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EXCLUSIVE INTERVIEW WITH

TAN SRI DR. MOHD SHUKOR HJ. MAHFAR

THE CHIEF EXECUTIVE OFFICER / DIRECTOR-GENERAL, INLAND REVENUE BOARD, MALAYSIA (IRBM)

Proposed Tax Changes in Finance Bill (No. 2) 2013 – What Lies Ahead?

Whither the Taxpayer's Privilege?

ctim

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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.1/2014/Q1
JANUARY 2014

04 **From the President's Desk**

05 **Editor's Note**
Transforming the Tax Landscape

06 **Institute News**

08 **Cover Story**
Proposed Tax Changes in Finance Bill (No. 2) 2013 – What Lies Ahead?

Feature Articles

16 Exclusive Interview with Tan Sri Dr. Mohd Shukor Hj. Mahfar

24 Inside View of Internal Tax Management and Challenges of the In-House Tax Department

30 Exemption for Home to Work Travel Allowance - Is it Still Available?

33 Whither the Taxpayer's Privilege?

38 Tax Audit Issues in Focus

44 **Technical Updates**

46 **Tax Cases**

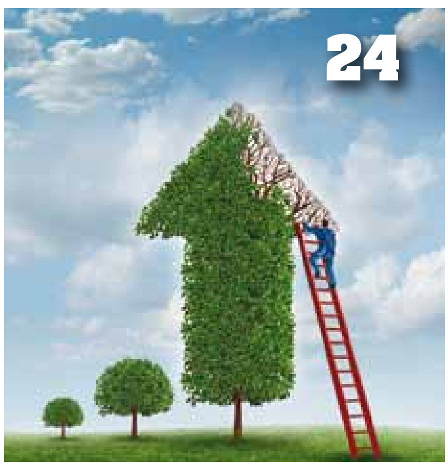
52 **International News**

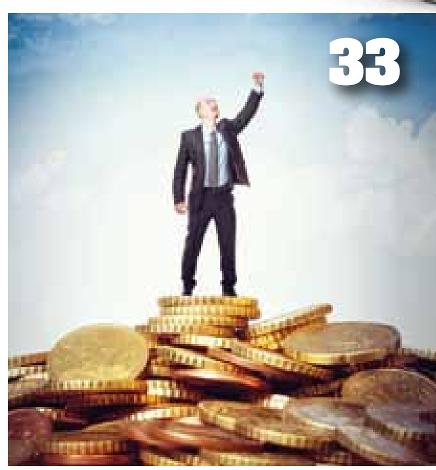
56 **Practice Management**
Employee Mobility Programmes Becoming More Accessible and Attractive to Meet Global Talent Needs

58 **Learning Curve**
Other Business Deductions

62 **CPD Training Calendar**

56





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 1,800 to 2,000 words submitted in a typed single spaced format using font size 10 in Microsoft Word via email.

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

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From the President's Desk

SM THANNEERMALAI

The most important development in the last three months was the 2014 Budget which included the proposal to introduce GST on 1 April 2015 and certain key amendments relating to taxpayers' rights and responsibilities. At the world level, the key area we need to keep an eye on is the work that is going on at the moment, at the OECD level in Paris, on Base Erosion and Profit Shifting (BEPS) as some of the proposed action plans, which are being formulated and are likely to be implemented, may impact Malaysia, both positively and adversely.

Internally the various Committees have been working very hard to keep CTIM at the forefront of tax developments within Malaysia. This is especially evident in the area of GST where we are regularly giving feedback to the Tax Review Panel (TRP) on the numerous GST guides issued to the public. We have also commenced classes to educate our members on GST and are currently engaged in talks with the TRP to obtain funds to run GST seminars for the general public. The response from the TRP, to date, has been positive.

Similarly, CTIM has been responsive to both the press and the authorities – particularly the MoF and IRB - in providing our immediate feedback on the 2014 Budget proposals. I understand that although the Finance Bill will go through as it stands, the IRB has promised us that the key concerns raised by CTIM, such as the curtailment of the right to appeal, and the restriction on the time given to taxpayers to produce documentary evidence to support the tax treatment adopted by the taxpayer, will be dealt with through public rulings. Rest assured that CTIM will keep on engaging the MoF and IRB until a satisfactory resolution, which will benefit both the taxpayers and our country, is found.

Currently CTIM is working on a project to collate and archive information kept in different locations and in different formats, into a reference for our members and the Secretariat. This will be a very useful source of historical information which can be referred to by the members when dealing with past matters.

INCREASED BURDEN AND RESPONSIBILITY ON TAXPAYERS AND TAX AGENTS

The two key proposals included in the 2014 Budget, which have serious implications to both the taxpayers and tax agents, are the amendments relating to the right of appeal in Section 99, and the restriction of the taxpayer's right to produce documents beyond the time given by the IRB to support the taxpayer's tax position in Section 39. These amendments will have a profound impact on taxpayers and the behaviour of tax agents. Under the proposal, the unfettered and unconditional right to appeal on a tax dispute directly to the Special Commissioners of Income Tax is being removed except where the taxpayer is aggrieved by the public ruling issued by the IRB. Similarly, the right to produce, at a future date beyond that given by the IRB, the documents to substantiate a taxpayer's position at a subsequent appeal, will no longer be available.

IMPACT ON TAXPAYERS AND TAX AGENTS

It is now extremely important for taxpayers to be aware that once a tax return has been filed under the self-assessment system, it is final and any subsequent amendment resulting in additional taxes will give rise to penalties and, currently - as the law stands - there is no room for a subsequent amendment which will lower the tax liability. Currently, in the latter situation, Section 131 (relief in respect of error or mistake) has been utilised to resolve the situation; however, the consistency of the application of Section 131 in all instances is debatable and will leave much room for discretion and will leave taxpayers in "no man's land".

There is hardly any choice left to taxpayers and tax agents. The tax returns will have to be complete and absolutely accurate and the positions taken in the tax computations have to be "supportable". Most subsequent amendments are likely to result in penalties and additional taxes. Therefore it is best to advise your clients to ensure that all information provided to the tax agents is correct and can be substantiated with documentary evidence before a tax return is filed.

To the tax agents, my message is: please be very mindful of the increased workload and responsibility, which will translate into more time being spent on each tax return. The time has arrived for each one of you to reconsider the fees you charge your clients and, more importantly, to evaluate your capacity to service your clients comprehensively in light of the potential risk of liabilities due to negligence that may arise in case of an overload, or lack of oversight.

PREPARE EARLY FOR GST

Now that GST is to be implemented on 1 April 2015, taxpayers have a great deal of work to do in preparing themselves to meet the challenges of GST. Information technology (IT) systems may need to be tweaked or even revisited to meet the needs of GST; other parts of the organisation - from human resources to finance to production to procurement, etc. - will need to be aware of the GST implications as GST is a broad-based and wide ranging tax.

For the practitioners, this is an opportunity to provide GST-related services to their clients. However, please do not do so without adequately preparing and arming yourselves with both theoretical and practical knowledge. I do not want any CTIM member to be accused of giving improper advice as this will not only damage your own reputation and business opportunities but it will also affect the good name of CTIM. In this regard, CTIM will continuously try and help our members by providing GST courses/seminars/workshops in 2014 and regularly disseminate information via our e-CTIMs.

Please encourage your clients and taxpayers at large to prepare early to meet the requirements of GST.

BEPS PROJECT

On the BEPS project there is relative silence from the MoF and I hope they are studying the implications the BEPS project will have on Malaysia as some of the changes proposed may not benefit the emerging markets such as Malaysia. For example, with regard to intellectual property (IP), this should not be a back-door avenue for the developed countries to allocate a greater share of the profits back to their countries under the guise of IP ownership.

Finally I would like to wish all our members and Secretariat staff a very happy new year and I hope 2014 will be another productive year for CTIM and its members.

K. SANDRA SEGARAN

TRANSFORMING THE TAX LANDSCAPE

An essential mission for us here at *Tax Guardian* is to keep CTIM members ahead of the curve and ready to capitalise on unfolding opportunities. Therefore, we want our content to reflect the latest trends and developments if we want to benchmark our members in line with global standards. From the holistic perspective, improving the quality and standards of local tax professionals will heighten Malaysian competitiveness and make the local business environment more attractive in a borderless world; adding value and international competencies to tax services will also help drive the national agenda of becoming a regional hub and exporter of value-added financial services.

Legislative changes are the focus of this issue's cover story, which takes a look at the salient amendments to the select tax legislation proposed in the 2014 Budget announcement and the Finance Bill (No. 2) 2013. We analyse several of the proposed changes which are not only interesting but will certainly impact taxpayer rights to a certain extent, perhaps even fundamentally and radically. While we understand that the taxman is obligated to protect the nation's revenue base, we also believe that certain proposals need due consideration before being enshrined in law as they may have far reaching implications to business, especially foreign direct investment which is a critical component for economic development.

A highlight of this issue is an exclusive interview with Tan Sri Dr. Mohd Shukor Hj. Mahfar, Chief Executive Officer and Director-General of the Inland Revenue Board of Malaysia (IRBM), a pivotal player in local taxation. Love it or loathe it, it cannot be denied that the IRBM has been reengineered into an efficient and customer-oriented revenue-collecting machine for the government in his capable hands. Turn to page 16 to find out how his management philosophy and style - which encompassed a cultural overhaul, an entrepreneurial mindset, people empowerment and unification through the *Hasilians* brand, succession planning and the introduction of many other innovations – enabled IRBM to achieve a sustainable target of collecting more than RM130 billion in annual tax revenue. More importantly, find out what IBRM has up its sleeve that could radically impact the tax scene as we know it.

To deal with spiking tax risks, it is imperative that companies have access to superior talent and many Malaysian corporations are establishing in-house tax functions in addition to hiring consultants. But corporate tax personnel must have more than generic local skills – specialisation and globalisation must be the order of the day as we argue in our feature on enhancing the performance of in-house tax departments. Only by becoming expert in GST, BEPS (base erosion and profit shifting), TP (transfer pricing) and international tax planning and legislation can tax strategists optimise their worth to companies as business partners, while championing the value and sustainability of the in-house tax function.

Elsewhere, we feature a technical update on the availability of exemptions for travel allowances between home and workplace according to the Income Tax (Exemption) Order 2009 [PU(A) 152/2009]. We believe a re-analysis of these exemptions might benefit clients in structuring their employee remuneration packages and optimising their tax structures.

Rounding up the issue, we also take a look at taxpayer's privilege according to the statutory law on Legal Professional Privilege (LPP) in Malaysia as well as the latest developments in tax audit issues.

As always, we welcome reader comments and recommendations. On behalf of CTIM, I'd like to wish everybody happy holidays and a happy new year. May 2014 usher in continued peace and prosperity.

CPD EVENTS

On 8 October 2013, CTIM successfully organised the Members' Technical Round Table Discussion at the CTIM's training room. The event was also attended by members who had sent their technical issues in writing before the event. Mr. Poon Yew Hoe, Chairman of the Public Practice Committee chaired the event and the discussion was conducted by the following Council Members:

Ms. Phan Wai Kuan, Chairman of Technical Committee – Direct Taxation (I).

Ms. Renuka Thuraisingham, Chairman of Technical Committee – Direct Taxation (II).

Mr. David Lai, Chairman of Technical Committee – Indirect Taxation (TC-IT).

It was a fruitful and lively discussion with many members sharing their thoughts and experiences on technical issues that impact on their practices. In addition, issues relating to the treatment in connection with the transition from Sales and Service Tax into the impending Goods and Services Tax (GST) regime and GST tax agent licensing process, were raised and discussed.

A seminar entitled "Selected Common Tax Issues Faced by Taxpayers – Part I" was held on 26 September 2013 at the Putra World Trade Centre, Kuala Lumpur. Several common tax issues such as deductibility of financing costs, issues surrounding CP58 and recent case law updates were highlighted by the invited speakers from the tax firms. Amongst the speakers involved in the seminar were Mr. Lim Kah Fan & Ms. Liew Ai Ling of Ernst & Young Tax Consultants Sdn Bhd, Ms. Seah Siew Yun of SJ Grant Thornton and Ms. Fung Mei Lin of PricewaterhouseCoopers Taxation Services Sdn Bhd. Dr. Nakha Ratnam, a CPD Committee Members chaired the entire seminar.

CTIM successfully organised the seminar on "GST: It's on Our Door-step!" on 17 October 2013 at the Putra World Trade Centre, Kuala Lumpur. The tax lawyers from Shearn Delamore & Co. i.e Mr. Anand Raj & Ms. Irene Yong presented a topic on the GST: "Essential Principles & Business Implication." In the afternoon session, Mr. David Lai, CTIM Council Member and Chairman of Technical Committee – Indirect Taxation presented a topic on the practical issues that taxpayers may face in implementing the GST. The seminar was chaired by Mr. Raja Kumaran of PricewaterhouseCoopers Taxation Services Sdn Bhd who has extensive knowledge on the GST.

CTIM organised

its annual Budget Seminars at various locations namely Kuala Lumpur, Subang, Ipoh, Johor Bahru, Penang, Melaka, Kuantan, Kota Kinabalu and Kuching in the month of November and December 2013. The first seminar was held on 7 November 2013 at the Renaissance Hotel, Kuala Lumpur and was attended by over 600 participants. The invited speaker from the Ministry of Finance Malaysia, Mr. Gunaseelan Kunjan, Deputy Under-Secretary, Tax Analysis Division highlighted the pertinent issues of the 2014 Budget Proposals and the impact on businesses. In addition, Dato' Subramaniam Tholasy, Director of Internal Taxes, Royal Malaysian Customs Department presented a brief presentation on the Goods and Services Tax (GST) as announced by the Finance Minister on the recent budget announcement day. Mr. Abu Tariq Jamaluddin, Director of Dispute Resolution Department, Inland Revenue Board of Malaysia shared his views on the 2014 Budget Proposals. Joining him in the panel discussion session was Ms. Phan Wai Kuan, a Council Member of CTIM. The session was moderated by Mr. SM Thanneermalai, President of CTIM.

BRANCH NEWS

On 7 October 2013, the Perak Branch Committee Members paid a courtesy call to the Royal Malaysian Customs Department (Perak Branch). The delegation was lead by Mr. Chak Kong Keong, Perak Branch Chairman and was received by Dato' Mohd Nasir, the State Director of Customs. Branch Committee Members Mr. Lam Weng Keat, Ms. May Ang, Mr. Murugan & Ms. Chew Lai Ling attended the meeting.

On 6 November 2013, the East Coast Branch, led by its Chairman, Mr. Wong Seng Chong held a dialogue with the Inland Revenue Board of Malaysia (Kuantan Branch). Present at the dialogue were En. Mat Lazim Salleh, the State Director of Pahang, En.Hussin Mohd, Pengarah Cawangan Kuantan, En. Mohd Zulkefli Sowkkat Ali, Pengarah Cawangan Siasatan, Kuantan, En. Mohd Najib Din, Pengarah Cawangan Temerloh, En. Sa'hari Draman, Pengarah Cawangan Raub, senior IRB officials, members of CTIM and tax practitioners from various firms in Pahang. Approximately 21 tax issues were raised by the tax practitioners to the IRB officials. In addition, a meeting with CTIM members and tax agents of Kuala Terengganu was held on 14 November 2013 at the Primula Beach Resort, Kuala Terengganu. The meeting was chaired by the Branch Chairman, Mr. Wong Seng Chong and various tax issues were raised by the members.

PROPOSED TAX CHANGES IN FINANCE BILL (NO. 2) 2013 – WHAT LIES AHEAD?

K. Sandra Segaran *and* Tan Hooi Beng

This article attempts to summarise the salient amendments to the select tax legislations proposed in the 2014 Budget announcement tabled in Parliament by the Honourable Prime Minister cum Finance Minister on 25 October 2013 and the Finance Bill (No.2) 2013. Several of the proposed changes have been described as interesting and to a certain extent radical and fundamental in its impact on taxpayer rights. Where relevant, we have provided our personal observations on the proposals.

REVIEW OF CORPORATE INCOME TAX RATES

With effect from the year of assessment (YA) 2016, the corporate tax rate for companies would be reduced from 25% to 24%. This rate also applies to the following entities:-

i. A trust body;

ii. An executor of an estate of an individual who was domiciled outside

Malaysia at the time of his death;

iii. A receiver appointed by the court; and

iv. A limited liability partnership.

For resident companies with a paid up capital of up to RM2.5 million (SMEs) at the beginning of their basis period, the tax rates have been reduced as **(in Table 1)**.

Table 1

	Current rate (%)	Proposed Rate (with effect from YA 2016)
First RM500,000 of chargeable income	20	19
Chargeable income in excess of RM500,000	25	24

OUR COMMENTARY

The above proposal is timely given that Malaysia needs to stay competitive and remain on the radar of the foreign direct investors. Some raise the question as to why YA 2016 and not now as by then, other neighbouring countries in the region would probably have further lowered the corporate tax rates. In any case, one should note that Malaysia does not impose dividend withholding tax, unlike some other countries in the region such as Thailand, Indonesia and China. In the case of foreign shareholders, this gives Malaysia an advantage from the profit repatriation standpoint, especially from a cash flow perspective.

TAX DEDUCTION FOR SECRETARIAL AND TAX FILING FEES

The Public Ruling 6/2006 expresses the IRB's current view that these expenses are not deductible for tax purposes. The professional bodies have been raising this issue since the removal of a concession to allow these expenses in the past, more so since the introduction of the self-assessment system. A restricted deduction will be allowed from YA 2015 as part of the incentive package in the smooth introduction of GST in April 2015. The following deduction will be given annually:

- **Secretarial fee – up to RM5,000**
- **Tax filing fee – up to RM10,000**

Further details are expected to be available once the relevant rules are gazetted.

OUR COMMENTARY

Question arises as to whether the proposed cap includes service tax/ GST and out-of-pocket expenses.

EXTENSION OF TAX INCENTIVE FOR ICT EQUIPMENT AND SOFTWARE

To encourage the use of ICT equipment and software by companies, it has been proposed that the existing accelerated capital allowance (ACA) of 100% on the purchase and installation of ICT equipment and software be extended to YA 2016.

TAX INCENTIVE FOR TRAINING IN ACCOUNTING AND ICT IN RELATION TO GST

As part of the incentive package for the smooth introduction of GST and to alleviate the increased cost of doing business, expenses incurred for GST related training in accounting and ICT will be given a double tax deduction for YA 2014 and 2015.

OUR COMMENTARY

Though this is an encouraging step it will not benefit taxpayers who incur these expenses post 2015, such as in the case of new companies or companies that come within the purview of the GST law later. Question arises as to whether GST implementation cost would fall within the ambit of the above proposal.

TAX INCENTIVE FOR FLEXIBLE WORK ARRANGEMENTS (FWA)

It has been proposed that expenses incurred in the training of employees, supervisors and managers as well as consultancy fees to design an appropriate FWA to be implemented by the employer be given a further deduction. The eligible expenses include the costs for training in:-

- **Optimising a work-life balance;**
- **Technology orientation;**
- **Managing a flexible workforce; and**

- **Helping managers embrace flexible work alternatives.**

The incentive is given for a period of three YAs and is subject to the companies obtaining FWA status from Talent Corporation Malaysia Berhad. Applications must be made from 1 January 2014 to 31 December 2016.

TAX INCENTIVE FOR IMPLEMENTATION OF MINIMUM WAGES

The minimum wages provisions came into effect on 1 January 2013 with the Minimum Wages Order 2012. The difference between the original salary (likely to be at 31 December 2013) and the minimum wages paid (in January 2014) by employers which are small and medium enterprises, cooperatives, associations and organisations are eligible for a further tax deduction. This incentive is limited to one year, i.e. for salaries paid from 1 January 2014 to 31 December 2014.

OUR COMMENTARY

It appears to us that the proposal is to incentivise those that have not implemented the minimum wage policy as opposed to those that have. We hope that the incentive would also be given to the organisations that have adhered to the policy on 1 January 2013.

TAX INCENTIVE FOR ANCHOR COMPANIES UNDER VENDOR DEVELOPMENT PROGRAMME (VDP)

To encourage more anchor companies to develop local vendors, it is proposed that the operating expenses incurred by anchor companies in implementing VDP be given a double deduction. Such qualifying operating expenses include:-

- **Cost of product development, research and development, innovation and quality improvement;**
- **Cost of obtaining ISO/Kaizen/5S certification, evaluation programme and business process reengineering for the purpose of increasing vendor capabilities; and**
- **Cost of vendor skills training, capacity building, lean management system and financial management system.**

The qualifying criteria for double deduction are as follows:-

- **Anchor companies are required to sign a Memorandum of Understanding (MoU) with the Ministry of International Trade and Industry (MITI) under VDP;**
- **Qualifying operating expenses must be certified by MITI before the anchor companies can claim the deduction;**
- **Qualifying operating expenses are capped at RM300,000 per year; and**
- **Deduction is given for three years of assessment.**

The tax incentive is given to anchor companies that have signed an MoU with MITI from 1 January 2014 to 31 December 2016.

