. These branches must now declare and pay VAT for imported goods at the point of import and are to charge VAT at the point of sale. In other words, trading branches are to have the same VAT status as other non-export processing enterprises.

(ii) Exempted items

– Fees related to the credit granting process conducted by credit institutions in their provision of credit facilities are exempt from VAT.

– Sale of collateral recovered in respect of defaulted loans (in accordance with the prescribed regulations).

– Imported parts/components (not produced in Vietnam) directly used for scientific research and technological development.

(iii) Taxable price - The taxable price of promotional goods and services are clarified as follows:

– Complimentary samples or trial periods have a taxable price of zero.

– The taxable price for discounted goods and services will be the discounted price.

– No VAT is required to be calculated or declared for promotional coupons/ vouchers given out.

(iv) 0% VAT - Export of goods eligible for 0% VAT includes sale of goods by local companies with both delivery and acceptance places in a foreign country even if the buyer is another local company. However, with respect to exported services, the circular does not provide any further guidelines on the requirement for "consumed outside Vietnam" to be eligible for 0% VAT. It does, however, confirm that services provided in Vietnam for overseas organisations and individuals associated with sales, distribution and consumption of products and goods in Vietnam are not entitled to the zero rate.

(v) Input VAT deduction

– Circular 219 further clarifies that creditable input VAT includes VAT paid in accordance with the assessment imposed by the customs authority.

– Circular 219 also clarifies that where bank transactions are used to substantiate input VAT credit claims of VND20 million or more, the transaction should be between the buyers and sellers bank accounts which have been registered with the tax authority. This is in line with the requirement under the amended Tax Administration Law for companies' bank accounts to be registered with the tax authority.

*By **Rachel Saw** and **Nina Haslinda Umar** of the International Bureau of Fiscal Documentation (IBFD). The International News reports have been sourced from the IBFD's Tax News Service. For further details, kindly contact the IBFD at ibfdasia@ibfd.org*

The technical updates published here are summarised from selected government gazette notifications published between 16 February 2014 and 15 May 2014 including Public Rulings and guidelines issued by the Inland Revenue Board (IRB), the Royal Customs Department and other regulatory authorities.

INCOME TAX

Announcement on application of Subsection 77A(4) and Section 140B, introduced under the Finance Act 2014

The Inland Revenue Board (IRB) has issued an announcement dated 19 March 2014 captioned "Announcement Regarding the Application of Subsection 77A(4) and Section 140B of the Income Tax Act 1967". The announcement is intended to provide clarification on two new provisions, which were introduced in the Income Tax Act 1967 (ITA) with effect from the year of assessment (YA) 2014, vide the Finance Act 2014.

The IRB has explained that the purpose of Subsection 77A(4) is to ensure that the income reported in the tax return is based on information that is true and fair as reported in the audited accounts. However, if there are provisions in the Companies Act 1965 that state that a company need not submit audited accounts to the Companies Commission of Malaysia, then Subsection 77A(4) will not apply and the company may submit its tax return based on information provided in the final accounts.

As Section 140B is deemed to be effective from YA 2014 onwards, the IRB has clarified that if the basis period of a company for the YA 2014 commenced in 2013, the computation of the interest income is based on the outstanding loans or advances from 1 January 2014.

Venture capital tax incentive guidelines

The Securities Commission (SC) has recently issued guidelines captioned "Venture Capital Tax Incentive Guidelines", "Issued: 28 August 2001, Amended: 18 April 2014" that supersede the earlier "Guidelines for Annual Certification of Tax Incentives for the Venture Capital Industry". The guidelines summarise the tax incentives that are available for a venture company (i.e. the income tax exemption on statutory income from all sources other than interest income arising from savings or fixed deposits and profits from *Shariah*-based deposits, and the tax deduction for an amount equivalent to the value of the investment made in a venture company). The guidelines also set out the qualifying criteria to be granted the incentives.

PETROLEUM INCOME TAX

Petroleum (Income Tax) (Exemption) (Amendment) Order 2014

The Petroleum (Income Tax) (Exemption) (Amendment) Order 2014 [P.U.(A) 57] amends the Petroleum (Income Tax) (Exemption) Order 2013 [P.U.(A) 122] and is deemed to have come into operation on 30 November 2010. The Petroleum (Income Tax) (Exemption) Order 2013 provides a petroleum income tax exemption on qualifying statutory income derived from petroleum operations in a qualifying marginal field. The 2014 Amendment Order substitutes an amended Paragraph 6(2) on non-application.

Petroleum (Income Tax) (Accelerated Capital Allowances) (Marginal Field) (Amendment) Rules 2014

The Petroleum (Income Tax) (Accelerated Capital Allowances) (Marginal Field) (Amendment) Rules 2014 [P.U.(A) 58] amend the Petroleum (Income Tax) (Accelerated Capital Allowances) (Marginal Field) Rules 2013 [P.U.(A) 119] and are deemed to have come into operation on 30 November 2010. The Petroleum (Income Tax) (Exemption) Rules 2013 provide an accelerated capital allowance (ACA) that will allow qualifying plant expenditure incurred for the purpose of carrying out petroleum operations in a qualifying marginal field to be written off over a period of five years. Previously, ACA was mutually exclusive of investment allowance under the Petroleum (Income Tax) (Investment Allowance) Regulations 2013 [P.U.(A)120] for a chargeable person. The 2014 Amendment Rules limit the non-application to a field or an area in respect of a deep-water project that has been granted an investment allowance. In addition, the non-application rules have been amended to include a chargeable person whose accumulated production of petroleum in a marginal field reaches an amount in excess of 30 million stock tank barrels of crude oil or 500 billion standard cubic feet of natural gas in a YA.

Petroleum (Income Tax) (Investment Allowance) (Amendment) Regulations 2014

The Petroleum (Income Tax) (Investment Allowance) (Amendment)

Regulations 2014 [P.U.(A) 69] was gazetted on 11 March 2014 and are deemed to have come into operation on 30 November 2010. The Regulations amend the Petroleum (Income Tax) (Investment Allowance) Regulations 2013 [P.U.(A) 120] that grant an investment allowance of 60% on qualifying capital expenditure incurred within a period of 10 years in respect of a qualifying project or an infrastructure asset as determined by the Minister.

Tax incentive guidelines and application forms for upstream petroleum industry

On 1 April 2014, the Ministry of Finance (MoF) issued the guidelines and application forms for tax incentives for the upstream petroleum industry. The applicant must elect for either the marginal field tax incentives (i.e. a petroleum income tax rate of 25% instead of 38% on petroleum operations in a marginal field, an accelerated capital allowance which allows the cost of assets to be claimed over five years instead of 10 years and export duty exemption) or an investment allowance incentive for specified promoted activities.