BASIS PERIOD FOR BUSINESS

With the proposed amendment to Section 21A(3) and 21A(4), determination of basis period is simplified to enable taxpayers to submit tax returns within the stipulated seven months from the financial year end. It is proposed that the first accounting period upon commencement be accepted as the basis period for a year of assessment for a company, limited liability partnership, trust body and cooperative. The first accounting period in the following situations will be accepted as basis period for a YA:

- **12 month accounts ending in the same year**
- **12 month accounts ending in the following year (second year)**
- **Less than 12 months accounts ending in the same year**
- **Less than 12 months accounts ending in the following year (second year)**
- **More than 12 months accounts ending in the following year (second year) or**
- **More than 12 months accounts ending in the third year.**

OUR COMMENTARY

With this, the saga of overlapping basis periods under the current provisions is avoided. In the past where there was an overlapping period, the taxable income for a basis period can only be ascertained correctly when the second set of accounts is available and the taxpayer is given a concession to submit the returns after seven months from the end of the second accounting period. With the above amendments, the DGIR also has the power to direct basis periods both when the accounting period ends on 31 December and other than 31 December where there is a failure to close accounts on a normal date.

ESTIMATE OF TAX PAYABLE FOR SMEs

In consequence of amendments to Section 21A, a new paragraph 107C(4A)(c) is inserted. With this a SME (paid up capital in respect of ordinary shares of RM2.5 million and less) is not required to furnish an estimate (CP 204) under Section 107C during which the company has no basis period in a YA in the year it commences its operation and two immediately following YAs. The paid up capital requirement of RM2.5 million must be observed at the commencement date and at the beginning of the two following YAs. The amendment is effective from YA 2014.

GAINS FROM COMPULSORY ACQUISITION OF STOCK IN TRADE

A new Section 4C is to be introduced and Section 24(1) is to be amended to counter several case law decisions (see our commentary below) and tax gains from disposal of stock in trade by any element of compulsion such as compulsory acquisition or forced sale to treat such gains or profits from a business. These amendments come into effect from YA 2014.

OUR COMMENTARY

Presently, gains or profits arising from the disposal of stock in trade in the ordinary course of business are subject to income tax. However, there is ambiguity on whether gains arising from disposal of stock in trade such as land under a compulsory acquisition are subject to income tax. The Court of Appeal decided in the case of *Penang Realty Sdn Bhd v KPHDN [(2006) MSTC 4206]* that compulsory acquisition of a taxpayer's land by the Government could not constitute a sale and the compensation received was not subject to income tax as the element of compulsion vitiates the intention to trade as established in the Supreme Court decision of *Lower Perak Cooperative Housing Society Bhd v KPHDN (1994) 2 MSTC 3406*. The High Court in a judicial review application in *Metacorp Development Sdn Bhd v KPHDN (2011) MSTC 30-024* on a similar point ruled that the failure of the DGIR to follow the decision of the superior courts renders its decision defective as the two cases were binding on the DGIR being an arm of the executive. Since the DGIR's decision was not based on the legal authorities of the superior courts, it was in excess of its authority.

ENTERTAINMENT / PROMOTION EXPENSE

The definition of entertainment is amended to include expenses incurred for the purpose of promoting its business with or without consideration. This amendment comes into effect from YA 2014.

OUR COMMENTARY

Similar to gains from compulsory acquisition of stock in trade, the proposal is also meant to counter the decisions in several case laws (e.g. Eli Lily v KPHDN etc). With this amendment, it simply means that certain promotional expenses would no longer enjoy a full tax deduction. Rather, they will be subject to the strict rule of deduction for entertainment expenses.

INTEREST OBTAINABLE ON DEMAND

Interest income will be treated as gross income when it is received. Interest is treated as received when it is obtainable on demand. It is proposed that interest from a loan between related persons is deemed obtainable on demand when the interest is due to be paid. This amendment comes into effect from YA 2014.

DEDUCTIBILITY OF INTEREST EXPENSE

Interest on moneys borrowed is an allowable deduction when it is incurred. It is proposed that interest can be deducted as an expense when it is due to be paid in that period. If it is not due to be paid, no deduction will be allowed for the interest expense. When the interest becomes due to be paid, a deduction can then be claimed for the period in which the interest became payable. This amendment comes into effect from YA 2014.

OUR COMMENTARY

It is interesting to note that a revision of tax return is required with a view to claiming a deduction on the interest expenses and the existing provision for self-amendment (Section 77B) and the proposed amendment to Section 99 (see commentary below), does not provide sufficient mechanism or avenue for appeal . It has been suggested that Section 131 (error or mistake) is relied on although this provision is technically not the appropriate avenue unless modified accordingly.

DEDUCTION DISALLOWED FOR FAILURE TO FURNISH INFORMATION

A tax deduction can be denied if information required by the DGIR by way of a notice under Section 81 is not furnished within the stipulated or extended time frame. A new sub Section 39(1A) is proposed to be effective from YA 2014. The scope of this new provision is confined to information required to justify any claim for deduction in arriving at the adjusted income.

OUR COMMENTARY

With the introduction of the new Section 39(1A) of the Income Tax Act 1967, taxpayers will need to ensure that the relevant information called for by the Director-General be furnished within the stipulated period to avoid disallowance of the deduction claimed by the taxpayers. While the principles of deduction would normally apply in ascertaining deductibility, where there is a dispute, documentary evidence may be called for to establish a fact. It is hoped that the Director-General will give adequate and reasonable notice for the taxpayer to furnish the required information and entertain requests for extension of time in reasonable circumstances.

REDEFINITION OF "DIRECTOR" UNDER SECTION 75A – DIRECTOR'S LIABILITY

Section 75A imposes on "any person who is a director of the company" a joint and several liability for tax liable to be paid by the company. A separate definition for a "director" is provided under this section in addition to the definition in Section 2. With the proposed amendment the shareholding threshold of 50% is reduced to a mere 20%.

OUR COMMENTARY

The proposal raises the question of whether a director individually or jointly with one or more associates holding 20% equity interest would be able to control the management or affairs of the company? Should such a director be held responsible for the decisions made by a controlling shareholder/director? The rationale for this proposed amendment to an already harsh provision that empowers the lifting of the veil of incorporation is unclear. It is left to be seen if this onerous liability will deter potential minority investors in Malaysia as well as deter entrepreneurship among SMEs.

RETURN OF INCOME

All companies are required to file their tax returns by electronic filing which shall be based on audited accounts. This amendment comes into effect from YA 2014.

RIGHT OF APPEAL ON DEEMED ASSESSMENT

The current appeal provision under Section 99(1) provides for the right of an appeal against all types of notices of assessment including deemed assessments. This proposal denies the right of a taxpayer to appeal to the Special Commissioners against a deemed assessment under the self-assessment system except where the taxpayer is aggrieved by such a deemed assessment as a result of complying with the public ruling issued by the Director-General.

OUR COMMENTARY

It is impossible for the authorities to issue public rulings in all areas, particularly those that are grey. The IRB's position may be articulated in other forums such as in court cases, decision impact statements, minutes of meeting with professional bodies, comments to the OECD frameworks, etc. It is impossible to anticipate the situations that could arise that would give rise to an appeal. Presumably the proposal is made with thoughts that Section 131 could offer an avenue to appeal. However it is to be noted that Section 131 is not an appeal provision and serves a different purpose to Section 99.

DISPOSAL OF APPEAL

If a mutual agreement procedure under a double taxation agreement has been invoked, an appeal to the SCIT regarding a similar matter will

not be forwarded to the SCIT until the mutual agreement procedure has been determined. This proposal is effective from the date of coming into operation of the Finance Bill (No. 2) 2013.

POWER TO COLLECT WITHHOLDING TAX ON DISREGARDED TRANSACTION

The DGIR is empowered under the general anti-avoidance Section 140 to disregard certain transactions under circumstances that come within this provision and raise an assessment or an additional assessment. However this may not apply to withholding tax matters, for example, those that involve payment of royalties or interest to non-residents where no assessments are raised. As such with the proposed amendment, the IRB may by way of issuing a notice, pursue the collection of withholding tax from a disregarded transaction. This is effective upon coming into force of the Finance Bill (No. 2) 2013.

OUR COMMENTARY

We believe that this proposal is in line with the international trend of curbing "treaty shopping". It is therefore for the non-resident recipient of income to demonstrate that it is not only the tax resident in the country of residence, but also the beneficial owner of the income.

MUTUAL ADMINISTRATIVE ASSISTANCE ARRANGEMENT

Exchange of information between Malaysia and another country is provided under a double taxation agreement (DTA) or a tax information exchange agreement (TIEA). It is proposed that mutual administrative assistance arrangement in tax matters may be entered into with the government of a territory outside Malaysia and declared by the Minister by way of statutory order. Such arrangement shall have effect under the Income Tax Act 1967 or other revenue legislation. This proposal is effective from the date of coming into operation of the Finance Bill (No. 2) 2013.

OUR COMMENTARY

It appears to us that this proposal is meant to facilitate the compliance of US tax legislation by the Malaysian financial institutions, namely the Foreign Account Tax Compliance Act (FATCA) that requires individuals to report their financial accounts held outside of the United States and foreign financial institutions to report to the

Internal Revenue Service (IRS) about their American clients. FATCA was designed primarily to combat offshore tax evasion and recoup federal tax revenues. As it stands, Malaysia does not have a comprehensive DTA with the US save for a navigational treaty whereas Malaysia normally enters into TIEA with the "tax havens".

LOAN TO DIRECTORS – DEEMED INTEREST INCOME

A company which gives any loan or advances from internal funds to a director is deemed to derive interest income from such a loan or advances under the proposed new Section 140B. Monthly interest is to be determined with a prescribed formula. Where interest is charged by the company and the total interest charged and payable by the director is more than the aggregate sum of interest determined based on the prescribed formula, this provision of deemed interest income shall not apply. Where the interest charged by the company is less than the aggregate sum of interest as determined based on the above formula, the actual interest charged shall be disregarded. The company shall be deemed to derive interest income based on the prescribed formula.

For the above purpose, "director" means any person who—

(a) is occupying the position of director (by whatever name called), including any person who is concerned in the management of the company's business; and

(b) is, either on his own or with one or more associates within the meaning of subsection 139(7), the owner of, or able directly or through the medium of other companies or by any other indirect means to control, not less than 20% of the ordinary share capital of the company.

This amendment comes into effect from YA 2014.

OUR COMMENTARY

As this amendment will be effective from YA 2014, companies with early financial year ends may be impacted by this retrospective effective date particularly on the estimate of tax payable. One issue that needs to be considered is whether the director will be given a deduction on the deemed interest expenses especially in the case where the loan is used to finance the acquisitions of income-generating assets such as real property that is subsequently rented out.

CAPITAL ALLOWANCE IN RELATION TO CONVERSION TO A LIMITED LIABILITY PARTNERSHIP

Balance of capital allowance of a company or partnership that is converted to a limited liability partnership (LLP) can be given to the LLP. It is proposed that controlled transfer provisions will apply to assets transferred to a LLP. A LLP is not entitled to claim allowances for the YA in which conversion takes place unless allowances have not been claimed by the partners or company for that YA. This amendment comes into effect from YA 2014.

REVIEW OF RESIDENT AND NON-RESIDENT INDIVIDUAL INCOME TAX BANDS AND RATES

For resident individuals, it has been proposed that the personal income tax bands and rates be revised as in **Table 2**.

The income tax rate for non-resident individuals is reduced by 1% from 26% to 25%. The rates will be in effect from YA 2015.

TAXABILITY OF WITHDRAWAL FROM A DEFERRED ANNUITY SCHEME

Currently there is no legislation to tax an individual on any withdrawal from a deferred annuity scheme. The proposed amendment is aimed at taxing the withdrawal from a deferred annuity scheme by an individual, which is made before the age of 55 (other than reasons of permanent total disablement, serious disease, mental disability, death or permanent departure from Malaysia). The withdrawal will be taxed at a rate of 8%. Deferred annuity refers to schemes contracted on or after 1 January 2014. Such schemes must contain the Retirement Saving Standards approved by Bank Negara Malaysia and must be issued by:

- **insurers licensed under the Financial Services Act 2013; or**
- **takaful operators registered under the Islamic Financial Services Act 2013**

The same tax treatment will apply for withdrawals made from Private Retirement Schemes. The amendment will be effective from 1 January 2014.

Chargeable Income (RM)	Current Tax Rate (%)	Proposed Tax Rate (%)	Reduction (%)
1 – 5,000	0	0	-
5,000 – 20,000	2	1	1
20,001 – 35,000	6	5	1
35,001 – 50,000	11	10	1
50,001 – 70,000	19	16	3
70,001 – 100,000	24	21	3
100,001 – 250,000	26	24	2
250,001 – 400,000	26	24.5	1.5
Exceeding 400,000	26	25	1

Table 2

As deferred annuity schemes are long term investment vehicles, the proposal is aimed to encourage contributors to retain their savings for retirement.

OUR COMMENTARY

It appears that this provision attempts to impose income tax on the entire withdrawal and not just the income portion.

SPECIAL TAX RELIEF FOR MIDDLE INCOME TAXPAYERS

In order to alleviate the financial burden of the middle income taxpayers, a special tax relief of RM2,000 will be given to resident middle income taxpayers earning up to RM8,000 a month with an aggregate income of up to RM96,000 per annum. With this proposal which is effective for year of assessment 2013 only, resident middle income taxpayers earning up to RM96,000 per annum will enjoy tax savings of up to RM480 upon claim of this one time relief.

MONTHLY TAX DEDUCTION (MTD) AS FINAL TAX

It is proposed that with effect from YA 2014, employees with total income tax equivalent to Monthly Tax Deductions (MTD) be exempted from filing of annual tax returns. This is applicable to employees:-

- **who receive employment income prescribed under Section 13 other than employment income in respect of use or enjoyment of benefits provided by employers pursuant to Section 13(1)(b) or Section 13(1)(c);**
- **whose MTD are made in accordance to the Income Tax (Deduction from Remuneration) Rules 1994;**
- **serving under the same employer for a period of 12 months in a calendar year;**
- **whose MTD are not borne by employers; and**
- **whose spouse did not elect for joint assessment**

Employees who satisfy the above conditions and did not furnish tax returns are deemed to have elected for MTD as final tax. However, the Director-General of Inland Revenue (DGIR) retains the power to raise assessment under Section 90(3) or Section 91 for any YA. Upon issuance of the assessment, the MTD deemed to be final tax shall be disregarded.

REAL PROPERTY GAINS TAX (RPGT)

With effect from 1 January 2014, the RPGT rates for the disposal of properties and shares in real property companies are to be revised as **(see Table 3)**.

Table 3

Holding Period	*Proposed RPGT rates*		
	Company	*Individual (citizen & non-PR)*	*Individual (non-citizen)*
Within 3 years	30%	30%	30%
In the 4th year	20%	20%	30%
In the 5th year	15%	15%	30%
> 5 years	5%	0%	5%

PENALTY FOR PROVIDING INCORRECT NOTIFICATION TO THE ACQUIRER

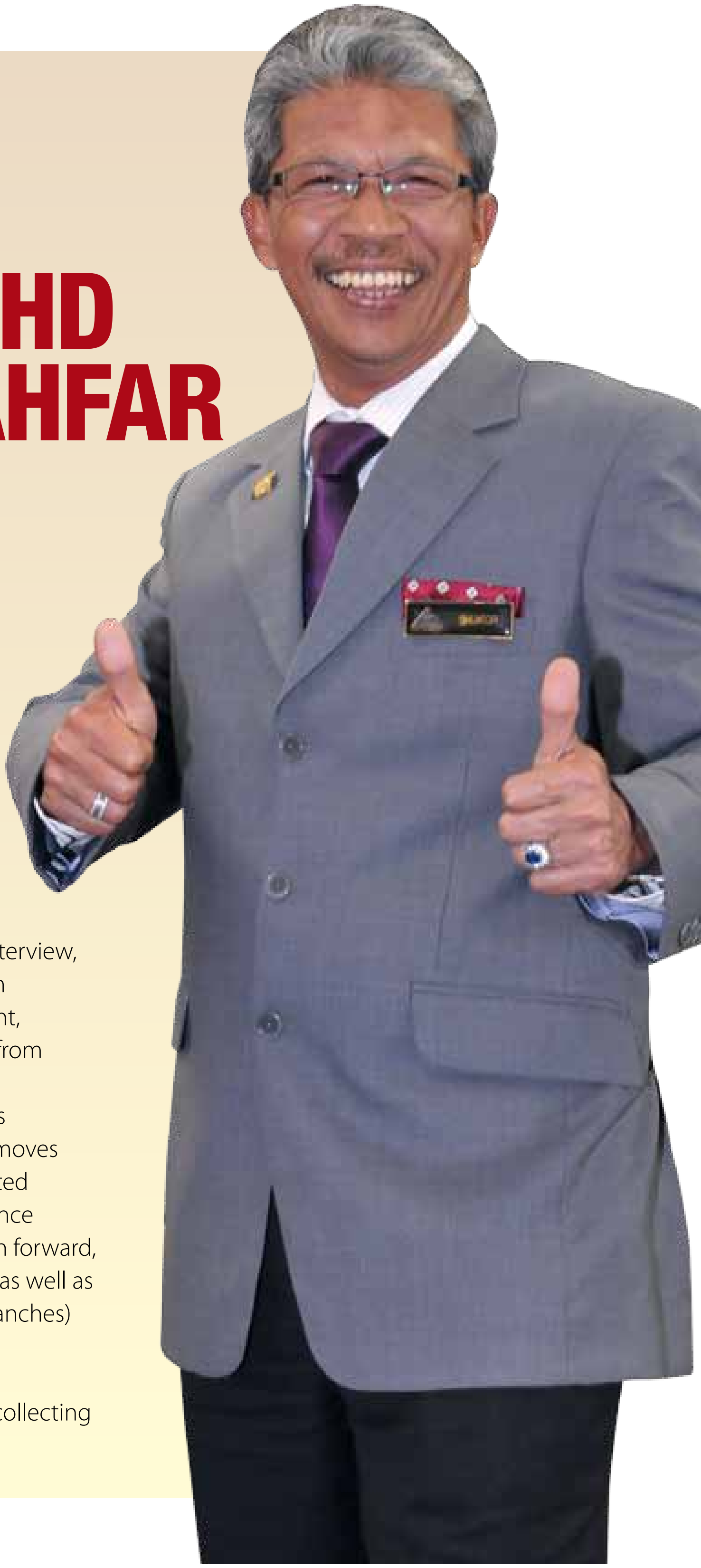
The RPGT Act provides for a 2% retention sum by the acquirer which must be remitted to the DGIR within 60 days. A penalty is imposed on the disposer of a chargeable asset where the acquirer fails to retain and remit tax as required by reason of an incorrect or wrong notification furnished by the disposer to the acquirer on the chargeability of the asset disposed. In computing the penalty the Bill proposes a definition of "tax payable" which effectively disallows brought forward losses in computing the tax liability. This will result in a heavier penalty on the disposer where there is an incorrect or wrong notification furnished by the disposer to the acquirer on the chargeability of the asset disposed. The amendment is effective upon coming into operation of the Finance Bill (No. 2) 2013.

Whilst this article is not intended to cover all proposals, we have highlighted the salient points and issues for further consideration. In any Budget Proposal, there will be goodies as well as eye-catching amendments. It is only right for the taxmen to plug any loopholes so as to protect the nation's revenue base but certain proposals mentioned above need due consideration before they become law as they may have far reaching implications to business, in particular foreign direct investors.

The authors are executive directors of tax at Deloitte Malaysia. The above views are their own.

EXCLUSIVE INTERVIEW WITH TAN SRI DR. MOHD SHUKOR HJ. MAHFAR

THE CHIEF EXECUTIVE OFFICER / DIRECTOR-GENERAL, INLAND REVENUE BOARD, MALAYSIA (IRBM)



Tan Sri Dr. Mohd Shukor was inspiration personified when he shared with Mr. SM Thanneermalai, President of the Chartered Tax Institute of Malaysia (CTIM) and Ms. M. Silverranie, CTIM Editorial Committee member, his greatest challenges and the most significant achievements as a leader at the helm of a very prominent organisation, the Inland Revenue Board of Malaysia (IRBM). In a frank and candid interview, he explains his philosophies behind his management style, which incorporated a cultural transformation, an entrepreneurial element, people-oriented empowerment of the *Hasilians* (a name coined from "Hasil" - Revenue), succession planning and introduction of many innovative programmes and changes to the organisation. Tan Sri's strategies to transform the organisational culture called for bold moves and an entrepreneurial mindset which maximised the use of limited resources of man, machine and money. Using KPIs (key performance indicators) as a major driving force, Tan Sri moves the organisation forward, all the time inspiring and motivating both the individual *Hasilian* as well as all his "proxies" (which include the state directors and heads of branches) to carry out his strategies.

In short, the interview tells the story about the incredible transformation, in a relatively short time, of the leading revenue-collecting agency in Malaysia.

THE GREATEST CHALLENGES

CTIM Since our very first interview in January 2011, a lot (that is indeed commendable!) has happened. Would you like to share with us your greatest challenges in achieving this, and the most significant achievements? What's the secret and how did you go about making this incredible transformation?

TAN SRI In 2011, I told you what I had planned to do; you couldn't have seen the results then, but now, you can.

In the two consecutive years prior to my taking office – from 2008 to 2009, and also in 2010 - there was a decline in revenue collection. In 2008 the collection was RM90 billion. In 2009 it was RM88 billion; and in 2010 it was RM86 billion. So, when I took over, I studied the history of Lembaga Hasil Dalam Negeri from 1996. What I noted was this: we experienced a revenue drop – first in 1998, during the world economic crisis, but the drop was minimal - less than RM2 billion. In 2004, there was another drop of close to RM2 billion. In this instance, there were reasons – including "worldwide" reasons: the Iraq war, SARS (Severe Acute Respiratory Syndrome) and JE (Japanese Encephalitis) - which had an effect on the economy.

However, when it came to 2009, it appeared that there were no good reasons (something external, perhaps?) to substantiate the decline. So I quickly came to the conclusion that if there was no external reason, then there must be a reason on the inside - and I had to do something about it. I believe that IRBM is just like any other corporation (lifeless in itself!). It is the people who give life to an organisation. My emphasis is on the people. I am people-oriented rather than task-oriented. As the CEO, there are two courses of action (open to me) – firstly, career-wise I'm a taxman; alternatively, being at the helm of the organisation (the question is), am I supposed to run the organisation as a typical taxman? If not, then what? I believe that I should use another skill - that of an entrepreneur. I asked myself, "How can I maximise my limited resources of man, machine and money?" The people needed direction and, from management theory, I know that the "Number One" (in the organisation) will create the culture.

CHANGE IN CULTURE

My foremost priority was to create the culture. I told my staff (we have coined a new name for them - "Hasilians") that the challenge is in revenue collection. There is no end to revenue collection. What is collected represents the tip of the iceberg. I told them that a lot needs to be done if we want to get extraordinary results, and we need to do it in a way that can be translated into revenue collection. In the year 2010, revenue collection was RM86 billion; in 2011 it shot up to RM109 billion, and in 2012 it went up further to RM125 billion. For this year (2013) the first target given to us was RM130 billion but it was increased (in September) to RM135 billion.

People (even my counterparts) ask me, "What's the secret?" To me, it is very simple - the people are my assets. They are the ones who are doing the job. So, if you know how to handle the people, the rest will come naturally; in fact, they will give you extra.

CTIM You are a people-oriented person. The change, as we can see, is driven by your people. But in dealing with people, what are the kinds of plans or actions that you took - on a micro scale - that made that difference to the people?

TAN SRI From experience (Doctorate in Management) I told myself, "I have to change the culture." As a leader, I needed to change the culture. I'm not a worker anymore, even though I've been trained as a taxman with technical knowledge. As a leader, where do I start? In order for me to mobilise my resources, my people must place their full confidence in me. With me as their leader, they either follow me or they don't. There is no "in-between" (half measure).

As an enforcement agency, we have a set of rules - all nicely written down - but we sometimes forget that we need to interpret the rules. Do the people really own the SOP (standard operating procedures)? If they don't, how, then, can they become champions with regard to their clients (in this case, the taxpayers)?

ROADMAP

To implement my strategy, I must be a prime mover. I use the term "prime mover", meaning "to move people". I must know the direction we need to head towards; and I also ask the five Ws - why, what, who, where, when - and the one H (how). As far as I am concerned, to motivate my people I must have a direction.

That is when I started to create what is called a roadmap for IRBM- a roadmap (connecting) to the goals of the nation.

At the micro level, with regard to my organisation, our goal is for IRBM to be a leading tax agency. Some will call it "world class". But how do we define "world class"? And that's when I started to change our pledge.

The IRBM's pledge has five pillars. Following the first pillar (which is "Rukun Negara"), the second pillar is about professionalism and integrity. The third pillar is about giving our best service, because it is only with professionalism and integrity that we can offer our best service. The third pillar leads to the fourth pillar, which is voluntary compliance. Without professionalism and integrity and providing the best service, I don't think you can get voluntary compliance from taxpayers. When all the four pillars are in place, then we come to the fifth pillar, which is to raise the image of the organisation.

You can see that the Government has put its trust in us. A good example was in 2011, when IRBM was entrusted with the responsibility of handling the BR1M (Bantuan Rakyat 1 Malaysia) payments.

What is interesting to note is that BR1M relates to another segment of the population; the Government could have gone to another agency to handle this. You must remember that the year 2011 was the first year for me as the captain of my ship. You know, with all my efforts, (starting with) the rebranding of the organisation etc., I was confident that we could carry out this task entrusted upon us. Why? This was due to the readiness of my *Hasilians*; they were willing to accept the challenge - because they knew where they were heading.

As the prime mover, I managed to keep my people (focused) in the same direction. But of course, this is not enough. Just like it takes two to tango, there must be something else for people to get excited about. For this to happen I added yet another role: I am the motivator to the *Hasilians*. So, with a combination of roles - as a great motivator and a prime mover - the direction for my staff was set. Interestingly, as a great motivator, it is aimed more at an individual level.

INNOVATION AND CREATIVITY

So, this brings us to the human resource of the organisation. We now have a succession plan to create knowledge workers. I have introduced what is called a "CEO incubator" programme. To me, at any one point, there can be only one CEO, but there must be thousands of (potential) candidates. The programme is open to all staff at the executive level; to me, only the "survivors" of the programme will be promoted. I have told them that in the "CEO incubator", we provide them with the opportunity; we train them in leadership because the higher you climb up the ladder, you are not talking about only "technical" (matters) anymore; instead, you will (also) be dealing with people.

The programme is intended to bring about an awareness of the potential for career advancement, etc. Once your staff are aware of what is going on, then the level of acceptance is high, and people will take up the challenge.

This year, I have also introduced flexi-hours for working hours. This is indeed an unprecedented move, unheard of in any government agency in Malaysia. Let me explain: sometimes, it's not by choice that someone comes late, but because of being ten minutes late, you penalise him/her. You spoil his/her day. Who loses? The Government loses. So now I have empowered the staff, giving them the self-responsibility

KPI AND REWARDS

CTIM **What you have done with regards to people is really commendable. In the end, people being people, how do you satisfy their needs? Is it just dollars and cents, or more than that?**

TAN SRI (As mentioned) I have actually put in place the culture of KPI (key performance indicators). I told the Board of Directors of IRBM: "I am going to accept whatever target that is proposed for the organisation but you must keep in mind that KPI is about two things – productivity and reward."

So, when it comes to KPI, people are expected to work more and more but as a human being, you also want to be rewarded, because, as we know, nothing is free in this world. You must give recognition accordingly. Hence, in my dealings with the Board of Directors, we set out our criteria based on our KPIs – the results, and the recognition to be given to us.

So, in order to encourage my officers, we have a strategy in place at both the national and the state levels. And now I've added an extra role for our state directors. I told them that, being a state director, "you are my "proxy" in your territory. It is your duty to ensure that the mission is accomplished, at the end of the day."

In this connection, we have designed (a scheme based on) colour-coding. For the highest ranking level, we use the colour purple. We have seven colours representing (different) levels from "on-target" up to "the highest".

Now, at the branch level, we have what is called a "purple" race; it means there is a race to determine which branch is going to reach the purple colour code, and get rewarded. In fact, this race is at the levels of the state, branch and the process-owner. So everybody knows.

Relating back to the KPI and rewards, in 2011 we were given five and a half months bonus; in 2012 we were given six months. To me, it was something we have never dreamed of before.

LEADERSHIP STYLE

CTIM **To what extent did you walk on the ground level to make it work? You were not, from what we could see, merely sitting in the ivory tower and giving instructions.**

TAN SRI Of course, as a leader, I must know who my followers are. In connection with this, last year it so happened that when I was in Boston, the author of "The Naked Leader" (David Taylor) told the audience that a leader must have good followers. "Without the followers, you are a nobody," he said. I strongly believe and agree with his theory.

When I visited my branch offices I tell them "without you, who am I?" So I arranged in the first year to visit my branches; I explained to them what we were supposed to do and why we did this, and why we did that. I changed the culture.

So for the first time ever, when this "crazy" DG enters a room, he enters, accompanied by music, to the tune of "we will rock you" - a message which effectively says "Let's rock the world". Now, this practice is well accepted.

REVENUE COLLECTION TARGET

CTIM **Could you share with us, Tan Sri, on how you have coped with the targets - for revenue collection - set by the government?**

TAN SRI In 2011, the initial figure given to me by the government was RM91 billion. But, the internal target to my staff was RM100 billion; it's the first time ever that the organisation was given an internal target of RM100 billion. We've never achieved that before. So I told them: "Look here, I have a lot of philosophy behind the figure, 100: First, 100 days; second, at 100 degrees centrigade, water boils, and to see the fastest man or woman, it's the 100m (race)."

In 2011, the Ministry of Finance (MoF) continued raising the target from RM91 billion to RM93 billion to RM96 billion, and in early September - RM103 billion; but we finally collected RM109 billion. We have now reached the "RM100 billion" zone. I believe we will be in this 3-digit zone i.e. 100 to 999 billion (for some time yet…that may take another 50 or 100 years)

We, IRBM, are not in version 2 (the 2-digit zone); we are in version 3 (the 3-digit zone).

CTIM **Going forward, Tan Sri, considering the fact that the targets have been climbing, how would you achieve future, similar, phenomenal growth - especially if GST comes on board?**

TAN SRI When you compare our taxpayers *vis-a-vis* the population, people always say, "oh, your taxpayers are five million and your tax-paying public is only about three million, but your population is 26 million".

We believe that, so long as there is a contribution towards GDP from the revenue collection, that is important (achievement)…instead of basing it on a "taxpayer vs population" comparison. Our contribution is around 13% of GDP. I keep telling the MoF that revenue growth should be twice the GDP growth. In this instance, it should be 11% - and only then can you say that you are efficient.

We must compare with the GDP - that is the RESULT.

The number of taxpayers is just a number. We are not talking about quantity; we are talking about the quality of our performance. For example, when we were asked to collect RM130 billion (at the start of 2013), to me, that (figure) is the outcome; it is not my output.

We developed it into our KPI ecosystem; we have ten components in our KPI ecosystem developed from the four quadrants of our Balanced Scorecard using the Kaplan Model / Theory.

So we say: in order to get the RM130 billion, we must have the output, and this output is very, very important – and the role of the IRBM headquarters is to ensure that the strategies are in place. How can we maximise our resources to optimise our productivity? Then I told them that if our collection is less than the target, it becomes a threat to me. Some people call it a tax gap. In my view, we cannot compare with the taxpayer base because every year, based on our track record, we are already increasing our taxpayer base at the rate of 10%.

ENGAGING WITH TAXPAYERS

CTIM **Could you clarify just a bit? To keep growing these numbers even larger, say, to 150 or 160 billion, or something like that, which is hypothetical - let's say, even 200 billion - is that something that can be achieved in the current economy? Is there a strategy that you have for incrementally higher targets... year by year, upwards?**

TAN SRI Recently, I commissioned several working groups to look into a strategy towards taxpayer segmentation. You know that 80 – 90% of our economy relies upon SMEs because they are the feeder to the giant corporations. (As you know that) when it comes to these SMEs, they are the ones who form the "OG" (other than the "salary group" (SG) taxpayers, and they are the ones mainly with challenges in record-keeping, because they are not required, by law, to have their accounts audited.

Adopting the OECD model, we have commissioned a working group to look into this area. Our emphasis, for 2014, is the SME group – the high-net worth individuals. In this context, the Corporate Tax Department (JCK – Jabatan Cukai Koporat) is now renamed Large Tax Office (LTO). Furthermore, we are going to introduce corporate compliance because we want to enhance compliance.

On this subject of (the term) "compliance"; literature says that compliance means we must file on or before the due date, or pay tax on or before the due date.

We are working not only on compliance; more than that, (we are focusing) on the "honest" taxpayer. It means that when you file your return, you must be honest - honest in the sense of doing what the law says, about the tax.

In future, why must we worry about the returns being filed (and act based on the submission)? We can just go randomly (irrespective of the filing aspect).

Right now, to discipline our taxpayers, we must go and warn them (about their non-submission, etc.). I don't want to be seen as being too fierce.

CTIM **Would that mean regular engagement with these people (the taxpayers) rather than on a one-off basis, or once in three years?**

TAN SRI We are now preparing for 2014 and CTIM will be included as one of our teams. Because you (CTIM) are an intermediary between us and the taxpayers, I am telling you in advance.

CTIM **Certainly, what you are alluding to is regular engagement rather than depending on the filing of the tax return and doing an audit. But (perhaps you could) have regular engagement where taxpayers, too, can contact you for assistance and you can also give them help.**

TAN SRI I am also going to co-opt the SME Corp - they are responsible for the SMEs - and also the SME Bank. We need to listen to them because they are dealing with the SMEs. We need to form a focus group on this matter.

TAX AGENTS

CTIM **On that point, we - CTIM - will certainly, as you say, have a role to play. And what is your view on how CTIM can help you? As far as CTIM is concerned, with our wide membership base, and (the fact that) we are filing most of the returns which are somehow coming to us or are being reviewed by us, how can we help?**
In looking at your LTOs, the SME group plus others, where would you expect us to partner you, even more than what we are doing now? What areas? What more can we do? At the end of the day, we, too, want the nation to benefit. In that sense, how can we work together even more?

TAN SRI The first move is to sell the idea to the Ministry of Finance that we must regulate the tax consultants or tax agents. This is the only profession that has not been regulated. For example, there is MMA, MIA and Bar Council, but in so far as the tax consultants (are concerned)... this is going to be the first move to regulate them. What is the role of a tax agent?

I keep on emphasising that the tax agent is a "proxy" of the IRBM. To be a "proxy" you have to tell the truth, and comply with the tax legislation. It may hurt. It may not make your client very happy with you. But professionally, you have to act in that way. But if you act only as a taxpayer's agent, that may be a different role. To me, we need to engage with you in the manner of a smart partnership. That's why I give my commitment to your roadshows. When we talk about our business process, the evolvement is very fast – due to the changes in the law and also Information Technology (IT). This is because, now, we are not talking about service delivery (which is on the supply side) alone, but we are also talking about demand management. So it's another side of the coin. (To) the taxpayers – they want fast and accurate answers.

That's the reason we have rebranded our PRO (public relations officers or the frontliners who are dealing with the taxpayers at the branch level). I told them that PR stands for public relations, but it is not enough to have relationship.

As a result, we have changed the name from PRO to CCO (Customer Care Officer). As frontliners, they are going to wear badges to indicate that they are the customer care group, and for the *Operasi Mesra Hasil* for "banci bisnes" (business survey) they will wear badges with the words "Hasil is your tax education partner". For our tax investigation officers and our auditors, they will wear badges that say "Hasil is your compliance partner".

DEFAULTERS AND PENALTIES

CTIM **You have talked about achieving targets, motivating people etc. All that is very good but sometimes the (public) perception in the marketplace (I use the broad word "marketplace") and amongst our members too, is that when the IRB is going out there "enforcing", it's going after the same targeted**

people, i.e. those who file the returns diligently; they make the odd mistakes and they get these additional taxes and penalties. They get the feeling that they are the people who are being hit. That's the individual perception. Secondly, the feeling of the public is that penalty should be imposed on those who are not filing the tax returns and those who choose not to come into the tax system.
There are two questions: Firstly, is it the same people who are being hit again and again? And secondly, penalties: are they being applied to the right people? Perhaps penalties should be applied in a bigger way on the people who really deserve it. What's your reaction to that?

TAN SRI I'm not defending the action, but it's a matter of argument. Let me go with a different argument and try to explain. For example, if you are driving on Jalan A and the police stops you (for whatever reason); can you complain to the policeman "why must you stop me?" on the reasoning that there is someone else who is on another road, committing offences but you are not stopping him? The analogy I have is one about the road you take. Say, the road you have taken is that of filing of your return; then, through the information which is within IRBM's control, it could lead to penalties under Section 113(2) being imposed for understatement of income. On the other hand if you had taken the road of not filing your return, estimated assessments under Section 90(3) will be raised and penalties under Section 112(3) may be imposed. You must remember that when you talk about tax and how much to pay, it must be through the return which is made under statutory declaration. So, without your return form, the IRBM cannot start work. That's why I say that the most important requirement for a taxpayer is to furnish the return form.

So you cannot raise the issue of "why me?" and that IRBM should go after those who are not in the tax net. For this category, we have our own ways to find them.

To me, filing a tax return is like (you are) going for a medical check-up. Why must you worry about your results if you are really healthy? But if they/you are not healthy, the doctor will say "sorry, your cholesterol is not that good for the past one year". So, it's not on purpose that we want to target (taxpayer) A, B or C. The rules are there for us to enforce, and if you think that the penalties are too burdensome, you still have the appeals process.

DISPUTE RESOLUTION DEPARTMENT (DRD)

Recently, I announced that I've changed the name of the Bahagian Rayuan Cukai (Tax Appeal Department) to Dispute Resolution Department (DRD), and it (DRD) is entirely independent from the Jabatan Dasar Cukai (JDC) (Tax Policy Department). In the past, with regard to any Form Q, you must go to the JDC; then (go) to Jabatan Pematuhan Cukai (JPC) (Tax Compliance Department). So I think, to some extent, the taxpayers are not happy; that's why we must be independent. That's why the DRD was formed.

CTIM **Who are the members of the DRD?**

TAN SRI One lawyer, Encik Abu Tariq, and our tax experts of course. I told them that they have to review taxpayers' appeals (filed through Form Q) just like a small court within IRBM, "You must act independently; you are like a judge." At the hearing only the members of DRD are present. The taxpayers will present their case to DRD. Even the tax auditors who raised the assessment are not allowed to be present. (In a recent case), the taxpayers were surprised that we allowed them to have "another round" before going to the Special Commissioners of Income Tax (SCIT)! Even if DRD is of the view that the matter is still in IRBM's favour and (that) they should proceed to the SCIT, they can still come to me. I'll be wearing the hat of a "junior" SCIT; I'll not be wearing the hat of the Director-General of Inland Revenue (DGIR). (laughter).

My philosophy is very simple. It doesn't mean that we are going to favour anybody. With the power that is given to me, as the DGIR, under the Act of Parliament (Income Tax Act 1967) I want to protect the Government's interest. I'm not talking about revenue; it is whether I interpret the Act correctly at my level - unless and until the High Court or the Special Commissioners overrule, because that will be beyond my control. As far as I'm concerned, I don't look at the amount involved. I see the principle/legislation in the matter under dispute

CTIM **On the issue of the tax evaders, how are they being distinguished from those under Section 113(2) where we have the penalties, and it's a normal process? Using your analogy of people going on the road, these haven't gone on the right road. They've gone on some other road; they've taken the river, and here you are, ordinary taxpayers, aggrieved; and they say "I'm paying the tax for some others to enjoy, whilst they don't." What measures are being taken to tell the world that it is not condoned? What is the deterrent?**

TAN SRI In 2011, when the Anti-Money Laundering and Anti-Terrorism Financing Act (AMLATFA) was introduced, Sections 112 and 113 of the Income Tax Act 1967 became predicate offences. For those persons who are not in our tax net (those whom we don't know about), with AMLATFA, Bank Negara Malaysia can give us their suspected transaction reports (STR). Then we can start somewhere, and we can issue return forms and, if we see that it is a non-compliance case, we can invoke Order 44.

As the DGIR, I cannot announce who these people are, but suffice to say that we are using the legislative powers to share information to track down, and take action against, such defaulters.

CTIM **How severe is the penalty if they are found guilty?**

TAN SRI In fact at this moment in time, we have not invoked the criminal provisions even with the civil penalties. When we invoke Order 44 (freezing of the accounts), that is already severe. Once the bank accounts are frozen, your creditors will know that something is "wrong" with you. That information is enough, even without the name being published. Of course, that is the legislative power that we have under AMLATFA, but we are not exercising the power rigorously as we choose the people who, we think, deserve this type of treatment.

INTERESTS/HOBBIES

CTIM **Moving away from the work-life at the helm of the organisation, where you have the daily pressures, Tan Sri, how do you manage your after-work hours?**

TAN SRI As the CEO of the organisation I have to do two things: I manage crises, and I manage the perception (people have of IRBM) from both the internal as well as the external (aspects). Most importantly, I must enjoy my life as the CEO. I'm in the role as an actor. Why do some films achieve box office success? For me I have managed to produce (metaphorically speaking) Hasil Box Office success in 2011, and again in 2012 because of the revenue collection. The question that is asked is, "did I do this at the expense of something else?"

People always say "office is office" and "personal is personal". But I believe that you cannot draw a line between office and personal, even if you try.

This belief trickles down to the *Hasilians*. The staff is a reflection of the boss. If you want to know how happy the boss is, look at the staff; you can tell what it's like with the boss. In this connection, if it is time to go for recreation, I go. I must enjoy (myself).There are 11 thousand *Hasilians* to be managed. (In spite of this) I exercise regularly. I have doubled my time for exercise / physical activity, since I became the CEO. [My physician tells me that I have the biological age of a 34-year old].

With regard to managing the perception of the *Hasilians*, the first time I visit a branch, it is like visiting my fan club – here, I get to explain what needs to be done, and why things are done this way and that (way). However, the next time (I visit), it is called a courtesy visit; it is a reflection of someone of a lower status visiting them. Then, I get to express my appreciation. It is the perception I want to create.

CTIM **Tan Sri, it's been a great afternoon. Thank you very much. It's been an honour to have been given the opportunity to interview you, and to have been able to capture the DNA that is you, and the DNA of the organisation, and what you have done thus far.**

TAN SRI It's my pleasure (with a broad charming smile…as usual).