STAMP DUTY

Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) Order 2014

Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) Order 2014 [P.U.(A) 50] was gazetted on 25 February 2014 and came into operation on 26 February 2014. The Order provides that any tax payable under the ITA on the money payable in respect of any agreement, note, instrument and document in relation to *Sukuk Murabahah* guaranteed by the Government of Malaysia shall be remitted in full. Also remitted is any stamp duty payable under the Stamp Act 1949 in relation to the said instruments.

Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) (No. 2) Order 2014

Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) (No. 2) Order 2014 [P.U.(A) 74] was gazetted on 17 March 2014 and came into operation on 17 March 2014. The Order relates to the *Sukuk Murabahah* programme issued by Perbadanan Tabung Pendidikan Tinggi Nasional (PTPTN). The Order provides that any tax payable under the ITA by the Issuer, any holder of the *Sukuk Murabahah* or any other party in relation to the *Sukuk Murabahah* on the money payable under any agreement, note, instrument and document in relation to *Sukuk Murabahah* or guarantee by the Government of Malaysia in relation to the *Sukuk Murabahah* shall be remitted in full. Also remitted is any stamp duty payable under the Stamp Act 1949 in relation to the said instruments.

Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) (No. 3) Order 2014

Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) (No. 3) Order 2014 [P.U.(A) 76] was gazetted on 18 March 2014 and came into operation on 18 March 2014. The Order relates to the Islamic Medium Term Notes and Islamic Commercial Papers (IMTNICP) programme issued by DanaInfra Nasional Berhad. The Order provides that any tax payable under the ITA by Danalnfra Nasional Berhad, any holder of the IMTNICP or any other party in relation to the IMTNICP on the money payable under any agreement, note, instrument and document in relation to the IMTNICP or guarantee by the Government of Malaysia in relation to the IMTNICP shall be remitted in full. Also remitted is any stamp duty payable under the Stamp Act 1949 in relation to the said instruments.

LABUAN

Guidelines on Investment Management for Labuan Insurance and Takaful Business

The Labuan Financial Services Authority (Labuan FSA) has issued "Guidelines on Investment Management for Labuan Insurance and Takaful

Business" that will come into effect from 1 January 2015. The guidelines set out Labuan FSA's expectations on the minimum standards to be adhered to by Labuan re-insurers and re-takaful operators.

Guidelines on the Establishment of Labuan Fund Manager

The Labuan FSA has issued revised "Guidelines on the Establishment of Labuan Fund Manager" that will come into effect immediately and supersede the "Guidelines on the Establishment of Fund Management Companies in Labuan", which were issued in April 1998 and updated on 2 September 2010. Although the new guidelines supersede the earlier guidelines, the new guidelines specify that all approvals granted by Labuan FSA relating to Labuan fund managers prior to the commencement of these new guidelines shall remain valid unless revoked. However, the Labuan fund managers are required to comply with the capital requirement and professional indemnity insurance by 1 July 2015.

Guidelines on the Establishment of Marketing Office in Kuala Lumpur and Iskandar Malaysia

The Labuan FSA has issued revised "Guidelines on the Establishment of Marketing Office in Kuala Lumpur and Iskandar Malaysia" that came into effect on 5 March 2014. It supersedes the "Guidelines on the Establishment of Marketing Office in Kuala Lumpur and Johor Bahru", which was issued on 14 November 2003. Under the revised guidelines, Labuan companies are now able to establish a marketing office in Kuala Lumpur and/or in Iskandar Malaysia.

Circular on Financial Reporting Standards (FRS) for Labuan Financial Institutions (Labuan FIs) and Directive on FRS for Labuan FIs

The FRS Circular updates the earlier Circular issued on 8 November 2007, to reflect the consequential changes arising from the revisions to the Labuan legislations in 2010. The Directive is to be read together with the Circular and clarifies the requirements of the Circular. For Labuan FIs that are required to change their accounting standards to be in line with the Directive, the Labuan FSA expects the Directive to be fully complied with for the financial years beginning 1 January 2016.

CUSTOMS AND EXCISE DUTIES

Customs (Anti-Dumping Duties) (Extension of Time) Order 2014 Countervailing and Anti-Dumping Duties Act 1993 and Customs Act 1967 [P.U. (A) 75/2014]

The Order provides for the effective period of the Customs (Anti-Dumping Duties) Order 2009 [P.U. (A) 125/2009] to be extended to 28 July 2014.

Customs (Anti-Dumping Duties) Order 2009 [P.U. (A) 125/2009] was previously effective from 21 March 2009 to 18 March 2014. The Order requires importers to pay anti-dumping duties in cash in respect of the goods specified in the Schedule exported from specified countries into Malaysia by specified exporters at the specified rates. The imposition of anti-dumping duties shall be without prejudice to the imposition and collection of import duties under the Customs Act 1967 and sales tax under the Sales Tax Act 1972 [Act 64].

Please refer to P.U (A) 125/2009 and 75/2014 for details.

Customs (Anti-Dumping Duties) Order 2014 Countervailing and Anti-Dumping Duties Act 1993 and Customs Act 1967 [P.U. (A) 81/2014]

Effective from 30 March 2014 to 29 March 2019, importers are required to pay anti-dumping duties in cash in respect of "Cellulose Fibre Reinforced Cement Flat Sheet and Pattern Sheets and specifically excluding external roofing" specified in the Schedule exported from Thailand into Malaysia by specified exporters or producers. The imposition of anti-dumping duties shall be without prejudice to the imposition and collection of import duties under the Customs Act 1967 and sales tax under the Sales Tax Act 1972 [Act 64].

Please refer to P.U (A) 81/2014 for details.

GOODS AND SERVICES TAX

Goods and Services Tax Bill 2014

In line with the announcement by the Prime Minister in the 2014 Budget Speech to introduce the goods and services tax (GST) to replace the current sales and service tax system with effect from 1 April 2015 at the standard rate of 6%, the GST Bill 2014 was tabled on 31 March 2014 and the Bill was passed on 7 April 2014 at the Dewan Rakyat. *The Bill has been passed at Dewan Negara in May and received the Royal Assent on 9 June 2014. The Goods and Services Tax Act 2014 has been gazetted on 19 June 2014.*

*Contributed by **Ernst & Young Tax Consultants Sdn. Bhd.** The information contained in this article is intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgement. On any specific matter, reference should be made to the appropriate advisor.*

CASE

Ketua Pengarah Hasil Dalam Negeri v Shell Refining Company (FOM) Sdn Bhd

In this article, Cynthia Lian discusses the case of Ketua Pengarah Hasil Dalam Negeri V Shell Refining Company (FOM) Sdn Bhd[1] on tax deductibility of expenditure incurred by a taxpayer in conducting feasibility studies.

The High Court decision in *Ketua Pengarah Hasil Dalam Negeri v Shell Refining Company (FOM) Sdn Bhd* ("Shell case") is a landmark decision on tax deductibility of expenditure incurred by a taxpayer in conducting feasibility studies.