INSIDE VIEW OF INTERNAL TAX MANAGEMENT AND CHALLENGES OF THE IN-HOUSE TAX DEPARTMENT

Esther Chang Hwei Sze *and* Saiyid Abdallah Syakir Al-Edrus

Until towards the end of the 1990s, the in-house tax department in Malaysian companies was a foreign concept as taxation was viewed as a specialist area leaving the recruitment of skilled tax personnel exclusively to professional firms . Taxation affairs were fully outsourced to external tax firms, effectively, the tax affairs of a company was managed by external tax agents or consultants. Top management of companies were comfortable to leave tax matters to external tax agents and advisors, where the focus was to meet the tax compliance requirement ensuring that the statutory tax returns are filed and tax due are paid within the stipulated time. Therefore the tax planning exercise are in most cases initiated by the external tax advisors usually at mid-year or towards year end with tax risks mainly confined to minimising tax leakages for the year as the focus is on analysing the historical data and assessing the tax treatment of income and expenses within the tax year.

With the start of the 21st century, national borders are getting less important as markets stretch across borders and global multinational companies ("MNCs") are well placed to take advantage of this. Businesses have more freedom to choose where to locate their operations and we have seen in the last decade companies move some of their services or key functions, manufacturing plants etc. to more attractive and tax efficient locations. The increasing globalisation of world trade and the evolution of business activities of Malaysian companies bring forth three distinct challenges to be addressed by the Board of Directors ("BOD") and top management of Malaysian companies.

BUSINESSES HAVE MORE FREEDOM TO CHOOSE WHERE TO LOCATE THEIR OPERATIONS AND WE HAVE SEEN IN THE LAST DECADE COMPANIES MOVE SOME OF THEIR SERVICES OR KEY FUNCTIONS, MANUFACTURING PLANTS ETC. TO MORE ATTRACTIVE AND TAX EFFICIENT LOCATIONS.

First, the increase of cross-border trade brings forth a new challenge to Malaysian companies by requiring them to have an understanding of the local tax regimes in the countries where they have their presence. Knowledge of Malaysian tax requirements is no longer enough; Chief Financial Officers ("CFOs") and Financial Controllers ("FCs") are expected to manage all financial risks including tax risks of their company or group of companies operating in foreign jurisdictions. Complexity of businesses means tax risks of Malaysian companies have evolved into something more than just the risks of not submitting relevant returns in Malaysia or other jurisdictions of operations; it encompasses the overall tax compliance, ranging from tax audit readiness at all levels, compliance with all tax legislation in jurisdictions where they operate and having certainty of tax exposures in countries outside their home.

Second, global MNC's setting up companies in Malaysia to support their global operations by bringing new high value job opportunities to Malaysia would have global tax departments managing the tax affairs of the parent company. More often than not, the parent MNC's in-house tax department would require at least a dedicated person, either assigned from the parent to the Malaysian subsidiary or local hiring of tax personnel in the subsidiary to meet the standardised reporting requirements set by the global MNC in meeting their tax risk management and compliance in their home country. This is prevalent in the US and European MNCs, where tax authorities in such jurisdictions would require reporting on foreign subsidiaries and branches by the parent MNC despite the subsidiaries themselves not being subject to the parent MNC's tax authorities' purview.

Third, tax authorities are also evolving at a rapid pace, owing to the paradigm shift of tax authorities around the world to protect its revenue base by the introduction of new assessment systems, tax collection mechanisms, various legislation and rules to curb tax evasion, unsubstantiated tax claims and tax shelters. The introduction of the "self-assessment system" in 2001 by the Inland Revenue Board Malaysia (IRBM) shifts the burden of tax assessments to corporate taxpayers, changing IRBM officers' role from that of an assessor to an auditor. In this connection, top management would need clear understanding of tax rules before making any decision to engage in any transaction especially cross-border transactions, related party transactions and restructuring of companies, not only meeting the objective of the company, but conforming to the tax requirements in multiple jurisdictions in demonstrating operational and commercial substance of each step taken by the management.

EVOLUTION OF THE IN-HOUSE TAX DEPARTMENT

Faced with growing demands of the management of tax requirements, Malaysian CFOs and FCs were increasingly hiring tax personnel to assist them to discharge tax responsibilities in the late 1990s and early 2000s. Initially, the in-house tax personnel were focused on attending to operational tax matters including corporate tax compliance and ad-hoc tax advisory, while strategic level tax advisory was dealt directly by CFOs and FCs with their external consultants. At times, finance personnel were double hatting as tax personnel to take care of the tax matters of their company.

Increase of business transaction volume and increasing tax compliance demands by tax authorities contributed to the formation of a formal department to handle taxation affairs to support companies' tax affairs on a full-time basis. As the in-house tax department usually sits in the finance division of a company, the department is regarded as a backroom support department and was initially focused in discharging functions such as filing tax returns, tax estimates responsibility and providing ad-hoc tax advisory involving tax treatment of income and expenses, dividend payouts, withholding tax rates for payments outside Malaysia and as a reference point for tax implication for each transaction. More often than not, in-house tax departments were not privy to strategic planning of the company in respect of future direction. As such, the role was seen as reactive in nature.

However, in the last six years, the authors have observed that the tax counsels are increasingly invited to strategic level meetings, sometimes they are involved in senior leadership meetings. The change of perception by CFOs and FCs, especially seasoned minded CFOs, towards the in-house tax department, allows the tax counsels to be seen as business partner to all levels of the company, rather than the old mind-set of a cost centre. Interestingly, tax counsels are getting proactive and showcasing their contribution in order to bring value to the company.

EXPECTATIONS AND CHALLENGES OF THE IN-HOUSE TAX DEPARTMENT

How does the in-house tax department contribute value to the company? In the authors' observation, the in-house tax department has two enduring objectives to the company:-

- *Managing Effective Tax Rate ("ETR") of the company; and*
- *Cash preservation and management of the company.*

DIAGRAM 1: STAKEHOLDERS AND AREAS OF TAX THAT THEY ARE INTERESTED IN

TAX AUTHORITIES
- Maximisation of tax revenue from companies (direct and indirect)
- Encouraging investments by companies

IN-HOUSE TAX DEPARTMENT
- Good relationship with tax authorities and full compliance
- Networking with internal and external stakeholders for knowledge sharing and value contribution

FINANCE DEPARTMENT
- Reduced tax costs
- Efficient cash management via speedy tax refunds
- Achieving financial targets

BOARD OF DIRECTORS
- Management of tax risks holistically
- Ethical tax practices in all jurisdictions of operations

INVESTORS
- Certainty of tax position
- Stable year on year tax charges
- Understanding of materialisation of future tax liability and potential tax law changes to the company

NON-GOVERNMENTAL ORGANISATIONS
- Campaigning against unsubstantiated tax schemes
- Asking companies to pay fair share of taxes
- Combating capital flight

CUSTOMERS
- Reduced consumption taxes and passing of tax savings in the product pricing

Any other goals or key performance indicators ("KPI") set by the in-house tax department would largely come back to the enduring objectives; let it be tax exemption applications, tax holidays, applications for refunds and other tax saving measures.

The in-house tax department is constantly faced with various demands from different stakeholder groups as depicted in **Diagram 1**.

Different stakeholders would have different expectations of the in-house tax department, which the tax counsel would need to balance and

find a common ground to meet the expectations without sacrificing the enduring objective of the in-house tax department i.e ETR management and cash preservation.

In this case, the in-house tax department cannot function in a reactive role in order to meet the expectations of various stakeholders; it is expected that the tax team take on more proactive roles to perform tax planning for the company.

At the same time, the in-house tax department is faced with internal challenges that have the potential to hinder its maximum effectiveness. From the authors' experience, the following challenges have direct correlation to the in-house tax department's effectiveness:-

Tax awareness: In most instances non-finance personnel are often not aware of the tax implications of their business transactions and thus the need to seek guidance.

Expectation gaps: In-house tax departments fall victims to miscommunications and expectation gaps by other departments within the company. More often than not, the word "tax" tagged in any kind of work is assumed automatically within the accountability of the in-house tax department, without careful inspection of the nature and purpose of the transaction. Among the common misconceptions are the placement of Deferred Tax within the in-house tax department, although the requirement of Deferred Tax is under the Malaysian Financial Reporting Standards ("MFRS") 112, a financial reporting requirement rather than a regulation under the Income Tax Act 1967. Another popular misconception is information request on payments of commissions or incentives to dealers by the IRBM is immediately construed as tax work, although it involves records from commission or incentive payments, which are better attended by the marketing department as they would have details of dealers receiving such payments.

Support from BOD/Top management: The in-house tax department depends on the support and mandate from the BOD and top management in order to carry out its functions effectively.

To overcome the challenges above, connections can be made via formal and informal ways ranging from organising tax awareness workshops on tax topics that have material impact on the company, monthly briefing by the CFO and FC on current tax status and health, volunteering of tax personnel in company events, offering views in meetings that have tax consequences and networking by tax personnel in trying to find out more on their colleagues' work to gather intelligence for tax planning opportunities. Also, clear demarcation of responsibilities should be agreed upfront between the tax counsel and his/her counterparts in other departments; The CFO's and FC's support to remove 'roadblocks' would greatly reduce the expectation gaps and help provide support from the top management for the in-house tax department.

TOP MANAGEMENT IS WELL AWARE THAT ADVERSE TAX EXPOSURE WOULD LEAD TO REPUTATION DAMAGE AND SCORN FROM THE BUSINESS COMMUNITY.

BUSINESS ETHICS AS PART OF TAX MANAGEMENT

Being part of the company, the in-house tax department would need to align its activities to meet the ethical requirement of the company. Most tax personnel are members of professional accountancy and taxation bodies that emphasise ethics in the code of conduct, which is in tandem with the ethical requirement of the company.

However, there are circumstances where in-house tax departments are faced with challenges such as in situations where stakeholders,have plans or transactions that cannot be supported from the tax perspective. In this case, it is imperative that the in-house tax department is firm with its views in advising the company on the correct approach in order to effectively manage the tax risks as well as reputational risks. Top management is well aware that adverse tax exposure would lead to reputation damage and scorn from the business community. In this connection, the in-house tax department needs to act as a check and balance for the company to avoid taking unnecessary tax risks without a sufficient business case.

PARTNERING WITH EXTERNAL TAX AGENTS AND TAX CONSULTANTS

With the growth of in-house tax departments within Malaysian companies, will the tax work be taken away from external tax agents and tax consultants? In the authors' experience, the opposite is true, where tax assignments have actually increased with the setting up of in-house tax

departments by Malaysian companies. Where the preparation of tax returns may or may not be taken up by the in-house tax departments, external tax firms are able to capitalise on the high value tax advisory work identified by in-house tax personnel.

In the management of the authors' own employer's tax affairs, the authors are involved in identification of strategic tax issues within the group and are able to have efficient access to such issues due to familiarity with the company's business activities. The authors are focused in digesting the business issues for tax implications within the group and providing a clear tax advisory and recommendation to stakeholders, while the external tax consultants provide support in advising on grey areas and assistance in technical reviews.

External tax firms play an important role of providing a second opinion and additional review from technical aspects on tax issues on hand where the tax treatment is unclear. In this connection, the in-house tax department and external tax agents and consultants could form a strategic partnership in managing tax risks of the company. This is possible due to the ability of the in-house tax department to focus on analysing key tax issues within the company due to familiarity of the company's operations and the external tax agents and consultants' roles as technical advisors to in-house tax departments on high risk tax issues.

WHAT'S NEXT FOR THE IN-HOUSE TAX DEPARTMENT?

With the advent of Goods and Services Tax ("GST") to be implemented on 1 April 2015, increased focus of the IRBM on transfer pricing ("TP") audits, TP compliant pricing for all related party transactions, tax exemption applications involving new and untested business concepts and international trade with other jurisdictions, it is the authors' view that in-house tax departments must rise up to the challenge and develop specialist tax skills, especially in GST, TP and international tax planning and exposure to cross-border transactions to continue to be seen as valued business partners. Such specialist tax skills are in demand as today's businesses would require holistic tax advice and views, and not merely textbook information such as direct and indirect tax rates, repatriation of profits and basic tax regime information.

Tax personnel are expected to continue improving themselves to meet the increased expectations of CFOs and FCs. As CFOs and FCs are expected to make strategic decisions for the company, in-house tax personnel are required to formulate tax strategies and recommendations to achieve overall tax efficiency while balancing the commercial requirements in any business decision. Development of specialist tax skills by the in-house tax department would greatly contribute value to the companies in business decisions as access to such skills is scarce.

As such, tax counsel would need to plan for the human resource of their department, which is no longer confined to just succession plans, but includes identification of tax personnel that have the talent and drive to champion specialist tax skills in order to continuously bring value to the company. The future of the in-house tax department depends on its personnel's ability to keep evolving to continuously bring value to the company through achieving the enduring objectives while acting as a business partner to CFOs and FCs in managing tax risks of the company.

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EXEMPTION FOR HOME TO WORK TRAVEL ALLOWANCE - IS IT STILL AVAILABLE?

Richard Thornton *and* Thenesh Kannaa

Like many others, we were of the opinion until recently that the exemption for employees receiving travelling allowance, petrol card and/or petrol allowance for travel between home and place of work was not available at all after the year of assessment 2010. However, on a thorough and careful re-reading of the Income Tax (Exemption) Order 2009 [PU(A) 152/2009] we have changed our view. The objective of this is to share our recent discovery with fellow tax practitioners who might wish to share this discovery with their clients who are in a position to benefit from it in structuring the employee remuneration packages. Nevertheless, the exemption is subject to some reservations which are mentioned below and readers ought to seek expert advice before relying on our interpretation of this law.

BACKGROUND OF THE ORDER

Subparagraph 2(1) of the Income Tax (Exemption) Order 2009 [PU(A) 152/2009] exempts the benefits and gifts received by an employee which are listed in the Schedule to the Order *(Table 1)*.

A financial limit applies to some of the benefits listed below and these are specified in subparagraph 2(3) of the Order. In particular, limits apply to the annual amount of exemption for travelling allowance, petrol card, petrol allowance, toll payment, child care allowance, discounted price for consumable business products and subsidy for interest on housing, education or car loan.

BENEFITS	GIFTS
• Travelling allowance, petrol card and petrol allowance	• Pager
• Toll payment	• Personal digital assistant
• Parking rate and parking allowance	• Telephone
• Meal allowance	• Mobile phone
• Child care allowance	
• Payment for traditional medicine and maternity expenses	
• Discounted price for consumable business products of the employer	
• Discounted price for services provided by the business of the employer and for the benefit of the employee, spouse and child of the employee	
• Monthly bill for subscription of broadband, fixed line telephone, mobile phone and pager registered under the name of employee or employer	
• Subsidy for interest on housing, education and car loan	

Table 1

THE RELEVANT LIMITATIONS ON THE EXEMPTION

> ***Subparagraph 2(3)***
>
> "The exemption granted to an employee under subparagraph (1) for the following benefit shall be subject to the limits as specified:
>
> (a) the travelling allowance, petrol card, petrol allowance or any of its combination, **for travelling to and from home to the place of work** shall not exceed RM2,400 per year;
>
> (b) the travelling allowance, petrol card, petrol allowance or toll payment or any of its combination, **for travelling in the performance of employment** at a place other than his place of work, shall not exceed RM6,000 per year."

(emphasis added by the authors)

Based on paragraph 1 of the Order, all provisions of the Order, except subparagraph 2(3)(a), are effective indefinitely commencing from the year of assessment 2008. Subparagraph 2(3)(a) was made effective from the year of assessment 2008 until the year of assessment 2010 only.

RESTRICTIVE OR PERMISSIVE?

It is important to understand that subparagraph 2(1) and the Schedule to the Order are of a permissive nature because they grant the exemptions. On the other hand, subparagraph 2(3) and the subparagraphs therein are of a restrictive nature, i.e. they limit the amount of the exemptions granted by subparagraph 2(1) and the Schedule.

By the time limitation mentioned above, it is only subparagraph 2(3)(a) that is not effective after the year of assessment 2010. What does it really mean? Is the benefit of a home to work allowance no longer exempt at all? No, it cannot be so because the exemption itself is still available since subparagraph 2(1) and the Schedule (which grants the exemption) are still effective. Instead, we are of the opinion, it is only the limit of RM2,400 that has been removed and the exemption is still effective after the year of assessment 2010.

A NEW PERSPECTIVE

In short, we interpret the law to mean that, after the year of assessment 2010, the exemption for:

- the travelling allowance, petrol card, petrol allowance or any of its combinations, for travelling to and from home to the place of work is still available for an unlimited amount; and
- the travelling allowance, petrol card, petrol allowance or toll payment or any of its combinations, for travelling in the performance of employment at

a place other than the person's place of work, continues subject to the existing limit of RM6,000 per year.

AN EXAMPLE

Teng Fang, a sales executive in XYZ Sdn Bhd, is paid the following allowances for the years of assessment 2010, 2011 and 2012:

Travelling allowance for travelling between home and workplace
RM350 per month

Travelling allowance for travelling in performance of employment
RM800 per month

The allowances are in accordance with company-wide policy.

We believe that the tax treatment of the allowances should be **(as in Table 2).**

Table 2

	Year of Assessment 2010 (RM)	Year of Assessment 2011 (RM)	Year of Assessment 2012 (RM)
INCOME UNDER SECTION 13(1)(A)			
Allowance for travelling between home and work place:			
Amount received (RM350 X 12 months)	4,200	4,200	4,200
Less: Exemption	2,400*	4,200**	4,200**
Income subject to tax	1,800	NIL	NIL
Allowance for travelling in performance of employment:			
Amount received (RM800 X 12 months)	9,600	9,600	9,600
Less: Exemption	6,000	6,000	6,000
Income subject to tax	3,600	3,600	3,600

** Exemption limited to RM2,400 by virtue of subparagraph 2(3)(a).*
*** Subparagraph 2(3)(a) is not effective any more and thus the whole of the allowance is exempt.*

SOME RESERVATIONS

According to subparagraph 2(2) of the Order, the exemption applies only to benefits and gifts that are generally provided to all employees. In other words, an unduly selective attitude on the part of the employer in giving the allowances may prevent the employees from benefitting from the exemption.

It is not uncommon for controlling shareholders of a company to be salaried in their capacity as executive directors or managers. In such a situation, the anti-avoidance provision of paragraph 3 of the Order which curtails the scope of the exemptions to such persons should be borne in mind. These provisions are not reproduced because they are not the primary focus of this article.

CONCLUSION

We perceive that the result of our conclusion on the exemption for home to work travelling allowance, petrol card and petrol allowance after 2010 is more favourable to taxpayers than before and it is possible that the Inland Revenue Board would be reluctant to accept our interpretation.

The authors offer this narrowly-focused article in order to share their views on an interesting matter of interpretation. Readers should exercise their own judgement as to the extent to which they wish to rely on it. No liability is assumed by the authors for any use to which it is put by readers.

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WHITHER THE TAXPAYER'S PRIVILEGE?

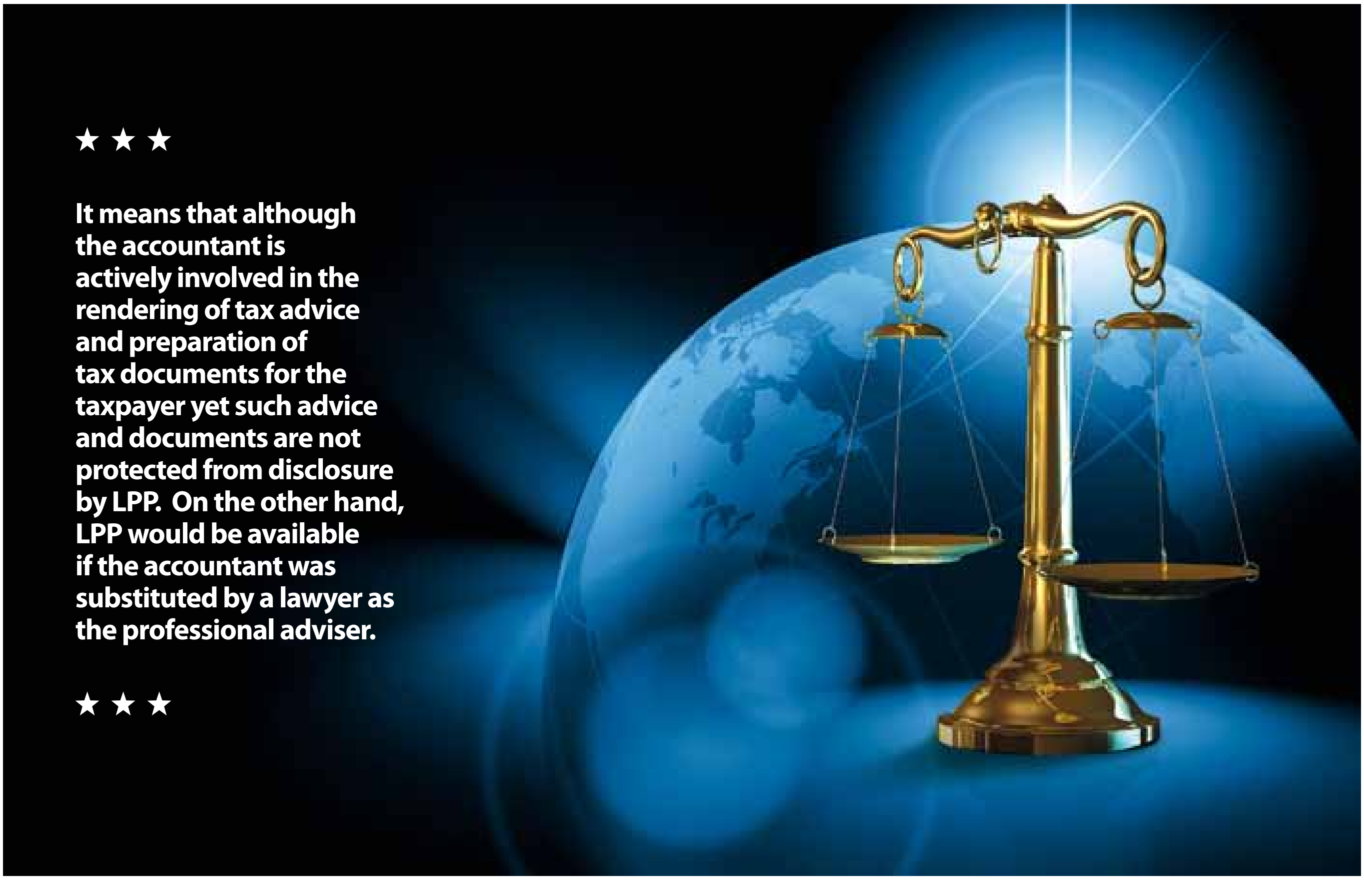
Chen Thim Wai

IN THE MODERN COMMERCIAL WORLD, A PERSON ENGAGES A LAWYER FOR LEGAL ADVICE AND IN MATTERS OF LITIGATION PROCEEDINGS WHILE HE SEEKS OUT AN ACCOUNTANT FOR TAX ADVICE APART FROM THOSE MATTERS RELATING TO ACCOUNTING. MORE OFTEN THAN NOT, THE ACCOUNTANT IS ALSO INVOLVED IN CONDUCTING AND APPEARING IN CASES BEFORE THE SPECIAL COMMISSIONERS OF INCOME TAX ON TAX DISPUTES.