FACTS

Shell Refining Company (FOM) Sdn Bhd ("Shell") carries on the business of refining and manufacturing of petroleum products. In the course of carrying on its business, Shell had engaged the services of Shell Global Solutions International ("SGSI"), its related company incorporated in The Hague, The Netherlands, to study its refinery operations in order to assist Shell in complying with the new emission standards introduced by the Government.

In consideration of the services and advice rendered by SGSI in conducting the feasibility study, Shell had incurred expenditure in the amount of RM3,476,716.79 in payments to SGSI and claimed tax deductions under Section 33(1) of the Income Tax Act ("ITA") on these payments. However, the Inland Revenue Board of Malaysia ("the Revenue") disallowed Shell's claim for deductions under Section 33(1) of the ITA and also imposed penalties under Section 113(2) of the ITA.

Shell, aggrieved by the Revenue's disallowance of the SGSI payments, appealed to the Special Commissioners of Income Tax ("SCIT"). The main issue before the SCIT was whether or not the expenses incurred by Shell in conducting the feasibility study on Shell's refinery constitute deductible revenue expenditure under Section 33(1) of the ITA. Further, Shell contended that the Revenue's imposition of penalties under Section 113(2) of the ITA was unreasonable and unwarranted taking into account all the relevant facts and circumstances of Shell's case.

LAW

The opening words of Section 33(1) of the ITA read as follows:

> *"Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source…"*

In this regard, expenses which fall within the general words of Section 33(1) of the ITA, also referred to by the leading Malaysian judgment in the Federal Court case of DGIR v *Rakyat Berjaya*[2] as the "general basket" provision are tax deductible. The crucial question that the Court had to consider in this instance was whether the payments to SGSI fell under the general basket provision of Section 33(1) of the ITA.

DECISION

The SCIT held that the payments to SGSI in respect of the feasibility study were tax deductible under Section 33(1) of the ITA and not disallowed under Section 39(1)(c) of the ITA.

Further, the SCIT discharged the penalties imposed on the taxpayer and held that the Revenue had acted mechanically in imposing the penalties without considering the facts and merits of Shell's case. The Revenue appealed to the High Court which affirmed the decision of the SCIT.

GENERAL PRINCIPLES OF DEDUCTIBILITY OF BUSINESS EXPENSES UNDER THE ITA

In arriving at the decision,

the SCIT highlighted certain well-established principles on deductibility of business expenses:

THE BUSINESS EXPEDIENCY TEST

A revenue expense is one that is required as a business necessity or expediency and is integral to the profit earning process and is not capital in nature. The principle of commercial expediency originated from the Privy Council case of *Tata Hydro-Electric Agencies Limited, Bombay v Commissioners of Income Tax*[3]. The Malaysian Courts have adopted the commercial expediency test in determining whether expenditure incurred was wholly and exclusively incurred in the production of income and the reasonableness of an expense is to be decided from the point of view of a businessman and not of the Revenue.

In the Shell case, without the SGSI services in conducting the feasibility study, Shell's profits from its refinery business would be reduced significantly and it would not have the appropriate facility to comply with the new emission standards. As such, the SCIT held that the SGSI expenses were integral to the profit-making activities of the company and Shell incurred the expenses as a matter of business expediency and necessity.

THE COMMON SENSE TEST FOR DEDUCTIBILITY OF REVENUE EXPENSES

In determining the deductibility of an expense, it is a trite principle of law that the weight to be given to a particular circumstance in a particular case should depend on "common sense rather than on a strict application of any single legal principle."[4] Further, it is trite that revenue expenses are deductible even if no income is produced.

The Federal Court in *Kulim Rubber Plantations Ltd v DGIR*[5] held that payments made by a company "in order to get rid of a contract which is of an onerous nature, or a servant whose continuance in service is undesirable in the company's interest, makes a payment, in such circumstances it is properly to be treated as a revenue payment and a deductible expense."[6]

FEASIBILITY STUDY AS DEDUCTIBLE REVENUE EXPENSES

The High Court in *International Food Sdn Bhd v KPHDN*[7] held that expenses incurred in respect of feasibility studies for purposes of increasing the efficiency and reducing the operating costs of a business were wholly and exclusively incurred in the production of a taxpayer's income and were deductible expenses.

CONCLUSION

The High Court affirmed the SCIT's decision that the payments incurred for the feasibility study were tax deductible under Section 33(1) of the ITA where the question of whether a particular expenditure is revenue expenditure incurred for the purpose of a taxpayer's business must be determined on a consideration of all the facts and circumstances of a case and it is a question which must be "viewed in the larger context of business necessity or expediency". As the SGSI payments were integral to the profits of the business of Shell, the payments were held to be revenue in nature.

COMMENTS

The High Court and SCIT decisions in the Shell case reiterate the important principles of law on deductibility of business expenses, namely that the question of deductibility is to be viewed in the larger context of necessity and business expediency and the application of principles of commercial trading. The nature and the ordinary course of the business of the taxpayer and the object for which the expenditure is incurred are crucial in determining the deductibility of the expenditure under Section 33(1) of the ITA.

1 R2-14-7-04/2013.
2 [1984] 1 MLJ 248.
3 [1937] 5 ITR 202.
4 Regent Oil Co Ltd v Strick [1966] SC 295.
5 [1981] 1 MLJ 214.
6 [1979] 2 MLJ at page 214.
7 [1999] MSTC 3,061.

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OTHER BUSINESS DEDUCTIONS

Redundancy and Retrenchment Payments

Siva Subramanian Nair

Payment of redundancy and retrenchment payments is a common expenditure encountered by many business enterprises arising from the need to lay off some of the employees because of various economic reasons such as reduction in demand for its products or services, downscaling of the business or simply, a cessation of the business venture. The payment of these expenses entails tax implications which are discussed in this article.

GENERAL PRINCIPLES IN DETERMINING DEDUCTIBILITY

There are no specific provisions in the Income Tax Act 1967 relating to redundancy and retrenchment expenditure and as such the general rule in S33(1) of whether the expenditure is "……wholly and exclusively incurred…. in the production of income" will apply. Therefore, it can be concluded that;

- payments made to downscale the business activity or to terminate some of incidental activities of the business which will facilitate the business as a whole to flourish, enhance profitability or at least, be able to sustain itself as a going concern, would rank for a deduction since it is an expenditure incurred for preserving the business. This will include voluntary and management separation

schemes where the intention is to reduce and not cease business operations
- payments made subsequent to cessation of business should not rank for a deduction as the income producing activity of that particular business has ended and therefore, the expenditure cannot be in the production of income.

Many legal cases have deliberated on the matter of redundancy and retrenchment payments and these are discussed below.