However, the law treats the communications made by a client with his lawyer differently from that made by a client with his accountant. The purpose behind the law is to protect a person's access to the judicial system by encouraging an open and frank disclosure to his lawyer by protecting such disclosure.

Hence, the communications made with the lawyer is privileged from disclosure whether under compulsion of court or law but not that which is made by the client with an accountant.

In a bid to have the accountants' position on the same footing with the lawyers on the issue of privilege, the Institute of Chartered Accountants in England and Wales has intervened in the case of *Prudential Plc v Special Commissioner of Income Tax*[1] but the UK Supreme Court has ruled that the privilege or which is better known as Legal Professional Privilege (LPP) is only available in a lawyer-client relationship and hence would not apply even where such taxation advice has been given to a client by non-lawyers such as accountants.



It means that although the accountant is actively involved in the rendering of tax advice and preparation of tax documents for the taxpayer yet such advice and documents are not protected from disclosure by LPP. On the other hand, LPP would be available if the accountant was substituted by a lawyer as the professional adviser.

WHAT IS LPP?

LPP is made up of two types:-

- Legal Advice Privilege
- Litigation Privilege

Recent articles[2] concerning LPP which have appeared in the *Tax Nasional* (now known as Tax Guardian) have been of assistance in clarifying this difficult area but with slight reference only to the relevant provisions in the Evidence Act 1950, in particular, Sections 126 and 129.

It is generally recognised by the courts that LPP is embodied in Sections 126 to 129 of the Evidence Act 1950 : *Dato' Anthony See Teow Guan v See Teow Chuan & Anor*.[3]

Although the two types of LPP are distinct but the courts in Malaysia have construed Section 126 as covering both types of LPP. In the case of *Dr. Pritam Singh v Yap Hong Choon*[4], the Court of Appeal regarded a medical report procured by the Plaintiff patient in a suit against the Defendant medical practitioner as being privileged under Section 126 of the Evidence Act. This is despite the fact that the purpose of procurement of the medical report in a pending litigation makes it of a Litigation Privilege type but the words in Section 126 of the Evidence Act, are, in the author's view, silent on this aspect and therefore do not include Litigation Privilege. However, Legal Advice Privilege is covered by Section 126.

The Singapore Court of Appeal in *Skandinaviska Enskilda Banken AB (Pub1), Singapore Branch v Asia Pacific Breweries (Singapore) Pte Ltd* and other appeals[5] (the Skandinaviska case) found it necessary to differentiate the two types of LPP with reference to Sections 128 and 131[6] of the Singapore Evidence Act. In the course of its judgement, an exposition of the two types of LPP by the Canadian Supreme Court[7] was cited with approval which offers a clear explanation of the two types of LPP:-

> "**Legal Advice Privilege** recognises that the justice system depends for its vitality on full, free and frank communication between those who need legal

advice and those who are best able to provide it. Society has entrusted to lawyers the task of advancing their clients' cases with the skill and expertise available only to those who are trained in the law. They alone can discharge these duties effectively, but only if those who depend on them for counsel may consult with them in confidence. The resulting confidential relationship between solicitor and client is a necessary and essential condition of the effective administration of justice.

Litigation Privilege, on the other hand, is not directed at, still less, restricted to communications between solicitor and client. It contemplates, as well, communications between a solicitor and third parties or , in the case of an unrepresented litigant, between the litigant and third parties. Its object is to ensure the efficacy of the adversarial process and not to promote the solicitor-client relationship. And to achieve this purpose, parties to litigation, represented or not, must be left to prepare their contending positions in private, without adversarial interference and fear of premature disclosure."

On the relationship between Litigation Privilege and Section 131 (equivalent of Section 129 of the Malaysian Evidence Act), the Singapore Court of Appeal said that it 'clearly envisages the concept of Litigation Privilege.'[8]

The Singapore Law Reform Committee in its report on LPP[9] in analysing the Skandinaviska case concluded that - the Singapore Court of Appeal merely observed that Section 131 "envisages the concept of litigation privilege" and that "while Section 131 clearly envisages that the privilege may be claimed in court, and therefore in the context of litigation, the privilege it provides for is legal advice privilege rather than litigation privilege"

Hence, there are different views on Litigation Privilege:-

- The Singapore Court of Appeal in the Skandinaviska case found Litigation Privilege in Section 131 of the Singapore Evidence Act (equivalent of Section 129 of the Malaysian Evidence Act)
- The Malaysian Court of Appeal in the Dr. Pritam Singh case regarded Litigation Privilege to be covered under Section 126 of the Evidence Act (Malaysian equivalent of Section 128 of the Singapore Evidence Act)
- The Singapore Law Reform Committee concluded that Litigation Privilege is absent in the Singapore Evidence Act and is only available by resorting to Common Law.

In India, where the LPP provisions in her Evidence Act is identical to the Malaysian and Singapore Evidence Act provisions, the authors in the leading Evidence textbooks have taken the view that no provisions in the Indian Evidence Act exists for Litigation Privilege[10], thus fortifying the conclusion of the Singapore Law Reform Committee.

ABROGATION OF PRIVILEGE BY THE INCOME TAX ACT 1967

Since the privilege belongs to the client in a lawyer-client relationship, it is for the client to lose or waive[11] the privilege but Parliament may still intervene to abrogate or remove the privilege by statute.[12]

Chang Min Tat J (as he then was) in *NTS Arumugam Pillai v Director General of Inland Revenue*[13] alluded to such statutory abrogation or removal in the form of Section 142(5) (i) [142 (5) (b)] of the Income Tax Act 1967, with these words, " ---- while subsub-section (ii) [Section 142 (5) (b)] removes the cloak of privilege from a taxpayer's documents and communications."

Sections 142(5) (a) and (b) of the Income Tax Act 1967 are reproduced below:-

"(5) (a) Save as provided in paragraph (b) nothing in this Act shall-

i. affect the operations of

Chapter IX of Part III of the Evidence Act 1950; or

ii. be construed as requiring or permitting any person to produce or give to a court, the Special Commissioners, the Director General or any other person any document, thing or information on which by that Chapter or those provisions he would not be required or permitted to produce or give to a court.

iii. Notwithstanding the provisions of any other written law, where any document, thing, matter, information, communication or advice consists wholly or partly of, or relates wholly or partly to, the receipts, payments, income, expenditure, or financial transactions or dealings of any person (whether an advocate and solicitor, his client, or any other person), it shall not be privileged from disclosure to a court, the Special Commissioners, the Director General or any authorised officer if it is contained in, or comprises the whole or part of, any book, account, statement, or other record prepared or kept by any practitioner or firm of practitioners in connection with any client or clients of the practitioner or firm of practitioners or any other person."

Although LPP is introduced into the Malaysian tax law by Section 142(5) (a) , but LPP is then removed by subsub section (b), which makes it appear that the accountants are placed on a level playing field with the lawyers as far as LPP is concerned.

However, the author is of the view that Litigation Privilege is not part of the Evidence Act 1950 following the views of the Singapore Law Reform Committee (endnote 8) and the authors in the Indian Evidence textbooks (endnote 9). Where the Evidence Act is silent on an aspect of law, regard can be had to 'established principles of law' as per the statement of Lord Diplock in *PP v Yuvaraj* [14]:-

"In Malaysia, as in India, the law of evidence has been embodied in a statutory code: the Evidence Ordinance [Act]. In so far as any part of the law relating to evidence is expressly dealt with by that Ordinance [Act] the courts in Malaysia must give effect to the relevant provisions of the Ordinance [Act] whether or not they differ from the common law rule of evidence as applied by the English courts. But no enactment can be fully comprehensive. It takes its place as part of the general corpus of the law. …. upon matters about which it is silent or fails to be explicit it is to be presumed that it was not the intention of the legislature to depart from well established principles of law."

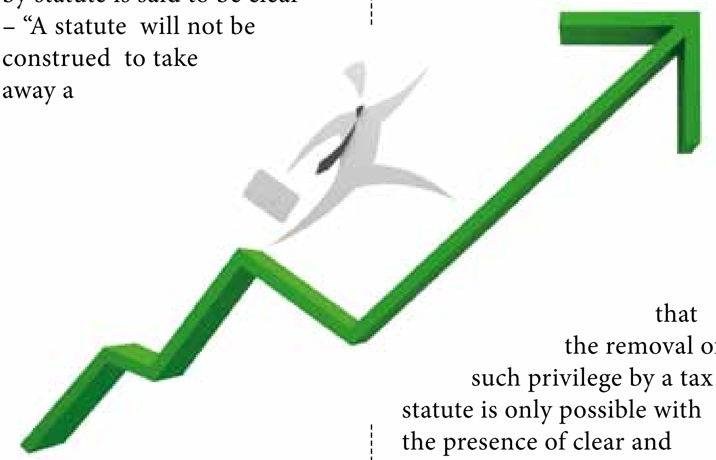
It is clear from the observations of Lord Nicholls of Birkenhead in *R v Derby Magistrate's Court*[15] that Litigation Privilege is a 'well established principle of law':-

"The law has been established for at least 150 years, since the time of Lord Brougham LC in *Greenough v Gaskell (1833) 1 My & K 98, [1824-34] All ER Rep 767:* subject to recognised exceptions, communications seeking professional legal advice, whether or not in connection with pending court proceedings, are absolutely and permanently privileged from disclosure even though, in consequence, the communications will not be available in court proceedings in which they might be important evidence."

Another aspect of Litigation Privilege which was extended to communication between a lawyer and

third parties was established long ago in the 1881 case of *Wheeler v Le Marchant.*[16]

The law on abrogation or removal of common law by statute is said to be clear – "A statute will not be construed to take away a



common law right unless a legislative intent to do so clearly emerges whether by express words or necessary implication".[17]

Another legal principle established by the courts in regard to tax statute which is of assistance to the taxpayer who is claiming the Litigation Privilege is the strict interpretation to be applied to a tax statute,[18] thus supporting the author's view that the removal of such privilege by a tax statute is only possible with the presence of clear and express words to that effect.

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CONCLUSION

Since Litigation Privilege is not part of the statutory LPP (embodied in Sections 126 to 129 of the Evidence Act 1950) which was adopted as part of the tax law by Section 142(5) (a) of the Income Tax Act 1967, hence it is not abrogated or removed by Section 142 (5) (b) of the same Act.

On the exposition of Litigation Privilege made by the Canadian Supreme Court[19], it is said that the "object [of Litigation Privilege] is to ensure the efficacy of adversarial process …….".

The House of Lords in Re L[20] also said that Litigation Privilege could only arise in proceedings which are adversarial in nature but not those proceedings which are inquisitorial or investigative.

While the availability of Litigation Privilege is rather limited however it may still be of use in any proceedings, pending or contemplated, before the Special Commissioners of Income Tax, which are of adversarial in nature.

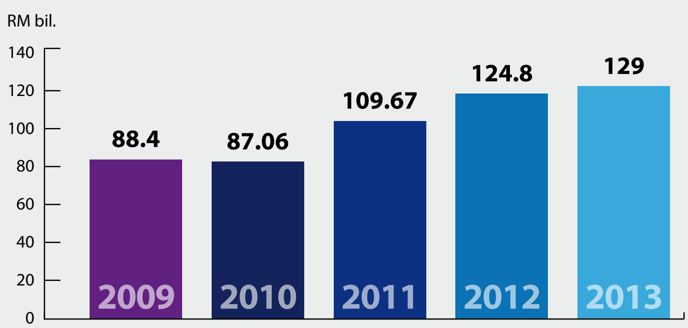
1. *(2013) UKSC 1, (2013) 2 WLR 325.*
2. *Taxpayer Confidentiality - A Question of Privilege by Maric Glaser/CIOT [2nd Quarter, 2007, Tax Nasional]; Legal Professional Privilege - A Fundamental Taxpayer's Right by Sudhar Thillainathan [3rd Quarter, 2007 Tax Nasional].*
3. *(2009) 3 MLJ 14*
4. *(2007) 1 MLJ 31*
5. *(2007) 2 SLR 367*
6. *Equivalent of Sections 126 and 129 of the Evidence Act, Malaysia.*
7. *Minister of Justice v Sheldon Blank (Attorney General of Ontario, The Advocates' Society and Information Commissioner of Canada (Interveners)) [2006] SCC 39.*
8. *Skandinaviska Enskilda Banken AB (Pub1), Singapore Branch v Asia Pacific Breweries (Singapore) Pte Ltd and other appeals (supra) at pg 395 para 67*
9. *Report of the Law Reform Committee on Reforming Legal Professional Privilege*
10. *Sarkar's Law of Evidence 11th Edition Reprint 2008 at pg 2219, "There is no special provision in the Act [Evidence Act] for the protection of similar communications for the purpose of litigation between the clients and persons other than legal advisers or between third persons and legal advisers"; Sir John Woodroffe & Syed Amir Ali's Law of Evidence 17th Evidence at pg 5562, "There are certain cases, however, for which the Act [Evidence Act] does not make specific provision, and in which the question of privilege generally arises on application for discovery or inspection before trial, in which communications made for the purpose of litigation between third persons and the adviser, or third persons and the client, for the purpose of submission to the adviser, are under the discretion given by Section 30 CPC 1908, which discretion, if exercised according to the practice of the Court, is protected from disclosure." Cf Tan Yock Lin, The Law of Advocates and Solicitors in Singapore and Malaysia (2nd Ed, 1998) at pg 551.*
11. *Dr.Pritam Singh v Yap Hong Choon (2007) 1 MLJ 31, Dato' Anthony See Teow Guan v See Teow Chuan & Anor (2009) 3 MLJ 14 at pgs 28-31.*
12. *Baker v Campbell (1983) 49 ALR 385.*
13. *(1977) 1 MLJ 67 at pg 70.*
14. *(1969) 2 MLJ 89 at pg 90.*
15. *(1995) 4 All ER 526 at pg 543.*
16. *(1881) 17 Ch D 675.*
17. *The Australian High Court in Baker v Campbell (1983) 49 ALR 385 at pg 418.*
18. *The Court of Appeal in Margaret Luping and 2 Ors v Ketua Pengarah Hasil Dalam Negeri (2000) 2 AMR 1363.*
19. *See endnote 7 and page 2 of this article.*
20. *(1997) AC 16*

TAX AUDIT ISSUES IN FOCUS

Soh Lian Seng

Under the Self Assessment System, tax audit has become a primary tool for the Inland Revenue Board ("IRB") to enhance voluntary compliance among taxpayers with the tax laws and regulations. In recent years, the IRB has been increasing their focus on tax audit and tax investigation activities. The implementation of an effective tax audit programme is one of the key factors in increasing tax collections. The programme has helped the IRB ensure that the level of tax compliance continues to improve and that taxpayers comply with the provisions of tax laws and regulations.

Table 1: IRB's revenue collection from years 2009 to 2013



Source: *IRB's annual reports 2009 – 2011, press reports, The Star, 24 January 2013*

Table 2: Tax audits and amount of additional taxes and penalties raised

	Tax Audits	
	Number of tax audits resolved (desk field audits) (company and non-company cases)	Additional taxes and penalties (RM'million)
2006	6,741	692.68
2007	279,175	1,410.57
2008	1,052,939	1,697.16
2009	1,399,660	3,054.95
2010	1,732,258	2,870.62
2011	1,910,913	2,672.78

Source: *IRB's annual reports 2006 – 2011*

To increase the transparency of tax audit activities and in an effort to garner greater co-operation from taxpayers, the IRB has once again amended its Tax Audit Framework ("TAF"), which was originally issued on 1 January 2007 and first amended on 1 January 2009, on 1 April 2013.

The notable changes in the 2013 TAF are as follows:

- Previously, tax audits generally covered a period of one to three years of assessment ("YAs"). Based on the 2013 TAF, the period to be covered in a tax audit has been reduced to one YA. However, the tax audit may be extended to a period of up to five YAs, if there are issues uncovered during the tax audit. The five year time limit is not applicable to cases involving fraud and tax evasion;
- During the course of an audit, the audit officer is allowed to examine all business records. In the audit of cases other than companies (such as sole-proprietorships and partnerships), the audit officer may also examine records other than business records, such as bank statements, records relating to the purchase of properties and records relating to personal expenses. The 2013 TAF indicates that audit officers may now examine additional records such as credit card statements, family expenses as well as records relating to asset ownership;
- Taxpayers are revised to keep and retain sufficient records (now extended to include financial statements) for a period of seven years;
- The IRB has revised the time to be spent by the field audit team at the taxpayer's premises from two to three days to between one and three days;
- The IRB has allowed an additional seven days (from 14 days previously) to 21 days for taxpayers to file their objection against the proposed tax adjustments made during a tax audit;
- Where a taxpayer furnishes his tax return by the due date and the IRB has made a general assessment or additional assessment under Section 91 of the Income Tax Act 1967 (the Act), and the taxpayer subsequently makes a voluntary disclosure within six months from the due date, the taxpayer is eligible for concessionary penalty rates. The concessionary penalty rates are 10% for voluntary disclosures made within 60 days from the due date and 15.5% for voluntary disclosures after 60 days but less than six months from the due date.
- Previously, for repeated offence, the penalties may be increased by 10% for every additional offence, up to 100% of the amount of tax undercharged. The IRB has removed the repeated offence penalty clause in the 2013 TAF.

The rollout of the new TAF sends a clear signal to taxpayers that the IRB is committed towards intensifying its tax audit activities. It is therefore imperative for taxpayers to take the necessary steps to enhance their tax risk management activities and to be aware of areas of focus by the IRB in the course of tax audits.

COMMON AREAS OF FOCUS IN TAX AUDITS

The following sets out some common areas of focus by the IRB during the course of tax audits **(see Graph 1).**

Claiming of tax incentives

Companies with tax incentives are commonly selected for tax audits. Amongst others, the IRB will evaluate the taxpayer's eligibility for the tax incentive, the extent to which the qualifying conditions of the tax incentive are satisfied and the availability of supporting documentation.

For example, for taxpayers which are enjoying reinvestment allowance ("RA"), the IRB will typically assess whether the taxpayer is carrying on a qualifying project and scrutinise the qualifying capital expenditure on which RA is claimed. Taxpayers may be required to provide documents such as project papers, feasibility studies, market research, business plans, budgets and financing arrangements to demonstrate that the company is undertaking a qualifying project.

During tax audits on RA claims, the IRB has in the past sought to disallow RA claims on non-production areas, capital expenditure claimed on replacement assets and assets which are not directly used in the manufacturing or production process. Notwithstanding the IRB's position, in recent case law developments, the courts have held that the definition of factory for RA purposes should not be restricted to production areas only and have allowed RA to be claimed on qualifying expenditure on non-production areas.

Graph 1

Illustration 1
Tax Audit Issue – RA Claims

The taxpayer is engaged in a manufacturing activity. The taxpayer has undertaken an expansion project (a qualifying project) and has claimed RA on qualifying capital expenditure incurred.

Tax audit findings:

The IRB carried out a RA audit on the taxpayer. During the audit, the IRB reviewed the source documents (i.e. RA claim forms, asset requisition forms, production capacity reports, process flowcharts, etc.), interviewed the taxpayer and conducted a site visit of the taxpayer's factory to sight the qualifying capital expenditure on which the RA was claimed.

Taxpayer's explanation:

The taxpayer provided the IRB with the asset requisition forms for the samples selected by the IRB which proved that the selected samples were incurred for purposes of the expansion project.

The taxpayer also explained the functions of the plant and machinery acquired in relation to the qualifying project and demonstrated how the plant and machinery were linked to the qualifying project and the production process. This was further supported by a manufacturing flowchart which illustrated the production process. During the site visit, the IRB also managed to sight the qualifying plant and machinery and verified that they were used in the production process. In addition, the taxpayer furnished the IRB with a production capacity report which demonstrated that the expansion project has resulted in an increase in its production capacity.

Based on the evidence the taxpayer made available, the IRB allowed the RA claims.

Withholding tax compliance

Payments made to non-residents are generally subject to withholding tax (WHT) under the Act. Where WHT has not been deducted on certain payments made to non-residents, the IRB may request for the taxpayer to provide the relevant supporting documents and explain why the particular payments should not attract WHT.

Examples of contentious areas with regards to withholding tax include:

- Whether payments made for the purchase of software constitute royalties and hence, are subject to withholding tax under Section 109 of the Act?
- Whether commission paid to non-residents fall under Section 4(f) of the Act and hence, are subject to withholding tax under Section 109F of the Act?
- Whether payments in the form of salaries and wages, bonus and employment benefits made to foreigners are akin to payments for technical services and hence, are subject to withholding tax under Section 109B of the Act?

Illustration 2
Tax Audit Issue - WHT on Commission Payments

The taxpayer is engaged in the sale of copyrighted software to companies in the Asia Pacific region. In the distribution and selling of its software to its overseas customers, the taxpayer would normally market them directly or through appointed agents. The appointment of agents is formalised by way of agency agreements between the taxpayer and the overseas agents. Pursuant to the agency agreements, the appointed agents are entitled to commissions.

Tax audit findings:

During the tax audit, the IRB informed the taxpayer that the commissions paid to non-resident agents are subject to WHT pursuant to Section 109F of the Act unless the taxpayer can prove with supporting documents that they are not gains or profits falling under Section 4(f) of the Act.

Taxpayer's explanation:

The taxpayer provided the IRB with a detailed breakdown of the commission expenses for the YAs covered during the tax audit, together with copies of the invoices relating to the commissions paid to the agents to demonstrate the frequency of the commission paid to its agents. The level of frequency of the commission received by the agents showed that the commission income was not of a casual nature or one-off income to the recipients and hence, should not fall under other gains or profits pursuant to Section 4(f) of the Act.

The taxpayer explained that the commission income was the agents' business income. The taxpayer evidenced this with supporting documentation (including written confirmation from the agents, auditors' confirmation letters and business registration details) from the agents which proved that the commission income have been treated as business income in the respective agent's accounts.

Based on the supporting evidence provided by the taxpayer, the IRB agreed with the taxpayer.

Deductibility of expenses

The IRB may request the taxpayer to explain the nature of expenses and to provide the relevant supporting documentation to support the claim for tax deduction. Where the taxpayer is unable to furnish such information, the IRB is likely to disallow the tax deduction claimed on the expenses.

Certain expenses such as advertising and promotional expenses, entertainment expenses, travelling expenses, specific provisions for bad and doubtful debts, interest expenses are also often scrutinised by the IRB. In addition, the IRB has been known to challenge the tax treatment between revenue and capital expenditure as well as provisions and accruals.

Illustration 3
Tax Audit Issue – Deductibility of Sponsorship Expenses

The taxpayer is engaged in the trading of pharmaceutical products. The taxpayer organised congresses to disseminate information and sponsored doctors to attend the congresses.

Tax audit findings:

During the tax audit, the IRB interviewed the taxpayer and reviewed source documents (such as ledgers, invoices, payment vouchers, tax computations and tax returns). The IRB queried the taxpayer on the reason for sponsoring doctors to attend the congresses and challenged the tax deduction claimed by the taxpayer on the sponsorship expenses pursuant to Section 33(1) of the Act.

The IRB disallowed the tax deduction claimed on the sponsorship expenses on the basis that they were entertainment within the definition of Section 18 of the Act and were thus not allowable for tax deduction under Section 39(1)(l) of the Act. The IRB raised additional assessments and imposed a penalty on the taxpayer.

Taxpayer's explanation:

The taxpayer explained

that its strategy in promoting the company's products was to identify hospitals, physicians, pharmacists and healthcare professionals and make them aware of the company's products. As a pharmaceutical company is not allowed by law to advertise its products directly to consumers, the products have to be promoted through doctors, pharmacists and healthcare professionals. As such, the sponsorship of doctors and speakers are vital in the promotion of sales.

In addition, the taxpayer stated that the sponsored speakers had provided a service by presenting a paper in return for the sponsorship of his travel and lodging costs while the sponsored doctors had invested time in attending the congresses. As such, there were practical advantages derived by both the taxpayer as well the sponsored speakers and doctors. As a practical advantage is considered "consideration", the taxpayer contended that the congress expenses were wholly and exclusively incurred in the production of income under Section 33 of the Act, and the said expenses should not fall under the definition of "entertainment" in Section 18 of the Act.

The taxpayer appealed against the additional assessments and penalties imposed by the IRB. This case has since been heard by the Special Commissioners of Income Tax (who held in favour of the taxpayer), followed by the High Court (which held in favour of the IRB) and subsequently by the Court of Appeal (which held in favour of the taxpayer).

Based on the recent 2014 Budget announcement, the IRB has proposed to broaden the definition of entertainment under Section 18 of the Act to include the provision of food, drinks, recreation or hospitality, accommodation or travel incurred in promoting a business or trade, which are provided with or without consideration. It appears that the IRB has taken note of the recent case law developments and is aiming at providing clarity to the taxpayer on the IRB's view with regard to entertainment expenses.

Related party transactions

Generally, taxpayers may be required during the course of a tax audit to furnish the IRB with contemporaneous transfer pricing documentation to demonstrate that related party transactions have been effected on an arm's length basis. The basis of charge for management fees, commission and allocation / sharing of expenses between related companies are commonly challenged by the IRB during tax audits.

With the issuance of the Income Tax (Transfer Pricing) Rules 2012 and the revised Transfer Pricing Guidelines 2012 followed by the Transfer Pricing Audit Framework on 1 April 2013, it is clear that the IRB is increasing its focus on related party transactions and transfer pricing issues. Given its importance and increasing scrutiny by the IRB,transfer pricing warrants further attention of the taxpayers.

Income recognition

The IRB is known to focus on the following areas in relation to the recognition of income:

- Timing of recognition
- Omission of income
- Understatement of sales
- Discrepancies between sales recognised and supporting documentation
- Whether the income is revenue or capital in nature

The IRB may require taxpayers to provide supporting documentation (e.g. invoices, credit notes, sales and debtor ledgers) to support the sales recognised and perform a sampling of selected sales transactions.

Employers' obligation in declaration of taxable benefits

The IRB may examine whether perquisites and benefits provided to employees have been duly reported by the employer and brought to tax accordingly.

Capital allowances

The IRB may scrutinise the capital allowances claimed by taxpayers and request for information such as fixed asset registers, bills of quantities, etc. The IRB may also challenge the appropriateness of the capital allowance rate applied and/or the claim for capital allowances on certain types of capital expenditure (e.g. multi-storey car park, lighting, transmission lines and capitalised interest costs).

CONCLUSION

With the intensification of tax audits, taxpayers should take proactive measures in ensuring compliance with the relevant tax legislation and in managing tax risks. Businesses should also be cognisant of the common areas of focus by the IRB during tax audits and familiarise themselves with the specific tax issues surrounding the industry that they are in. Whilst tax audits are inevitable, proper management and preparation for tax audits will make these less time-consuming and alleviate unnecessary surprises in the form of additional tax assessments and ensuing penalties.

***Soh Lian Seng**, is an Executive Director of KPMG Tax Services Sdn Bhd. The views expressed in this article are the author's own views and do not necessarily represent those of KPMG. The author can be contacted at lsoh@kpmg.com.my*

Technical Updates

The technical updates published here are summarised from the selected government gazette notifications published between 16 August 2013 and 15 November 2013 including Public Rulings and guidelines issued by the Inland Revenue Board (IRB), the Royal Customs Department and other regulatory authorities.

INCOME TAX

Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) (No. 4) Order 2013

The Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) (No. 4) Order 2013 [P.U.(A) 264] was gazetted on 21 August 2013 and came into operation on the same day. The Order provides that any tax payable under the Income Tax Act 1967 (ITA) or stamp duty payable under the Stamp Act 1949 in respect of any agreement, note, instrument and document in relation to *Sukuk Ijarah* issued by the "Issuer" or in relation to the "Guarantee" shall be remitted in full.

Income Tax (Exemption) (No.11) Order 2013

The Income Tax (Exemption) (No. 10) Order 2013 [P.U. (A) 286] was gazetted on 11 September 2013 and deemed to have come into operation from the year of assessment (YA) 2012. The Order provides a tax exemption on statutory income (the formula for determining statutory income is provided in the Order) derived from the business of providing qualifying services by a qualifying company established pursuant to a scheme of merger that is completed on or after 3 July 2012 but not later than 2 July 2015, and verified by the Small and Medium Enterprises Corporation Malaysia. The exemption is applicable for a period of five consecutive YAs commencing from the YA in which the merger is completed.

Income Tax (Exemption) (No. 12) Order 2013

The Income Tax (Exemption) (No. 12) Order 2013 [P.U.(A) 287] was gazetted on 11 September 2013 and came into operation from YA 2012. This Order is identical to P.U.(A) 286 and the only difference is that it applies to a scheme of acquisition instead of a merger.

Income Tax (Exemption) (No. 13) Order 2013

The Income Tax (Exemption) (No. 13) Order 2013 [P.U. (A) 294] was gazetted on 24 September 2013 and is effective from YA 2013. The Order provides a 100% tax exemption on the statutory income (as determined under the Order) derived by a qualifying resident company for a period of 10 consecutive YAs from the business of carrying on commercialisation of research and development findings in a non-resource based activity or products (as listed in the Schedule) wholly owned by a public research institute or public institution of higher learning in Malaysia.

Income Tax (Tax Agents Application Fee) Order 2013

The Income Tax (Tax Agents Application Fee) Order 2013 [P.U. (A) 301] gazetted on 30 September 2013 provides that the application fee for an approval or renewal of tax agents' licence is RM200. The Order is deemed to be effective from 1 October 2013 and revokes the Income Tax (Accountants Application Fee) Order 1987.

Income Tax (Deduction for Expenditure on Issuance of Agro Sukuk) Rules 2013

The Income Tax (Deduction for Expenditure on Issuance of Agro Sukuk) Rules 2013 [P.U.(A) 305] gazetted on 2 October 2013 provides that for YA 2013 until YA 2015, expenditure incurred by a company resident in Malaysia on the issuance of Agro Sukuk approved or authorised by the Securities Commission under the Capital Markets and Services Act 2007,be allowed a double deduction.

Income Tax (Deduction from Remuneration) (Amendment) Rules 2013

The Income Tax (Deduction from Remuneration) (Amendment) Rules 2013 [P.U. (A) 314] gazetted on 17 October 2013 amended the Income Tax (Deduction from Remuneration) Rules 1994 and took effect from 1 January 2013. The Rules 1994 provide that the employer must determine and make monthly tax deductions (MTD) from the employees' salaries based on either the schedule or the computerised calculation method. The Amendment Rules 2013 incorporate changes pursuant to the computerised calculation method which the IRB confirmed that they have already been included within the IRB software since 1 January 2013.

Guidelines on claiming accelerated capital allowances for manufacture of promoted products

The Malaysian Investment Development Authority (MIDA) has recently published the "Guidelines and Procedures on Application for

Confirmation Letter by a Company which Manufactures Promoted Products Under the Promotion of Investments Act 1986 to Claim for Accelerated Capital Allowance (ACA) under the Income Tax Act 1967", dated 18 June 2013. The guidelines set out the procedures to claim the incentive for a company that is eligible for the incentive.

Addendum to Guidelines on Form CP58

Further to the IRB's Guidelines on Form CP58 dated 1 July 2013, an addendum to the guidelines dated 15 August 2013 was issued to provide three examples of incentives which do not need to be disclosed in the Form CP58.

Tax Investigation Framework (TIF)

The IRB recently uploaded on its website, the procedure and practice in conducting tax investigations in a framework titled "Rangka Kerja Siasatan Cukai" (available in Bahasa Malaysia only) which took effect from 1 October 2013. The new TIF revises the original TIF issued on1 January 2007 and similarly sets out the rights and responsibilities of the IRB, the taxpayer and the tax agent in a tax investigation situation. The main difference in the new TIF is the inclusion of the IRB's procedures in a criminal investigation under the *Anti-Money Laundering and Anti-Terrorism Financing Act 2001* (AMLATFA).

STAMP DUTY

Stamp Duty (Exemption) (No.1) Order 2013

The Stamp Duty (Exemption) (No. 11) Order 2013 [P.U. (A) 285], gazetted on 11 September 2013, provides a stamp duty exemption on specified instruments executed on or after 3 July 2012 but not later than 2 July 2015 by a qualifying person carrying on business of providing qualifying services pursuant to a scheme of merger or acquisition which has been approved by the Small and Medium Enterprises Corporation Malaysia.

LABUAN

Guidelines on single counterparty exposure limit (SCEL) for Labuan banks

The Labuan Financial Services Authority, vide a letter dated 23 August 2013 addressed to the Chairman of the Association of Labuan Banks, Labuan Investment Banks Group and the Association of Labuan Trust Companies, has released revised guidelines on the SCEL for Labuan banks. The guidelines shall come into effect from 1 January 2014. The guidelines have been issued for the purpose of clarifying prudential requirements in relation to SCEL and the new guidelines specify that all exposures whose terms have been agreed upon before the effective date of the new guidelines will be allowed to run to maturity.

CUSTOMS AND EXCISE DUTIES

Custom Act 1967 [P.U. (A) 255/2013]

Effective from 5 August 2013, "semi-finished printed bank notes which are not yet legal tender either in the country of issue or elsewhere" classifiable under HS tariff 4907.00 900 are listed as Item 61 in Part I of the Third Schedule to the Customs (Prohibition of Imports) Order 2012. Importation (from all countries) of such goods must be accompanied by an import licence from the Ministry of Home Affairs.

Please refer P.U (A) 232/2013 for details.

Customs Duties (Goods under the Preferential Trade Agreement among D-8 Member States) Order 2013 Customs Act 1967 [P.U. (A) 328/2013]

The Customs Duties (Goods under the Preferential Trade Agreement among D-8 Member States) Order 2013 came into operation on 1 November 2013. Under this Order, the importation of goods [as specified in Column (4) of the Second Schedule] originating from D-8 Member States will be subject to preferential import duty rates, subject to compliance of the Rules of Origin and Operational Procedures/Rules.

D-8 Member States refer to the countries of Bangladesh, Indonesia, Iran, Malaysia, Egypt, Nigeria, Pakistan and Turkey.

Please see P.U. (A) 328/2013 for details.

Customs (Prohibition of Imports) (Amendment) (No. 2) Order 2013 Custom Act 1967 [P.U. (A) 333/2013

Effective 1 December 2013, "baby feeding bottle of polycarbonate plastic" classifiable under HS tariff 3924.90 900 is listed as Item 62 in Part I of the Third Schedule to the Customs (Prohibition of Imports) Order 2012. Importation (from all countries) of such goods must be accompanied by an import licence from the Food Safety and Quality Division of the Ministry of Health.

Please refer P.U (A) 333/2013 for details.

*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.*

Goh Ka Im

Should Royalty Form Part of the Value of Goods Imported into Malaysia for Purposes of Imposing Customs Duties and Sales Tax?

In this article, Goh Ka Im analyses the recent landmark decision of the Federal Court in Nike Sales Malaysia Sdn Bhd v Jabatan Kastam Diraja Malaysia & Ors which dealt with the above question.

BRIEF FACTS

Nike Sales Malaysia Sdn Bhd ("Nike Malaysia") is the importer of footwear, apparel and sports equipment under the Nike brand ("licensed goods") for sale in Malaysia. The same products are also sourced by Nike Malaysia from Malaysian manufacturers for sale in Malaysia. Pursuant to a purchase commission agreement between Nike Inc. and Nike Malaysia, Nike Inc. will negotiate terms with the non-Malaysian manufacturers for the goods Nike Malaysia wishes to order and forward the purchase orders placed by Nike Malaysia. Pursuant to an intellectual property licence and exclusive distribution agreement between Nike Malaysia and Nike International Ltd. ("NIL"), Nike Malaysia has to pay NIL a royalty of 6% of the net invoiced sales revenues of the licensed goods sold in Malaysia. Nike Inc. is the ultimate holding company of Nike Malaysia and NIL. Nike Malaysia did not include royalty as part of the value of the goods imported for purposes of imposing customs duties and sales tax.

CUSTOMS (RULES OF VALUATION) REGULATION 1999 ("THE REGULATIONS")

As a starting point, the customs value of imported goods is the price paid for the goods when exported to Malaysia but adjustments can be made to the customs value in certain circumstances, one of which is to add:

> *"royalties and licence fees, including payments for patents, trademarks and copyrights in respect of the goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to Malaysia, exclusive of charges for the rights to reproduce the goods in Malaysia."*

This is provided for in Regulation 4(1) read together with Regulation 5(1)(a)(iv) of the Regulations.

MAIN DISPUTE

The crux of the dispute between Nike Malaysia and the Royal Customs Department Malaysia ("KDRM") was described by the High Court in the following manner,

> *"Ignoring for the moment the intricate legal wordings applicable, the dispute between the parties is reduced to this proposition: Nike Malaysia says the royalty should not be part of the value to be assessed for customs duties and sales tax because it is not a condition of sale by the exporter, whereas KDRM says it has to be included in the customs value, although the declared value states otherwise, since it must be taken as an adjustment item because the royalty is, directly or indirectly, a condition of the sale of the goods for export to Malaysia."*

REGULATION 5

Regulation 5 of the Regulations was adopted from the Agreement on Implementation of Article VII of The General Agreement on Tariffs And Trade 1994 ("WTO Valuation Agreement") as Malaysia is a signatory to the WTO Valuation Agreement.

Not surprisingly, the same regulation can be found in the Customs legislations of the many countries which are signatories to the WTO Valuation Agreement and the two leading cases on this issue are the unanimous decision of the Canadian Supreme Court in Deputy *MNR v Mattel Canada Inc.* ("Mattel Canada") and the majority decision of the New Zealand Court of Appeal in *Chief Executive of New Zealand Customs Service v Nike New Zealand* ("Nike New Zealand").

DECISION OF THE HIGH COURT

While both Mattel Canada and Nike New Zealand were considered by the High Court, the reasoning in Mattel Canada was preferred by the High Court and the following test was adopted:

> *"The overriding test is whether the buyer or importer has, or has not, the obligation to pay the royalty in order to purchase or import the goods. If the obligation arises from a separate agreement that is unrelated to the sale or importation of the goods, it cannot be regarded as a condition of the sale of the goods."*

Applying the test, the High Court decided in favour of Nike Malaysia that the royalty payable by Nike Malaysia to NIL cannot be taken as a "condition of the sale of the goods for export to Malaysia".

DECISION OF THE COURT OF APPEAL

However, the Court of Appeal was in agreement with the majority decision in Nike New Zealand and overturned the decision of the High Court. The Court of Appeal held that in order for royalty to be added, two features had to be present, that is:

- the royalty had to be payable to

the manufacturer or another person as a consequence of the export, and

- the party to whom the royalty was payable must have had control of the situation going beyond the ordinary rights of a licensor of intellectual property and giving it the ability to determine whether the export could or could not occur.

The Court of Appeal concluded that the two features were present in this case so that the royalty payable by Nike Malaysia to NIL after the licensed goods were sold in Malaysia was an adjustment item to be added to the price of the licensed goods.

DECISION OF THE FEDERAL COURT

The Federal Court agreed with the test adopted by the High Court and found the judgement of the Canadian Supreme Court in Mattel Canada more convincing.

It was held by the Federal Court:

> *"… Since royalties paid by the Plaintiff to Nike International Ltd. are not expressed to be paid as a condition of sale for the export of the goods by the independent foreign suppliers to the Plaintiff, the royalties are therefore not to be added to the transaction value of the imported goods.*

If the royalties are to be added in determining the transaction value of the goods exported into Malaysia regardless of whether it is expressly stated to be a condition of sale as decided by the Court of Appeal, then the words "as a condition of sale for the goods to be exported to Malaysia" would be rendered redundant as any time royalty is paid in relation to goods exported to Malaysia, royalties would be automatically added to the transaction value. If this were the true intent then the WTO Valuation Agreement could have easily made this intent explicit."

In summary, the main issue was whether the royalties were paid as a condition of the sale of the licensed goods into Malaysia and since the obligation to pay royalty only arose from a separate agreement unrelated to the export of licensed goods to Malaysia, royalty did not have to be included for duty purposes.

The Federal Court also gave due regard to the advisory opinions given by the Technical Committee on Customs Valuation established under the WTO Valuation Agreement and the advisory opinion for a scenario similar to the current facts came to the conclusion that,

> *"Although the importer is required to pay a royalty to obtain the right to use the trademark, this results from a separate agreement unrelated to the sale for export of the goods to the country of importation. The imported goods are purchased from various suppliers under different contracts and the payment of a royalty is not a condition of the sale of these goods. The buyer does not have to pay the royalty in order to purchase the goods. Therefore, it should not be added to the price actually paid or payable as an adjustment under article 8.1(c)."*

In addition, the Federal Court took into account that in other Commonwealth countries like the UK, Australia, India and Singapore, royalties paid on Nike goods have not been added to the value of imported goods for customs duties and sales tax and held that Nike New Zealand appeared to be inconsistent with decisions in other Commonwealth countries.