H RUBBER ESTATES LTD V. DGIR (1979) 1 MLJ 115

Facts: On 30 December 1973 H Rubber Estate Bhd. disposed of all its properties to R Rubber Estate and merged with the latter after serving termination notices to all its workers. In accordance with the agreement in 1969 between the Malaysian Agricultural Producers Association (of which H Rubber Estate Bhd. was a member) and the National Union of Plantation Workers, H Rubber Estate Bhd. was supposed to compensate the workers through a redundancy benefit totalling RM26,023. However, since the agreement between the companies provided for the acquiring company to pay and discharge all debts, liabilities and obligations of the disposing company, this amount was paid by R Rubber Estate.

H Rubber Estate Bhd argued that although it did not make the payment but it was payable by them and therefore, was incurred by them.

Decision of the Court: The Special Commissioners agreed that since the payment was payable by H Rubber Estate Bhd, it was also incurred by that company but they nevertheless disallowed the expenditure on grounds that the payments were to facilitate the sale of the rubber estate and not in producing income. This decision was not reversed by the High Court nor the Federal Court where Gill CJ agreed with the opinion of the Special Commissioners on the fact that the taxpayer was under an obligation to make the redundancy payments; [but] did not make the expenditure an outgoing or expense wholly and exclusively incurred in the production of income for the purposes of Section 33(1). It was also observed in this case that the payment was made in order to terminate the business rather than to carry on the business.

AMPAT TIN DREDGING LTD V. DGIR, 1982 2 MLJ 46

Facts: Upon the exhaustion of its tin ore reserves, Ampat Tin closed down and ceased its tin mining operations on 24 July 1970 and went into voluntary liquidation on 29 April 1971. Payments of retrenchment benefits amounting to RM247,838 were made to the various employees between July and November 1970 in accordance with the terms of two agreements between the Malayan Mining Employers' Association, of which the company was a member, and two trade unions representing the employees, entered into by the parties in 1967. The agreement stipulated that an employee "shall qualify for retirement benefit:

(a) if he has fully attained the age of 55 and has completed not less than 10 years' continuous service with the company or
(b) if he has completed five years' continuous service with the company but not having attained the age of 55 and is certified by the company's Medical Officer as incapable of carrying out his employment and permanently unfit for any further employment within the mining industry or
(c) if he dies whilst in the service of the company or
(d) if he is retrenched due to the closure of a mine or redundancy."

The company contended that the payments are outgoings and expenses wholly and exclusively incurred in the production of gross income.

Decision of the Court: The judge agreed that any payment in respect of the circumstance mentioned in the agreements would be wholly and exclusively incurred in the production of income with the exception of the first limb of (d) i.e.

retrenched due to the closure of a mine. He opined that for the others "the payment would be made not with a view of cessation of business but rather for continuation of business in the production of income, whereas the first limb of (d) is expressly for the purpose of cessation of business".

> *"When the retrenchment benefits were paid due to redundancy, they should in appropriate cases be deductible as the taxpayer company would be able to prove that the sum is expended for the purpose of saving the company from extinction and, therefore, deductible as money incurred exclusively in the production of income. But, in the case of retrenchment due to closure of business, it seems to me that the purpose of incurring the expenses or outgoings has nothing to do with the production of income."*

Accordingly he disallowed the expenditure as a tax deduction.

Comments

Candidates would have noted an interesting article by Anand Raj entitled "The end of Ampat Tin is in sight" in the *Tax Nasional* (as the *Tax Guardian* was formerly known as) Vol. 12/2003/Q1 where he "critically examine(s) the genesis and scope of the High Court decision" in the Ampat Tin Dredging case in light of the precedents established in the cases of Kulim Rubber Plantations and Cosmotron, which are discussed below. However, in differentiating the two cases from the Ampat Tin Dredging case, the author acknowledges that "it is clear that Ampat Tin had no intention of converting its business at the material time" unlike Kulim Rubber Plantations and that "as Cosmotron [Privy Council decision] is not binding in Malaysia, the Ampat Tin case still represents Malaysian law on this subject, at least for the moment." He concludes that "until Ampat Tin is overruled or disapproved of by a Malaysian court through the industry of a taxpayer who is minded to press the point, the conservative majority of taxpayers will have to put up with the Revenue's outdated reliance upon Ampat Tin".

However where the retrenchment or redundancy payments are not related to the cessation of the business; for instance in the case of a reduction in operations or enhancement of efficiency etc. then it would rank for a deduction in ascertaining the adjusted income from that business. This is illustrated in;

IF SDN BHD V. KPHDN (2001) MSTC 3835

Facts: The parent company of the taxpayer, Nestle (M) Sdn Bhd had commissioned an efficiency study on all its subsidiaries with the view of increasing productivity and reducing costs. The recommendation from that study was to retrench some of the staff. The taxpayer claimed a deduction for its share of the cost of the efficiency study plus it incurred RM393,369 in respect of gratuity and retrenchment benefits.

Subsequently, in order to comply with the New Economic Policy of the Government, a restructuring exercise was undertaken resulting in the liquidation of the taxpayer. A claim was made by the taxpayer amongst others, for the retrenchment costs as being wholly and exclusively incurred in the production of income.

Decision of the Court: The Special Commissioners decided in favour of the taxpayer with the view that the retrenchment exercise was not

due to the cessation of the taxpayer's business but rather as a result of the efficiency study after which the company was still in operation. Although the High Court reversed the decision, it has been reinstated by the Court of Appeal.

KULIM RUBBER PLANTATIONS V. DGIR 1979 2MLJ 298

Facts: The taxpayer company undertook a major reconstruction of its business based on the intention of replanting its rubber estates with oil palm. This resulted in some of the less profitable rubber estates being sold to raise funds which were wholly expended in the oil palm development on the remaining land which served to enhance the company's earning capacity both as to gross income and taxable profits. The disposal of the estates also entailed discharging the services of some of their agents and for this the company incurred RM405,334 as compensation for loss of earnings in line with legally binding agreements. The company claimed the compensatory payment as a deduction which was disallowed by the Revenue.