CONCLUSION

This is a landmark decision as:

- it is the first case in Malaysia dealing with the question of whether royalties payable upon the sale of imported goods in Malaysia should be added to the valuation of imported goods.
- it is the first case in Malaysia involving the interpretation of Regulation 5(1)(a)(iv) of the Regulations which is a provision adopted from an international agreement, that is, the WTO Valuation Agreement.

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TaxCases

Siti Fatimah Mohd Shahrom & Ashley Lee Si Han

CASE

Best judgement assessment - Van Boeckel v Customs and Excise Commissioners (1980) 1 BVC 378 (High Court, United Kingdom)

FACTS

The taxpayer was a licencee of a public house, which was run by a manager. He prepared his VAT returns on the takings handed to him by his manager. When the Customs visited the taxpayer's public house, they concluded that the taxpayer's VAT returns were incorrect because the taxpayer had failed to account accurately and declare tax due on the full value of supplies made by him. The taxpayer suggested that pilferage was probably the cause of the deficiency. The officers did not interview the manager nor did they visit the public house during opening hours. The Customs conducted a test over a period of five weeks by noting the takings and on that basis issued the additional assessment.

The taxpayer appealed to the VAT Tribunal and contended:

(a) The assessment had not been made to the best of the Customs' judgement.

(b) The Customs had taken insufficient steps to ascertain the true amount of tax due.

(c) The period of five weeks over which the test was conducted was too short a period on which to base an assessment covering a three-year period.

(d) The Customs had taken no account of the possiblity of pilferage.

The Tribunal dismissed the appeal but reduced the amount of the assessment to take account of pilferage. The taxpayer appealed against the decision of the VAT Tribunal. The taxpayer argued that the assessment should be quashed as being one which is, in effect, made *ultra vires*.

Before the High Court, the taxpayer argued as follows:

(a) The assessment in question was not valid because the Customs had taken insufficient steps to ascertain the amount of tax due before making the assessment. The very use of the word 'judgement' makes it clear that the Customs are required to exercise their powers in such a way that they make a value judgement on the material which is before them. Clearly they must perform that function honestly and bona fide. It would be a misuse of that power if the Customs were to decide upon a figure which they knew was, or thought was, in excess of the amount which could possibly be payable, and then to leave it to the taxpayer, on appeal, to reduce that assessment.

(b) There must be some material before the Customs on which they can base their judgement. If there is no material at all it would be impossible to form a judgement as to what tax is due.

(c) Bearing in mind the primary obligation that it is for the taxpayer to make a return himself, that the Customs should not be required to do the work of the taxpayer in order to form a conclusion as to the amount of tax which, to the best of their judgement, is due.

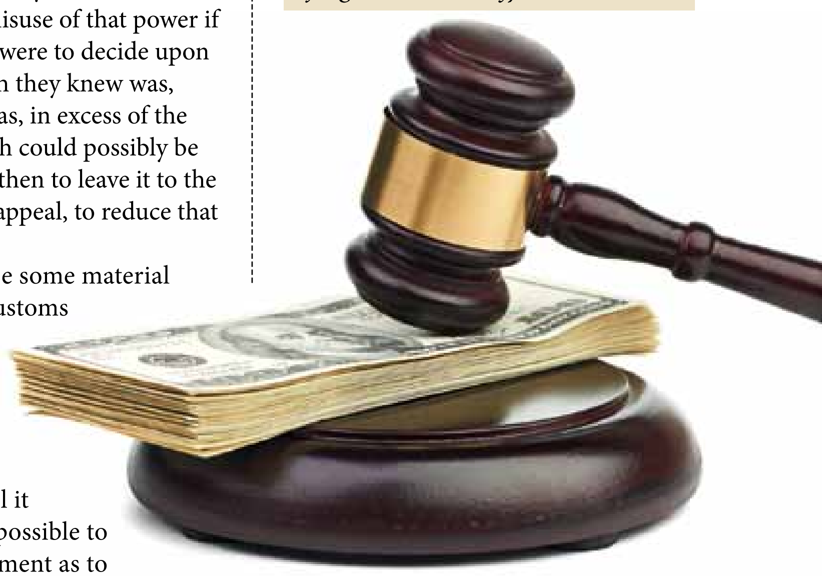
ISSUE

Whether the Customs had exercised best judgement in raising the impugned assessment?

DECISION

The High Court observed that the power of the Customs to assess VAT is contained in Section 31(1) of the Finance Act 1972, which reads:

> *"Where a taxable person has failed to make any returns required under this Part of this Act or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect they may assess the amount of tax due from him to the best of their judgement and notify it to him."*



Among others, Section 31(1) enables the Customs to raise an assessment where in the best judgement of the Customs it appears to them that the returns which were made were incomplete. If the conditions or one of the conditions are fulfilled which give the right to make an assessment, then the power of the Customs is to make an assessment of the amount of tax due from the taxpayer to the best of the Customs' judgement.

The High Court held that the use of the phrase "best of their judgement" does not envisage the burden being placed upon the Customs of carrying out exhaustive investigations. The phrase envisages that the Customs will fairly consider all material placed before them and, on that material, come to a decision which is one which is reasonable and not arbitrary as to the amount of tax which is due. As long as there is some material on which the Customs can reasonably act then they are not required to carry out investigations which may or may not result in further material being placed before them.

The High Court made reference to the Privy Council's decision in *Commissioner of Income-Tax, United and Central Provinces v Badrida Ramrai Shop, Akola, Owner Laxminarayan Badrida Shrawagi of Akola (1937) 64 L. R. Ind. App. 102* and relied on the following:

"...The officer is to make an assessment to the best of his judgement against a person who is in default as regards supplying information. He must not act dishonestly, or vindictively or capriciously, because he must exercise judgement in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by and assessments of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate: and though there must necessarily be guess-work in the matter, it must be honest guess-work. In that sense, too, the assessment must be to some extent arbitrary. Their Lordships think that the section places the officer in the position of a person whose decision as to the amount is final and subject to no appeal; but whose decision, if it can be shown to have been arrived at without an honest exercise of judgement may be revised or reviewed by the Commissioner under the powers conferred upon that official..."

The High Court also applied the following passage from the Privy Council's decision in *Argosy Co. Ltd. v. I. R. Commrs. [1971] 1 W. L. R. 514:*

"Once a reasonable opinion that liability exists is formed there must necessarily be guess-work at times as to the quantum of liability. A resident may be known to be living well above the standard which his declared income would support. The Commissioner must make some estimate, or guess, at the amount by which the person has understated his income. Or reliable information may reach the Commissioner that the books of account of some particular taxpayer have been falsified so as to reduce his tax. Again the Commissioner may have to make some guess of the extent of the reduction. Such estimates or guesses may still be to the best of the Commissioner's judgement – a phrase which their Lordships think simply means to the best of his judgement on the information available to him. The contrast is not between a guess and a more sophisticated estimate. It is between, on the one hand, an estimate or a guess honestly made on such materials as are available to the Commissioner, and on the other hand some spurious estimate or guess in which all elements of judgement are missing. The former estimate or guess would be within the power conferred by Section 48(4): the latter without it."

Applying the above principles, the High Court dismissed the taxpayer's appeal and ruled that the assessment raised by the Customs was made to the best of the judgement of the Customs. The High Court agreed with the VAT Tribunal that the assessment which was based on a five-week period which was not arbitrarily applied to the whole period of assessment. The other reasons provided by the High Court are:

(a) It was perfectly proper for the Customs, if they choose to do so, to make a test over a limited period such as five weeks, and take the results which are thrown up by that test period of five weeks into account in performing their task of making an assessment for a period of three years in accordance with the law.

(b) Although, as a matter of good administrative practice, it is desirable that the Customs should make all reasonable investigations before making an assessment, there was no necessity for the Customs to interview the manager or visit the public house when it was open.

(c) The fact that the VAT Tribunal found that there should be a reduction made in the amount of the assessment to make an allowance for pilferage of stock does not mean that the validity of the assessment was called into question. When VAT Tribunal decided to reduce the assessment, they were making a decision on the material before them as to the proper amount of tax in fact due. It was quite open to the VAT Tribunal, on the balance of probabilities, to come to the conclusion that there had been in fact pilferage which had to be taken into account in arriving at the amount of tax which was in fact due.

(d) However, the VAT Tribunal's finding in item (c) above does not mean that one could challenge the validity of the exercise performed by the Customs in making assessment. Just as the VAT Tribunal, on the material before them, were entitled to come to a conclusion as to the likelihood of pilferage being an explanation for part of the deficiency, so it was open to the Customs, having heard what the taxpayer explained, to have come to a conclusion that this was not a case where it was proper on the material before them to make a reduction. The Customs officer's good faith was not being challenged, and on the material put before the VAT Tribunal there

was no way it could be said that it was wholly unreasonable for the Customs not to make further investigations into the question of pilferage nor to come to a conclusion that there was pilferage in this case which had to be taken into account.

CASE

Price quoted is taken to include GST if GST is not specified - Kuo Ching Yun & Anor v H&L Investments Holding Pte Ltd (1995) (2 MSTC 7295) (High Court, Singapore)

FACTS

1 September 1994

The defendant was given an option to purchase a property by the then owners of the property.

3 October 1994

The defendant exercised this option.

26 October 1994

The defendant gave an option to purchase the same property to one Wang Chen Wing and/or nominee.

7 November 1994

The option given to Wang Chen Wing was exercised by Kuo Ching Yun, the first plaintiff.

12 December 1994

The first plaintiff transferred his rights and interests in the contract to W & N Management Pte Ltd, the second plaintiff.

1 January 1995

The defendant was registered as a GST registered company.

3 January 1995

The sale of the property was completed by way of a tripartite transfer. The property was transferred to the second plaintiff and GST was paid by the solicitors for the plaintiffs under protest as the defendant disputed their liability to pay GST.

2 February 1995

The plaintiffs filed an application by way of an originating summons for the necessary directions for the return of this sum by the defendant.

The plaintiffs argued that the price quoted by the defendant for the sale was inclusive of GST for the following reasons:

Section 8(3) of the Goods and Services Tax Act provides that tax is a liability of the person making the supply, in this case the defendant.

There was no provision in the option between the plaintiffs and the defendant for the plaintiffs to pay the defendant's GST liability.

(a) Regulation 65(1) of the Goods and Services Tax (General) Regulations 1993 provides that where a vendor quotes a price, then that price is inclusive of GST.

Meanwhile, the defendant raised the following arguments to contend that the liability to pay the GST fell on the second plaintiff:

Sections 38(1) and 38(2) of the Goods and Services Tax Act 1993 impose the obligation to pay GST on the second plaintiff. Further, Section 40 of the Goods and Services Tax Act 1993 implied a term into the contract which imposed the obligation on the second plaintiff.

(b) Alternatively, Condition 12 of the Law Society Conditions of Sale 1994, which formed part of the terms and conditions of the purchase, imposed the obligation on the second plaintiff. The defendant's argument was that on the date of the contract, the defendant was not registered with the Inland Revenue Authority of Singapore for the purpose of GST. Condition 12 which read:

"The purchaser shall on completion repay to the Vendor the amount of any expenses incurred by the Vendor in complying with any requirement made between the date of contract and completion by any Government Department ..."

The defendant argued that the tax authority was a Government Department and as the defendant was compelled to pay GST to a Government Department between the date of the contract and the date of completion, the said Condition 12 made it incumbent on the second plaintiff to reimburse the defendant.

ISSUE

Whether the liability to pay GST lies on the first plaintiff and/or second plaintiff or the defendant?

DECISION

The High Court ruled that the plaintiffs were not liable to pay the GST to the defendant and among others, ordered that the defendant refund or repay to the second plaintiff the sum of $49,192.06 together with interest from 3 January 1995 to date of the refund.

The High Court gave the following grounds in support of its decision:

(a) Section 38(1) of the Goods and

Services Tax Act 1993 reads:

> *"Where any person makes any prescribed supply of goods or services to another person and that supply is a taxable supply but not a zero-rated supply, the prescribed supply shall be treated for the purposes of the First Schedule — …"*

(a) Section 38(5) of the Goods and Services Tax Act 1993 defines "prescribed supply" as:

"For the purposes of this section, 'prescribed supply', in relation to goods or services, means such supply of:

goods or services comprising in or related to land or any interest in or right over land, as may be specified or described in regulations made by the Minister."

No rules or regulations as to what constitutes "prescribed supply" within Section 38(5)(c) appear however to have been made as yet. Section 38 was a contingent section and has yet to come into effect. In any event, a perusal of the whole of Section 38 and particularly Section 38(2) indicates that Section 38 is an accounting provision.

(b) Section 40 of the Goods and Services Tax Act 1993 provides for adjustments in the terms of a contract on a change in the rate of GST charged. Since the Act came into force, there has been no change in the tax charged. Further, Section 40 can only apply, if the contract for the sale of this property had been entered into before 1 April 1994, with completion taking place thereafter or if there is a change in the tax rate. As there had been no change in the tax rate and as this contract was not entered into before 1 April 1994, Section 40 does not apply.

(c) Condition 12 of the Law Society Conditions of Sale 1994 does not support the defendant's submission as GST payment does not fall within the scope of this condition. The term "Government Departments or other local or statutory authorities" refers to Government Departments such as the Public Works Department. As the property was still in the owner's name between the date of completion and the option to purchase, notices issued by Government Departments and local or statutory authorities are addressed to the owner requiring the owner to carry out and to pay for these works.

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International News

The column only covers selected developments from countries identified by the CTIM and relates to the period 16 August 2013 to 15 November 2013.

CHINA (PEOPLE'S REP.)

Business tax on disposal of financial products clarified

The State Administration of Taxation (SAT) issued SAT Gong Gao [2013] No. 63 on 6 November 2013 on business tax on disposal of financial products which is effective from 1 December 2013 and replaces Art 14, Chp 4 of Guo Shui Fa [2002] No. 9. After 1 November 2013, financial products disposed of will no longer be differentiated as shares, bonds, foreign currency for business tax purposes. The gains/losses of one sort of product can be offset against the gains/losses of another product within the same tax period. The balance after the offset forms the tax base of business tax. If the balance is negative, the remaining losses can be carried over to the next tax period. However, if the balance at the end of the year remains negative, the losses cannot be carried over to the next accounting year.

New implementation rules on mutual agreement procedure (MAP) published

The SAT issued new implementation rules on the mutual agreement procedure (MAP) on 24 September 2013 (SAT Gong Gao [2013] No. 56) which is effective from 1 November 2013. Note that the SAT will issue separate MAP implementation rules for Special Tax Adjustments (transfer pricing, CFC and thin-capitalisation, etc.).

Application of MAP by Chinese residents

A Chinese resident who considers that the conduct or measures of the contracting state are not in accordance with the provisions of the tax treaty, may apply with the tax bureau (at the provincial level) for the SAT to commence MAP with the relevant contracting state to resolve the following issues: (i) disputed residence status; (ii) determination of permanent establishment (PE) or attribution of profits to PE; (iii) dispute on taxation/exemption of income or capital or tax rates; (iv) violation of non-discrimination provision or in the case of tax decimation; (v) dispute on interpretation or application of treaty provisions which cannot be resolved; and (vi) other possible/existing cases of double taxation.

New industrial catalogue of foreign investment in central and western regions – published

The National Development and Reform Commission and the Ministry of Finance (MoF) issued the new Priority Industry Catalogue for Foreign Investment in Central and Western Regions of 2013 (the Catalogue) on 9 May 2013 to replace the one dated 2008. The Catalogue has expanded the scope of sectors which are open to foreign investment and eligible for certain incentives. Foreign investment in these sectors may be eligible for a preferential enterprise income tax rate of 15% (standard rate is 25%) provided pursuant to the SAT Gong Gao [2012] No. 12.

The sectors that are open to foreign investment are mostly manufacturing industries, (e.g.) car/motorcycle manufacturing. New sectors included are broadband internet, cloud computing, telecommunication technology, new information technology and production of animation/film.The Catalogue took effect from 1 June 2013. The local government is responsible for implementing the policy.

VAT on exported services – details

The SAT issued SAT Gong Gao [2013] No. 52 on 13 September 2013 providing the details of VAT on exported services, which apply from 1 August 2013. Among the exported services rendered outside China that are exempt from VAT relates to engineering projects, mining exploration, storage, leasing, publishing and broadcasting, international transportation , design services, R & D services and advertising. There are several preconditions required for this.

Tax subsidy for foreign workers in Qianhai (Shenzhen) Modern Service Cooperation Zone

The Qianhai (Shenzhen) administration published the "Implementation Rules of Provisional Measure on Tax Subsidy for High-Level Foreign Workers" on 13 August 2013.

As a result of the subsidy, from 1 January 2013, the individual income tax marginal rate for qualifying foreign workers will be reduced to 15%.

INDONESIA

Tax policy for economic problem

The government has issued several tax regulations to ease the economic problems in the country:

- Regulation of Minister of Finance No.120/PMK.04/2013 dated and effective from 26 August 2013, amends the regulation on bonded zones and, amongst others, enables a company located in a bonded zone to sell up to 50% of its total production in the domestic market with simpler procedures for the import of capital goods.
- PMK No.124/PMK.011/2013 dated and effective from 27 August 2013, reduces the amount of monthly tax instalments (per Article 25 of the Income Tax Law), for the period September 2013 until December 2013, for certain taxpayers in the textile, confection, footwear, furniture and toys industries. A reduction of up to 25% will be given to non-export-oriented taxpayers and up to 50% reduction to export-oriented taxpayers. Further, a postponement of the settlement of income tax payable for 2013 may be granted to these taxpayers.

INDIA

Documentation rules for transactions with persons located in notified jurisdictions

On 26 June 2013, the CBDT issued rules for maintenance of information and documents by taxpayers who have transactions with persons located in notified jurisdictions. On 26 June 2013, Cyprus was declared a notified jurisdiction. This new provision impacts transfer pricing, withholding tax, deductibility of expenses and recognition of income in addition to documentation requirements.

Final transfer pricing safe harbour rules released

The CBDT via Notification No.F.No.73/2013 [142/28/2013-TPL] dated 18 September 2013 issued the final safe harbour rules. The eligible international transactions and the corresponding safe harbours (for the relevant international transaction in the nature of interest/profit ratio) are listed therein and would be applicable for a period of five years starting with assessment year 2013-14:

Administrative rules for implementation of the general anti-avoidance rule notified

On 23 September 2013, the CBDT amended the ITR, to introduce specific rules for the "Application of the General Anti-Avoidance Rule" (the Rules). Simultaneously with the GAAR (chapter XA, Sections 95-102) in the ITA, these Rules are scheduled to come into force on 1 April 2016. There are various situations listed that will be an exception to the Rules.

The Rules also stipulate a number of limitations of time corresponding with the duties of the tax authorities.

SINGAPORE

FSI Scheme – details

Details of the changes proposed in relation to the Financial Sector Incentive (FSI) (as announced in HYPERLINK *"http://online.ibfd.org/linkresolver/static/tns_2013-02-26_sg_1?WT.z_nav=crosslinks" \o "Singapore - Budget for 2013 – details (26 Feb. 2013), News IBFD." Budget 2013)* are:

- The FSI Scheme is extended up to 31 March 2018 with the exception of the FSI-Islamic Finance (FSI-IF) scheme, which expired on 31 March 2013.

The FSI Scheme is refined as follows:

With effect from 1 April 2014, the FSI-Standard Tier (FSI-ST) award is expanded to cover qualifying Islamic activities which were previously under the FSI-IF award. Beginning from 1 January 2014, the qualifying activities include trading in collective investment schemes which are listed on any foreign exchange, or not listed on an exchange but issued by an entity which is neither incorporated nor resident in Singapore. The need to track currency repayment is also removed.

- Effective 25 February 2013, withholding tax exemption will be granted automatically to the FSI-Headquarter Services (FSI-HQ) services award recipients on interest payments made during the period of their award on qualifying loans.
- Effective 28 June 2013, new applicants seeking a renewal of the FSI-Fund Management (FSI-FM) incentive will be subjected to having minimum "assets under management" of at least SGD250 million, in addition to other existing factors under the scheme.
- Effective 1 January 2014, the FSI-Bond Market (FSI-BM) and FSI-Equity Market (FSI-EM) awards will be merged to form a single FSI-Capital Markets (FSI-CM) award.
- Effective 1 January 2014, the qualifying activities for the FSI-Credit Facilities Syndication (FSI-CFS) award includes project finance advisory services.
- Effective 1 January 2014, the current five sub-schemes under the FSI-Derivatives Market (FSI-DM) will be merged into a single FSI-DM scheme.

THAILAND

Recent Supreme Court decisions on royalties

Over the course of 2013, the Supreme Court of Thailand (SC) issued three decisions that dealt with the definition of royalties. These decisions are seen as key in differentiating between a payment for general services and a royalty.

Where there is an applicable tax treaty (and there is no permanent establishment), Thai withholding tax usually is not imposed on payments for general services. Conversely, a royalty payment will always be subject to a withholding tax (albeit at a more beneficial treaty rate). Thus, it is important to be able to differentiate between the two.

Section 40(3) of the Revenue Code defines royalty payments as "value received for goodwill, copyright or any other rights, annuity or income in the nature of yearly payments derived from a will, any other juristic act, or judgement of the court". Logically, it follows that payment for the "right to use" (including the provision of know-how) would be considered a royalty payment but that the sharing of knowledge/experience may not. This, coupled with the lack of further guidance, has resulted in some differences of opinion. It is hoped that the decisions in the following cases would provide some much needed guidance.