Decision of the Court: As their appeal to the Special Commissioners was unsuccessful, an appeal was advanced to the higher courts which in finding for the taxpayer opined;

> *"...The true situation in our view is that there is no disappearance of any source of revenue; rather, the utilisation of the proceeds of sale for the conversion of the retained rubber lands into oil-palm estates results in the retention of the source of revenue from planting with, hopefully, increased revenue.*
>
> *Here, the taxpayer was continuing to trade and while the action for damages was always a possibility if it should refuse to abide with the terms of its agreements, the purpose was factually not to invite this action and to retain the services of the agents of the remaining acres of its estate holdings in the new role they had to play."*

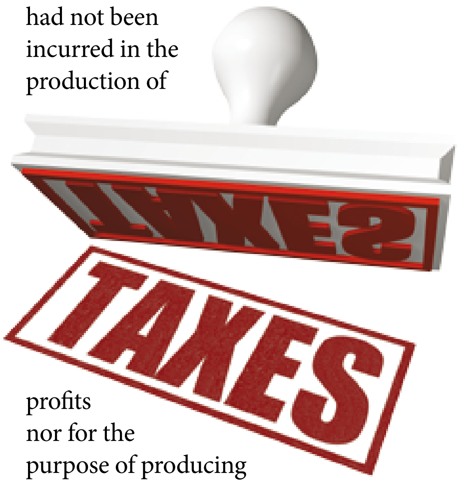
Comments

There has been an evolution in the judicial decisions handed down. Even in cases where the business has ceased and the company has closed down, retrenchment or redundancy payments are held to be deductible where such payments are contractual i.e. the employer has given an undertaking to make such payments pursuant to the agreement with the employee or with the respective staff unions. It then becomes a normal staff cost; similar to an incentive for the potential employee to join the company, and as such would rank for a deduction. The argument here is that in order to produce the income (profits), the employer needs the services of the employees who in turn joined the company based on the security of this compensatory clause in the agreement, so it is "……wholly and exclusively incurred….in the production of income.

CIR V. COSMOTRON MANUFACTURING LTD [1997] 70 TC 292

Facts: A metal products manufacturing company in Hong Kong closed its factory and ceased its trade in March 1991. The company was obliged under the employment ordinance to make severance payments to all its retrenched employees who had been employed under a continuous contract for at least two years and in consequence claimed a deduction for the payments.

The Commissioner of Inland Revenue refused the deduction on the grounds that the severance payments had not been incurred in the production of profits nor for the purpose of producing profits as required by the Inland Revenue ordinance. The Commissioner took the view that the payments had been made for the purpose of discharging the employees and closing down the trade.



Decision of the Court: The Board of Review allowed the company's appeal, accepting its contention that the severance payments were deductible because the company's obligation to make them had arisen from the terms upon which the employees had been engaged. Therefore, the obligation had been incurred, together with the company's other obligations towards its employees, for the purpose of producing profits throughout the period of their employment. Findlay J upheld that decision, and his decision was upheld by the Court of Appeal. The Commissioner appealed to the Privy Council.

The Privy Council decided that the payments were allowable. The Privy Council explained that a payment made to discharge an obligation entered into by a company as an ordinary incidence of its contract of employment was deductible in ascertaining the profits to which it was chargeable to tax. In summarising their judgement, the cited the judgement of Findlay J. in the High Court with approval;

> *"It is, in my view, quite wrong to say that the liability to pay the expense of severance payments is incurred for the purpose of closing up a business. It is not a businessman's aim to close up his undertaking. It may be a consequence of the closing of the business that the employees become redundant, and, therefore, the liability crystallises. The employer has always had a potential liability as an unavoidable part of conducting his business; that potential is realised by the closing of the business, but liability was not incurred for the purpose of closing the business. The employer does not undertake the obligation in order to close up his business; he undertakes it because he wishes to employ people in order to make things, so that he can sell them and make a profit. It is true that the event which triggers the payment to the employee is the dismissal by reason of redundancy because the business is shut down, but that is not the purpose for which the expense was incurred."*

Comments

The facts in Cosmotron showed that the redundancy payments were normal employment costs and not incurred for the purpose of going out of business.

The Inland Revenue Authority of Singapore (www.iras.gov.sg/irasHome/page04) also has indicated a similar stand i.e. where contractual retrenchment payments refer to those provided for in employment contracts or collective agreements with trade unions…such contractual retrenchment payments are deductible, regardless of whether there is a complete cessation of business. This is on the basis that they are incurred as part of the pre-existing obligation of the employer when the employer employed the staff. Even if the event that triggered the payment was the termination of employment by reason of redundancy because the trade had ceased, the entitlement to these payments had accrued over the years of employment on a contingent basis. Therefore, the expenses can be considered to be expended for the purpose of producing past profits and are deductible.

ANALYSIS OF EXAMINATION QUESTIONS

Having looked at the cases relevant to this topic let us now examine a few of the past year questions pertaining to this subject matter

Q: In **CTIM Tax II Dec 2003 Q5(b)(ii)**, candidates were required to advise on the deductibility of RM60,000 paid as retrenchment payments to two managers because the company has decided to focus on the rubber plantation business instead of its oil palm business which was sold to a Singaporean company

Solution: Payments made to employees on the cessation of business as a result of the sale of the company's income generating asset would not be deductible. The reason is that such expenses are not wholly and exclusively incurred in the production of income. The payments were made in the course of the cessation of the business and not in the course of producing income (see Ampat Tin Dredging Ltd v DGIR).

Q: In **CTIM Tax IV Dec 2010 Question 6 (A)** provided the following scenario;

SYN Sdn.Bhd. the parent company commissioned WTS Consultants to conduct efficiency study of its subsidiaries which included KYU Sdn. Bhd. Consequently KYU Sdn.Bhd. and another subsidiary were amalgamated and KYU Sdn.Bhd. was placed in voluntary liquidation. In addition staff members of KYU Sdn.Bhd. were retrenched.

KYU Sdn.Bhd. incurred cost on the efficiency study and had to make retrenchment payments. *Required:*

State, with reasons and based on the provisions of the ITA 1967 and case laws the tax treatment to be accorded to the cost of efficiency study and retrenchment payments.

Solution: This question is on Sections 33(1)and 39(1)(b);

- Wholly and exclusively incurred in the production of income
- Do not result in the business acquiring assets or rights of a capital nature
- Expenditure incurred in increasing efficiency and reducing operating cost was an unavoidable part of conducting business and is wholly and exclusive incurred in the production of gross income
- Retrenchment exercise as a result of efficiency study and not due to cessation of business

CIR v Anglo Brewing Ltd. (1925) 127C 803
Ampat Tin Dredging Ltd. v DGIR, 1981 (1950-1985) MTC 428
Cosmoton Manufacturing Ltd. v Commissioner of Inland Revenue (1997) STC 1134
KPHDN v IF Sdn.Bhd. [(2007) MLJ102]

Q: In **CTIM Tax IV Dec 2011 Question 6(i)** candidates were required to advise on the tax deductibility of the following expenditure giving reasons and judicial precedent, for their advice.

RM86,000 paid as retrenchment payments to two managers of the company on 2 November 2010 upon selling off its plantation business to another company in order to focus on the construction arm of its business instead of its plantation business.

Solution: RM86,000 paid to company managers on the cessation of business due to the sale of the company's income generating asset, is not deductible, as it was not incurred in the production of gross income but upon the cessation of its business and the termination of its capital asset.
- CH & Co. (Perak) Sdn.Bhd. v DGIR
- Atherton v British Insulated & Helsby Cables Ltd
This concludes our discussion on the deductibility of redundancy and retrenchment expenditure.

***Siva Subramanian Nair** is a freelance lecturer. He can be contacted at sivasubramaniannair@gmail.com*

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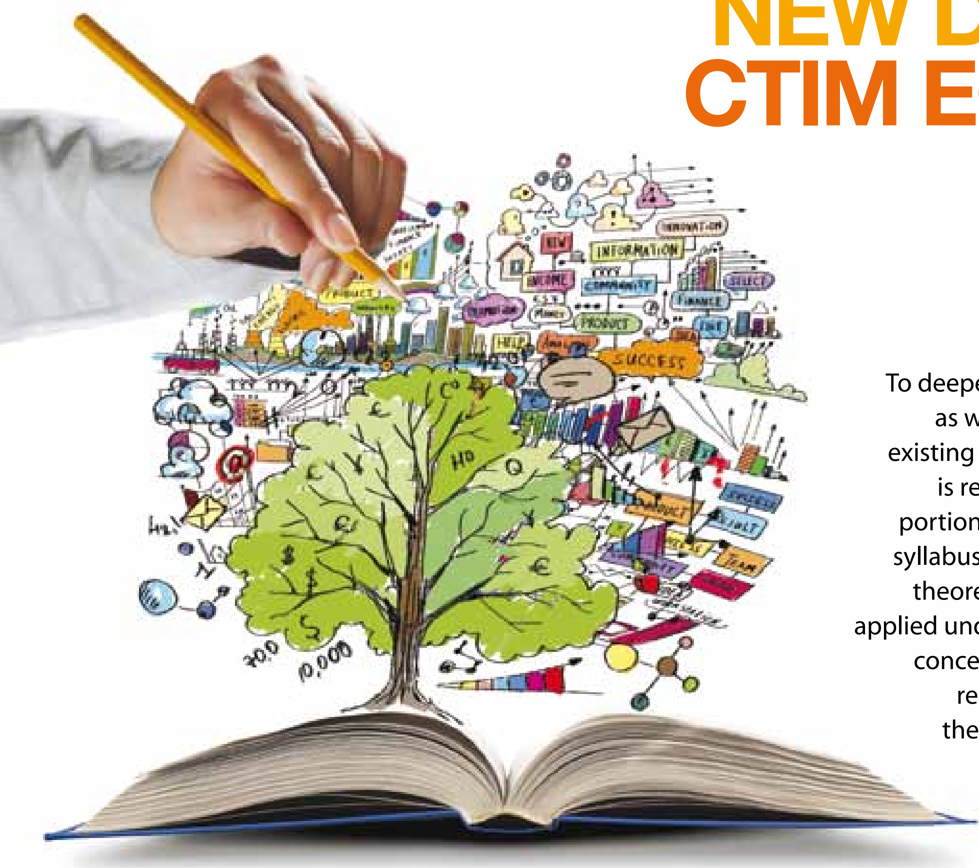
NEW DESIGN FOR CTIM ECONOMICS PAPER



Dr. Ashutosh Sarker

To deepen students' insights on issues of economics as well as taxes in the context of economics, the existing "Economics and Business Statistics" syllabus is revamped by replacing the business statistics portion with more issues from economics. The new syllabus is designed to educate students on various theoretical perspectives, policy challenges and an applied understanding of basic economics models and concepts in order to enable them to comprehend relevant ongoing issues in Malaysia, including the Goods and Services Tax (GST) which will be implemented from 1 April 2015.

PRINCIPLES OF ECONOMICS

Renamed as Economics, the new syllabus will be effective from December 2014. The modifications made to the old syllabus reorganises and elaborates contents of economics with an added focus on tax issues.

Economics accompanies two major branches: microeconomics and macroeconomics. After defining what economics is from the perspective of scarcity and choice and how it is classified into two major divisions, the syllabus proceeds to discuss 10 core principles in economics as narrated by a prescribed textbook Principles of Economics (Malaysian Edition) by N. Gregory Mankiw and associates.

TEN CORE PRINCIPLES

The first four principles review how the behaviour of individuals who make decisions - whether in Malaysia or any other country in the world - shapes a country's economic behaviour. **PRINCIPLE 1** details how decision-making individuals face trade-offs when scarcity of resources forces them to forgo one choice (e.g., clean air) to gain another (e.g., a higher level of income); it further describes how the introduction of a clean air tax on vehicles in urban areas may play a role in the management of urban air quality.

PRINCIPLE 2 highlights the costs and benefits of alternative choices, when individuals make deliberate choices to achieve certain goals. Economists assume that humans are rational, and **PRINCIPLE 3** gives us an overview of how rational people think at the margin benefit. This explains the puzzle of why water, which is needed to survive, is cheaper than diamonds, which is not needed for us to survive. **PRINCIPLE 4** is concerned about incentives such as tax breaks and exemptions that induce rational people to act in a certain direction as they make decisions by comparing costs and benefits of alternative courses of action. Students will learn from Principles 5 to 7 how rational individuals interact with each other as they make decisions in a country. For instance, **PRINCIPLE 5** is about how trade makes everyone better off in an economy. **PRINCIPLE 6** describes how markets organise economic activities without government intervention such as tax provisions, when the interaction of many firms and households shapes resource allocation. **PRINCIPLE 7** explains why we may need the involvement of government authorities to improve market performance and how such authorities may help prevent market failure through the introduction of

taxes, for example.

The rest of the principles focuses on issues of how an economy as a whole works when individuals interact with one another in making decisions. **PRINCIPLE 8** points out how a country's standard of living depends on its ability to produce goods and services. **PRINCIPLE 9** is about inflation, stating that prices rise when the government prints too much money and thus creates an economic problem. **PRINCIPLE 10** states how society encounters a short-run trade-off between inflation and unemployment.

Once these 10 principles are discussed in both theoretical and empirical settings in Malaysia, the syllabus will lead the students to learn how supply and demand interact with prices and thereby determine a market's equilibrium prices and quantities of goods and services. From the discussion of supply and demand the students will be familiar specifically with the costs of taxation, including the deadweight loss of taxation. Relevant issues also include how a tax affects market participants in measuring the gains and losses from a tax on goods. The course material will discuss how the government's tax revenue is determined by the supply and demand curves, the country's welfare with and without taxes. The course will also describe how deadweight loss occurs due to taxation.

Then, the syllabus details the economics of the public sector including the design of the tax system in Malaysia. The issues of financial overview of the government, sources of tax revenue, tax policies and economic growth, tax incidence and tax equity, the Goods and Services Tax (GST), and corporate income tax will be especially addressed in the context of Malaysia's 2020 vision.

Issues of firm behaviour and the organisation of industry are placed towards the end of the first half of the syllabus. Issues specifically include costs of production, economies and diseconomies of scale, monopolistic competition, oligopoly, and competition regulation in Malaysia. The second half of the syllabus is related to macroeconomics, which focuses on the economy as a whole. Students will learn some basic macroeconomics issues, including Gross Domestic Product (GDP) and Gross National Product (GNP) and their measurements in Malaysia. Students will also learn about other macroeconomic issues, including money and inflation; unemployment (real-wage rigidity and structural unemployment and minimum wage laws); economic growth (capital accumulation and population growth); government debt; and money supply and demand.

CONCLUSION

Economics is the social science that deals with the production, distribution, and consumption of goods and services, or the material welfare of humankind. This paper highlights the 10 core principles of economics. In addition to microeconomics, macroeconomics aspects are also covered in the paper. The author will soon be preparing a pilot paper for the new Economics paper for the benefit of the students.

Dr. Ashutosh Sarker *is a former Associate Professor who was attached to the Yokohama National University, Japan. He is an expert in the field of Economics and has published numerous economics-based articles in reputable international journals*

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: JULY – SEPTEMBER 2014

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
JULY 2014								
Workshop: GST Transitional Issues	3 July	9a.m. – 5p.m.	Kuala Lumpur	Thenesh Kannaa	350	400	450	8 WS/037
Workshop: Understanding the Basics of Computing the Corporate Income Tax	10 – 11 July	9a.m. – 5p.m.	Ipoh	Kularaj	670	770	870	16 WS/041
Workshop: Preparing Manufacturers for the GST Implementation	16 – 17 July	9a.m. – 5p.m.	Kuala Lumpur	Thenesh Kannaa	700	800	900	16 WS/038
Public Holiday *(Hari Raya Aidilfitri: 29 & 30 July)*								
AUGUST 2014								
NATIONAL TAX CONFERENCE 2014	**12 – 13 Aug**	**9a.m. – 5p.m.**	**Kuala Lumpur**	**Various Speakers**	**Early Bird 1,300 Normal 1,500**	**Early Bird 1,400 Normal 1,600**	**Early Bird 1,500 Normal 1,700**	**25**
Workshop: Taxation of Real Properties, Income Letting of Real Properties & Investment Holding Companies	20 - 21 Aug	9a.m. – 5p.m.	Penang	Kularaj	670	770	870	16 WS/043
Workshop: GST for Property Developers & Construction Companies	27 - 28 Aug	9a.m. – 5p.m.	Kuala Lumpur	Thenesh Kannaa	700	800	900	16 WS/045
Workshop: Understanding the Basics of Computing the Corporate Income Tax	28 - 29 Aug	9a.m. – 5p.m.	Melaka	Kularaj	670	770	870	16 WS/042
GST Training Course (6 days) GST Examination Day *(subject to RMC confirmation)*	15 - 17, 21 - 23 Aug	9a.m. - 5p.m.	Kuantan	Royal Malaysian Customs	2,200 *(fee for 6 days course)*	2,700 *(fee for 6 days course)*	3,000 *(fee for 6 days course)*	JV/009
Public Holiday *(National Independence Day: 31 August)*								
SEPTEMBER 2014								
Workshop: Taxation of Real Properties, Income Letting of Real Properties & Investment Holding Companies	3 – 4 Sept	9a.m. - 5p.m.	Johor Bahru	Kularaj	670	770	870	16 WS/044
Workshop: Preparing Manufacturers for the GST Implementation	10 – 11 Sept	9a.m. - 5p.m.	Johor Bahru	Thenesh Kannaa	670	770	870	16 WS/039
Workshop: Preparing Manufacturers for the GST Implementation	17 – 18 Sept	9a.m. - 5p.m.	Penang	Thenesh Kannaa	670	770	870	16 WS/040
GST Training Course (6 days) GST Examination Day *(subject to RMC confirmation)*	12 - 14, 20 - 22 Sept	9a.m. - 5p.m.	Kuala Lumpur	Royal Malaysian Customs	2,200 *(fee for 6 days course)*	2,700 *(fee for 6 days course)*	3,000 *(fee for 6 days course)*	JV/010
GST Training Course (6 days) GST Examination Day *(subject to RMC confirmation)*	20 - 22, 25 - 27 Sept	9a.m. - 5p.m.	Kuching	Royal Malaysian Customs	2,200 *(fee for 6 days course)*	2,700 *(fee for 6 days course)*	3,000 *(fee for 6 days course)*	JV/011
Public Holiday *(Malaysia Day: 16 Sep)*								

DISCLAIMER : CTIM reserves the right to change the speaker (s)/date (s), venue and/or cancel the events if there are insufficient number of participants. A minimum of three days notice will be given.

ENQUIRIES : Please call Yus, Jason, Ally or Nur at 03-2162 8989 ext 121, 108, 123 and 106 respectively or refer to CTIM's website ***www.ctim.org.my*** for more information on the CPD events.

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25 CPD points

*HRDF claimable under the SBL Scheme, subject to HRDB's approval.

DAY 1
12 August 2014
Tuesday

PROGRAMME

7.30 - 9.00 am	**Registration & Arrival of Guests**
9.00 - 9.10 am	**Arrival of Guest of Honour** Prime Minister / Minister of Finance
9.10 - 9.20 am	**Welcoming Speech** President, Chartered Tax Institute of Malaysia
9.20 - 9.30 am	**Opening Address** YBhg Tan Sri Dr Mohd Shukor Hj Mahfar Chief Executive Officer, Lembaga Hasil Dalam Negeri Malaysia
9.30 - 10.00 am	**Keynote Address by Guest of Honour** Prime Minister / Minister of Finance
10.00 - 11.00 am	**Morning Refreshments/ Tour of Exhibition Booths/ Press Conference**
11.00 – 12.15 pm	**TOPIC 1: Economic Outlook for Malaysia** *Chairman:* To be advised *Speaker:* To be advised
12.15 – 12.30 pm	**Question & Answer Session**
12.30 – 2.00 pm	**Networking Lunch & Tour of Exhibition Booths**
2.00 – 3.00 pm	**TOPIC 2: Dispute Resolution** *Chairman:* Mr Jeremy Lee Eng Huat Chief Executive Officer, Financial Mediation Bureau *Speaker:* Mr Abu Tariq Jamaluddin Director, Dispute Resolution Department, Lembaga Hasil Dalam Negeri Malaysia
3.00 - 3.15 pm	**Question & Answer Session**
3.15 - 4.30 pm	**TOPIC 3: Forum - Tax Enforcement & Anti-Money Laundering and Anti-Terrorism Financing Act (AMLATFA)** *Moderator:* Mr Adzhar Sulaiman Director, Malaysian Tax Academy, Lembaga Hasil Dalam Negeri Malaysia / Co-Organising Chairman of NTC 2014 *Panelists:* Mr Dzulkifli Ahmad Head of Commercial Crimes Unit, Attorney General's Chamber Mr Abdul Rahman Abu Bakar Director, Financial Intelligence and Enforcement Department, Bank Negara Malaysia Mr Anand Raj Partner, Shearn Delamore & Co
4.30 - 5.30 pm	**End of Day 1 & Refreshments**

PROGRAMME

DAY 2
13 August 2014
Wednesday

8.50 – 9.00 am	**Overview of Day 1** Ms Yeo Eng Ping Co-Organising Chairman of NTC 2014
9.00 - 10.30 am	**TOPIC 4: Base Erosion and Profit Shifting (BEPS)** *Chairman:* Mr Poon Yew Hoe Council Member, Chartered Tax Institute of Malaysia *Speaker:* Mr David Bradbury Head of Tax Policy and Statistics Division, Centre for Tax Policy and Administration, Organisation for Economic Cooperation and Development (OECD) *Panelist:* Ms Noor Azian Abdul Hamid Director, Multinational Tax Department, Lembaga Hasil Dalam Negeri Malaysia
10.15 - 10.30 am	**Question & Answer Session**
10.30 - 11.00 am	**Morning Refreshments / Tour of Exhibition Booths**
11.00 - 12.30 pm	**TOPIC 5: Tax Cases Update** *Chairman:* YBhg Dato' Francis Tan Council Member, Chartered Tax Institute of Malaysia *Speaker:* Ms Hazlina Hussain Director, Legal Advisory Division, Legal Department, Lembaga Hasil Dalam Negeri Malaysia *Panelist:* Mr Saravana Kumar Partner, Lee Hishamuddin Allen & Gledhill
12.30 - 12.45 pm	**Question & Answer Session**
12.45 – 2.15 pm	**Networking Lunch & Tour of Exhibition Booths**
2.15 - 3.15 pm	**TOPIC 6: Tax Incentives – Way Forward** *Chairman:* Ms Khodijah Abdullah Deputy Under-Secretary, Tax Division, Ministry of Finance Malaysia *Speaker:* YBhg Dato' Azman Mahmud Chief Executive Officer, Malaysian Investment Development Authority *Panelist:* Mr Amarjeet Singh Partner, Ernst & Young Tax Consultants Sdn Bhd
3.15 – 3.30 pm	**Question & Answer Session**
3.30 – 4.30 pm	**TOPIC 7: Round Table Discussion on Current Issues Affecting Taxpayers** *Moderator:* Mr SM Thanneermalai President, Chartered Tax Institute of Malaysia *Panelists:* YBhg Tan Sri Dr Mohd Shukor Hj Mahfar Chief Executive Officer, Lembaga Hasil Dalam Negeri Malaysia YBhg Dato' Sri Khazali Hj Ahmad Director General, Royal Malaysian Customs Department
4.30 – 5.00 pm	**End of Conference & Refreshments**

NATIONAL TAX CONFERENCE 2014

Closing Date : 31 July 2014

Conference Fees

* Registration of participants will be confirmed upon receipt of full payment or an acceptable employers guarantee and settlement of previous outstanding dues.
* Walk–in participant registration is subject to availability of seats and full payment.
* Certificate of Attendance will be issued upon full attendance and receipt of full payment.
* Normal rate will be applicable for unpaid early bird registrations after 18 July 2014.

	Early Bird Fee (with payment before or on 18 July 2014)	Normal Fee (after 18 July 2014)
LHDNM officer / CTIM member	RM 1300	RM 1500
Member's Firm Staff Member of Supporting Body Member / Staff of Supporting Sponsor	RM 1400	RM 1600
Non-Member	RM 1500	RM 1700
Overseas Delegates	Not applicable	USD 700
Premier Plus	1 FREE seat for every 10 delegates registered from the same organisation	

PARTICIPANT DETAILS *(Please write details clearly)*

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(As per IC)

I/C No or Passport No ______________ Designation ______________

Organisation ______________________

Address ______________________

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Personal Assistant *(if any)* ______________________

Dietary requirements: ☐ Normal ☐ Vegetarian

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☐ Cash for amount of RM ______________

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E: SophiaF@mohg.com

Traders Hotel Kuala Lumpur
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F: 03-2332 2672
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Maya Hotel
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F: 03-2711 2277
E: reservation@hotelmaya.com.my

Grand Hyatt Kuala Lumpur
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T: 03-2182 1235
F: 03-2182 1222
E: reservation.kuagh@hyatt.com

Impiana Hotel
Contact Person : Joash Denics
T: 03-2147 1111
F: 03-2147 1028
E: joash.denics@impiana.com

Corus Hotel Kuala Lumpur
Contact Person : Shahira Salleh
T: 03-2161 8888
F: 03-2162 3428
E: corporate3@corushotelkl.com

IMPORTANT NOTES

Reservation can be made by facsimile / post but will only be confirmed upon receipt of registration form and payment.

Kindly contact the following Conference Secretariat for more information.

1. Chartered Tax Institute of Malaysia
B-13-1, Block B, 13th Floor, Unit 1
Megan Avenue II
No. 12, Jalan Yap Kwan Seng
50450 Kuala Lumpur, MALAYSIA

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Website : www.hasil.gov.my

Cancellation Policy
Conference fees are non-refundable once reservation has been confirmed. No refund is given for cancellations or withdrawals. Cancelled unpaid registrations will also be liable for full payment of the Conference fees.

Replacements
Please note registrations for the event are not interchangeable but replacements are acceptable. Please notify us at least five days prior to the event if you intend to send a replacement. CPD points will be allocated to the designated attendee. If the replacement is not a Member but a Member's Firm Staff or Non-Member, the appropriate fees will apply.

Member's Firm Staff / Member of Supporting Body / Member or Staff of Supporting Sponsor
Member's Firm Staff is the staff of a CTIM member within the same firm. Member of Supporting Body or Member or Staff of Supporting Sponsor, kindly indicate which body you are associated with in the registration form.

Sponsorship and Exhibition Opportunities
For more information, kindly contact Ms Nur / Ms Ally at 03-2162 8989 ext 106 / 123 or email to ntc@ctim.org.my

Confirmation of Registration
A confirmation letter will be issued within 3 weeks before the conference. Please contact us immediately if you have not received the confirmation letter 7 days prior to the conference.

Reminder
Certificate of Attendance will only be released to registered participants (must register before 11.00am on day 1), full attendance with full payment and after completion of the Conference.

Disclaimer
All information contained in this brochure is correct and accurate at the time of printing. The Conference Organisers reserve the right to cancel, make any amendments and/ or changes to the programme if warranted by circumstances beyond the control of the Organisers. The Conference Organisers also reserve the right to make alternative arrangements without prior notice should it be necessary to do so. Upon signing the registration form, you are deemed to have read and accepted the terms and conditions.