Thai Tank Terminal

(a) **Facts**. Thai Tank Terminal (TTT) had two agreements with its Dutch Parent – an Intellectual Property License Agreement (IPLA) and an Offshore Services Agreement (OSA). The IPLA provided TTT with the right to use its parent's expertise and know-how regarding the design, construction, operation and maintenance of a petrochemical and petroleum terminal. The fee for this was 0.5% of TTT's gross income on which TTT deducted and remitted 15% withholding tax.

Under the Offshore Services Agreement (OSA), TTT was required to pay its Dutch parent a monthly fixed fee for the first six years of the contract and a variable fee (1% of gross income) for the entire agreement period. Pursuant to the agreement, the fees were payment for the administrative and managerial assistance provided by the parent for matters such as budgetary control, recruitment and training, procurement, safety and security, etc. TTT did not withhold tax on these payments.

The TRD claimed that the monthly fixed fee was a "hidden royalty", especially since it was payable even when no service is provided. Additionally (in the TRD's testimony) the 0.5% fee under the IPLA was considered by the TRD to be relatively low and this lent weight to the TRD's suspicion that a "hidden royalty" was being paid.

(b) **Decision**. The SC held that the monthly fixed fee payment was not a royalty payment. The SC held that the taxpayer was able to provide sufficient evidence to counter TRD's argument that a fixed percentage fee which was payable regardless of the level of service provided was a "hidden royalty". In arriving at its decision, the SC carefully considered the terms of the signed agreements; this highlights the importance of proper supporting documentation, especially where there is a possibility that the payments may be construed as royalty payments.

Esso (Thailand) Plc.

(a) **Facts**. Esso (Thailand) Plc. (ETP), a company listed on the Thai Stock Exchange, entered into a Master Services Agreement with its affiliate Esso Coordination Center N.V. (ECC), (a Belgian entity), for cost allocation in respect of its global accounting system. ECC was a centralised company which gathered accounting information from Esso Affiliates. ECC used "SAP R/3" a computer software that was licensed by Exxon Mobil Corporation for the use of Esso affiliates worldwide, consequently ECC was not the owner of the software nor was it a sub-licensee. However, ETP paid ECC a fee of USD5.18 million as part of its allocated costs.

(b) **Decision**. The SC held that ECC was not a service provider. Thus, the payment for cost allocation ought to be deemed a royalty payment for the right to use the SAP R/3 software which was passed through ECC.

Philips Electronics (Thailand)

(a) **Facts**. Under a Marketing Service Agreement (MSA), Philips Electronics (Thailand) (PT) paid a fixed rate marketing fee of 0.5% of annual net sales to a Dutch Philips entity.

(b) **Decision**. The SC held that the marketing fee paid was a royalty payment. The SC relied on the MSA and concluded that the Dutch entity was required to provide marketing services and sales in respect of "standard orders", "manuals" and "risk control processes". The SC was of the opinion that services provided contained elements of proprietary right and confidentiality and that they amounted to the provision of "trade secrets". In this instance, the SC held that the lack of correlation between the fee and the provision of services lent to the argument that the payment was a royalty payment.

VIETNAM

Decree 92/2013 on implementation of CIT and VAT

Decree No. 92/2013/ND-CP dated 13 August 2013 has been issued to provide guidance on the implementation of the amendments to the corporate income tax (CIT) and value added tax (VAT) as previously reported.

- Reduction of CIT to 20% for enterprises with a total annual revenue not exceeding VND20 billion, effective since 1 July 2013. The reduced CIT rate applies to total revenue from the sale of goods and services from the preceding year. Enterprises in operation for less than one year, may apply the reduced rate if they have an average monthly revenue (until 30 June 2013) less than VND1.67 billion.

The reduced rate of 20% does not apply to revenue from:

- capital transfer, transfer of right to contribute capital, revenue from real estate transfer (except for revenue from investment and business in social houses specified in article 3 of Decree No. 92/2013/ND-CP), revenue from transfer of investment projects, transfer of rights to participate in investment projects, transfer of rights to explore and exploit minerals, and revenues from activities of production and business outside of Vietnam;
- exploration and exploitation of petroleum, other rare and precious natural resources, and revenues from exploiting minerals;
- the provision of services that are subject to excise tax.
- Reduced CIT rate of 10% for revenue from investment and business in social housing. "Revenue" refers to the income received from the sale, lease or lease for purchase of social housing from 1 July 2013. The income from such activities should be accounted for separately so as to avoid any confusion.
- Reduced VAT rate of 5% for the sale, lease or lease for purchase of social houses and 50% reduction on the VAT rate for the sale, lease or lease for purchase of commercial houses. The reduced rate of 5% applies to contracts concluded after 1 July 2013 and/or payments made from 1 July 2013 onwards.

The 5% VAT rate applies to the gross price but excludes interest due on instalment payments, late payments and other similar interest.

The 50% reduction of VAT tax rate for contracts of sale, lease or lease for purchase of commercial houses applies to payments made from 1 July 2013 to 30 June 2014.

MIDDLE EAST

United Arab Emirates

The MoF has recently changed the rules for issuing tax residence certificates. The MoF now requires that the applicant company must have been in existence for at least three years. Also, the MoF generally issues certificates for companies registered in free zones where the free zone authority concerned has entered into a memorandum of understanding with the MoF. This is the case of Jebel Ali Free Zone, Dubai International Financial Centre and Fujairah Free Zone, which all require a certain substance from registered companies. Other requirements include presentation of audited accounts and lease contract and payment of fees.

Kuwait

The government enacted a new Investment Law (Law No. 116 of 2013) concerning Foreign Direct Investment, which is effective from 16 December 2013 and repeals Foreign Capital Direct Investment Law No. 8 of 2001. The Law provides for the following tax incentives:

- Exemption from income tax and other taxes for up to 10 years from the date of actual commencing of activities. The exemption may also be granted in respect of extensions of existing projects.
- Total or partial exemption from customs duties and other taxes due on the importation of: (i) machinery, equipment, vehicles, etc., (ii) spare parts and maintenance equipment, and (iii) raw materials, semi-finished goods and packaging materials. The exemption remains, however, subject to the provisions of the Gulf Cooperation Council (GCC) Unified Customs Law No. 10 of 2003. The sale or other forms of disposition of any exempt goods or commodity is subject to restrictions.

Executive regulations and other implementation guidelines are expected to be issued.

*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.*

EMPLOYEE MOBILITY PROGRAMMES BECOMING MORE ACCESSIBLE AND ATTRACTIVE TO MEET GLOBAL TALENT NEEDS

PwC'S ANNUAL SURVEY OF GLOBAL MOBILITY POLICIES DEMONSTRATES SHIFTS IN EMPLOYEE ASSIGNMENT PROGRAMMES

Global companies are taking steps to make their employee mobility programmes more accessible and attractive, according to PwC's 2012 Survey of Global Mobility Policies. Companies are adopting new non-traditional workforce mobility programmes, such as frequent business travel; they are also relying on commuter and short-term assignments in place of longer-term assignments. These new programmes are also broader in reach, affecting more than 10 per cent of employees, compared to traditional short and long-term programmes that impact only one per cent.

The survey, which provides a perspective on the ways corporate mobility programmes have evolved over the decade 2002-2012, reflects how businesses are responding to major changes in workplace demographics, technology and a globalising economy. For example, companies are increasingly committed to reviewing and updating their employee mobility programmes; half (50 per cent) of participants reported that they are focused on refining their policies, while 48 per cent want to simplify administration. Ten years ago the top two areas of focus were cost reduction and regional policy development.

"In today's highly competitive global marketplace, the structure and appropriateness of global mobility policies can significantly impact your organisation's workforce," said Eileen Mullaney, Principal and U.S. Global Mobility Consulting Leader at the International Assignment Services (IAS) practice of PwC US. "These days it is all about choice. Mobility packages should offer multiple options so business leaders as well as the employees can choose what works best for their specific situations or interests."

Additional survey findings demonstrate the changing nature of mobility programmes. In 2012,

- Forty-six per cent offered permanent transfer policies, compared with 29 per cent in 2002
- Thirty-seven per cent had localisation policies, compared with 20 per cent in 2002
- Twenty-six per cent offered graduate training policies, compared with 14 per cent in 2002
- Twenty-one per cent offered commuter policies, compared with eight per cent in 2002
- Seventy-one per cent had extended business travel policies, compared with 30 per cent in 2002

The changes in mobility programmes reflect the need to match evolving economic and workforce

employee mobility programmes becoming more accessible
and attractive to meet global talent needs

demands. Increasing business globalisation and activity in emerging markets, younger employees seeking international work opportunities early and often in their careers, as well as a focus on developing future leaders with global mobility experience are leading companies to take a more strategic approach to mobility that better aligns the programmes with business growth objectives and longer-term talent and career development plans.

According to the survey, the demographics of mobility programme participants have broadened to become less focused on employees who come from headquarters locations or who are at the executive level; for example, less than 50 per cent of participants came from headquarters in 2012, compared to 80 per cent in 2002. There has also been a marked decline in executive-level assignments (more than 60 per cent since 1992) in favour of developmental assignments and technical and subject matter expert roles.

OTHER BUSINESS DEDUCTIONS

Siva Subramanian Nair

• Compensations – Part 2

The last article discussed some of the forms of compensatory payments made by companies and evaluated their status in terms of ranking for a tax deduction. This article will deliberate on compensations paid to staff.

Firstly, the general contention is that expenditure incurred in relation to the appointment and dismissal of staff is allowable in arriving at the adjusted income of a business. In cases involving takeovers, reorganisations etc. it is common for redundant staff to be laid off and paid compensation. These are generally allowable as it relates to loss of office. Even if the company is subsequently liquidated, the payments would still rank for a deduction as shown in the case of *CIR v Patrick Thomson Ltd [1956] 37 TC 145* where the control of three subsidiaries of Scottish Drapery Corporation Ltd. was acquired by House of Fraser Ltd. The organisational change entailed the termination of the contracts of service of the managing directors of the three companies for which they were compensated and led to the eventual liquidation of those companies.

In allowing a deduction for the compensatory payments the learned judge opined:

> it is found as a fact that the decision to liquidate the company in January 1953, was not in any way connected with the cancellation of [the managing director's] service agreement, and these two events therefore were not part of any scheme or device to secure an advantage to [the managing director] at the expense of the company. Indeed it is perfectly clear that but for the subsequent liquidation it could never be suggested that the expenditure in question was not a proper deduction from profits, for there would be no ground for saying that it was not incurred for the purposes of the trade or business.

However, what if you had to remove an onerous character to preserve the business as a going concern. Candidates should refer to the Learning Curve article in *Tax Guardian* (Vol. 2/ No.3/ 2009/ Q4) where it was stated that the net of the "wholly & exclusively" rule in Section 33(1) extends to capture expenditure incurred in the preservation of the source which produces the income.

This issue was deliberated in the case of *Mitchell v B W Noble Co Ltd [1927] 11 TC 372.*

FACTS OF THE CASE

The company needed to dismiss one of the directors whose performance was dissatisfactory but instead of just sacking him (which would have been cheaper and which they were entitled to do) they negotiated a compensatory package with him. This was done because the company opined that negotiating a solution was better than an open dismissal as the latter would adversely affect the reputation of the company. The company agreed to pay him £19,200 for retiring from the company, sell his shares to the other directors at par value and surrender certain notes issued by the company which entitled him to participate in surplus profits for cancellation. The director accepted the sum in full satisfaction of all claims against the company or the directors.

DECISION OF THE COURT

The payment was held to be deductible.

Arguments submitted by the judge to justify the decision are detailed below. This could be used by candidates when requested to discuss a scenario-based question similar to the case above.

Generally

- the cost of hiring and firing employees in the normal course of business is an allowable expense.
- sums paid in lieu of notice would be allowable.

The Amount Is Too High

- this reflected the peculiar circumstances of this particular case.
- this director had a substantial salary, and the normal measure would be the loss of his salary, subject to a discount on the ordinary principle, in consideration of the fact that he might be out of employment.
- the measure of damages must include the loss of the premium value of his shares i.e. he had to sell his extraordinarily valuable shares - shares which paid 677 per cent dividend - at par!!
- he also had to surrender some profit-sharing notes which he held, which were very valuable property.

The Expenditure Was Capital

- the payment was NOT made to buy an asset or to purchase an enduring advantage; it was more like a payment made to remove a recurring disadvantage.
- it was a payment made in the course of business dealing with a particular difficulty which arose in the course of the year and was made NOT in order to secure an actual asset to the company but to enable it to continue to carry on the same type and high quality of business unfettered and unimperilled by the presence of one who might have caused difficulty to the business.

He concludes…

> *It seems to me it is simply this, although the largeness of the figures and the peculiar nature of the circumstances perplex one, that this is no more than a payment to get rid of a servant in the course of the business and in the year in which the trouble comes.*

This was also illustrated in another case i.e. *W Nevill & Co Ltd v Federal Commissioner of Taxation [1937] 56 CLR 290*

FACTS OF THE CASE

The appellant company, which had been managed by a single managing director, decided to introduce a system of joint management, and L. L. King was appointed as an additional managing director. He was engaged under an agreement, which provided a salary of £1,500 per annum with a percentage of profits. However, as business had seriously decreased, an arrangement was made for the resignation of King under which the company agreed to pay him a sum of £2,500 in consideration of his cancelling his agreement, £1,500 to be paid in cash and the balance of £1,000 by ten equal monthly payments of £100.

DECISION OF THE COURT

The payment was granted a deduction because;

- It Was Not a Capital Expenditure.
- No asset was acquired by the expenditure of the sum of £2,500.
- The agreement between the company and King for the employment of King was not something affecting the whole structure of the company's business.
- Its cancellation cannot be regarded as involving the acquisition of a capital asset.
- The cancelled agreement was an agreement for the employment of a servant made in the ordinary course of the company's business.

It Was a Bona Fide Expenditure in the Course of Business in the Interests of the Efficiency of the Business.

- fall within the terms of the proposition of Viscount Cave L.C. in *British Insulated and*

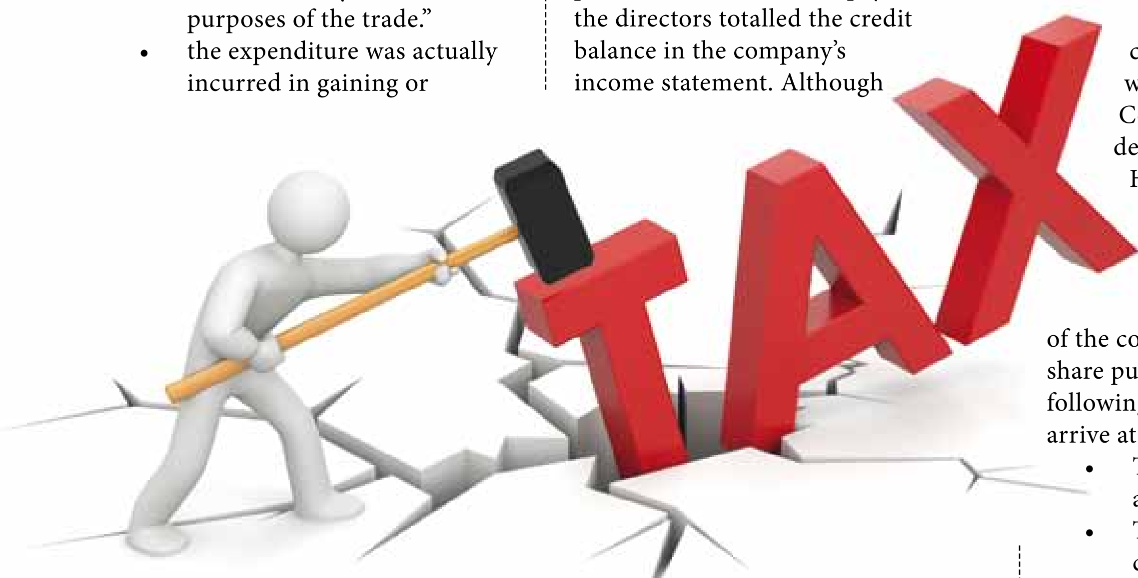
Helsby Cables v. Atherton:
"A sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade."

- the expenditure was actually incurred in gaining or producing the assessable income of the year in question.
- the expenditure was made for the purpose of increasing the efficiency of the company and therefore increasing its income producing capacity.

However, candidates should note that the above two cases were decided under the British and Australian tax legislations respectively, which contain provisions relating to deduction of expenditure which are similar but not synonymous with that in the Malaysian Income Tax Act 1967. Therefore, there are reservations expressed by some tax professionals in Malaysia with regard to the applicability of the above decisions in Malaysia because the words used in our Act are seemingly more restrictive.

Not all compensatory payments to staff will qualify for a deduction. Examples of these include payments made just before or upon sale of the business.

In the case of *Overy v Ashford Dunn & Co Ltd [1933] 17 TC 497*, three persons who were the directors and shareholders of Ashford Dunn & Co Ltd were paid £3,000 compensation for 'loss of office'. This plus other remuneration payable to the directors totalled the credit balance in the company's income statement. Although the company argued that the retirement of the directors was in the best interests of the Ashford Dunn & Co Ltd on the grounds that it enabled the trade to be conducted more economically, the High Court held that the payment was not allowable because it was a distribution out of profits and not an expense incurred in earning profits.



Another case was *Bassett Enterprise Ltd v Petty [1938] 21 TC 730* which involved a family controlled company.

FACTS OF THE CASE

The company was paying excessive remuneration to family members and its general manager. A disagreement arose when some members wanted to sell their interest in the company and this was settled (through court) whereby the sale was allowed but the company obtained a release from the service agreements by paying £3,000 to the general manager £1,500 to each member of the family.

The company claimed a deduction for the amounts paid in respect of the release from the service agreements which they described as being onerous.

DECISION OF THE COURT

The appeal by the company to claim a deduction was dismissed by the Special Commissioners and this decision was upheld at the High Court upon further appeal by the taxpayer. The judge opined that the amounts paid were not incurred in the interests of the company, but was part of the share purchase transaction. The following facts paved the way to arrive at that decision.

- The transactions took place at the same time.
- The transactions were contained in the same documents.
- The members of the groups were not paid with reference to the facts of the case but were paid one fixed level sum of £1,500 each, notwithstanding that some of them were performing no services and others were performing services which were valued.

Similarly, in *James Snook & Co Ltd v Blasdale [1952] 33 TC 244*, a deduction was denied in respect of compensation paid by the company to two of its directors because they were of advanced years and their methods were old-fashioned and the auditor of the company who was suppose to resign in line with a provision in the agreement involving the sale of the shares in the company.

The judge explained that the two events (i.e. the payment of compensation and the sale of the shares in the company) happening at or about the same time placed the onus on the company to prove that the one was unconnected with the other. The duality of purpose in the payment in this case was fatal to the claim for deduction i.e. it failed the "wholly & exclusively" rule.

The disallowance of a deduction for compensation paid also applies when its linked to the acquisition of a company as illustrated in *Royal Insurance v Watson [1896] 3 TC 500*.

In acquiring the business of Queen Insurance Company, The Royal Insurance Company agreed to take on the former's manager at a salary of £4,000 a year. However, they had an option to dispense with the manager's services and commute his salary based on the company's annuity tables and on condition that the manager should not at any time accept office under any other, fire or life insurance company. The option was exercised and the manager was paid off.

The amount paid was not granted a deduction on grounds that it was a capital sum, being part of the consideration for the business acquired.

That concludes our discussion on compensatory payments to staff.

Siva Subramanian Nair is a freelance lecturer. He can be contacted at sivanair@tm.net.my

FURTHER READING

Choong, K.F. Malaysian Taxation - Principles and Practice, (Latest Edition), Infoworld,
Kasipillai, J. A Comprehensive Guide to Malaysian Taxation under Self-Assessment (Latest Edition), McGraw Hill.
Malaysian Master Tax Guide, (2013), CCH Asia Pte. Ltd.
Singh, V. Veerinder on Taxation (latest edition), CCH Asia Pte. Ltd.
Thornton, R. Thornton's Malaysian Tax Commentaries, (Latest Edition), Sweet & Maxwell, Asia.
Thornton, Richard. 100 Ways to Save Tax in Malaysia for Partners and Sole Proprietors (latest edition), Sweet & Maxwell Asia.
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Yeo, M.C., Alan. Malaysian Taxation, (Latest Edition), YSB Management Sdn Bhd.

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: January - March 2014

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
JANUARY 2014								
GST Training Course (10 days)	Jan: 24, 25 Feb: 7, 8, 13, 14, 15, 20, 21, 22	9a.m. - 5p.m.	Kuala Lumpur	Royal Malaysian Customs	3,000 (fee for 10 days course)	3,400 (fee for 10 days course)	3,700 (fee for 10 days course)	JV/001
GST Examination Day	Feb 25	9a.m. - 5p.m.	Kuala Lumpur	Royal Malaysian Customs	3,000 (fee for 10 days course)	3,400 (fee for 10 days course)	3,700 (fee for 10 days course)	JV/001
Half-day Seminar: Transfer Pricing	Jan 6	8.45 a.m. - 12.45 p.m.	Penang	SM Thanneermalai	125 Subsidised fee	350	400	4 SE/001
Workshop: Limited Liability Partnership	Jan 9	9a.m. - 5p.m.	CTIM Training Room	Vincent Josef	300	350	400	8 WS/001
Workshop: Limited Liability Partnership	Jan 15	9a.m. - 5p.m.	Ipoh	Vincent Josef	335	385	435	8 WS/002
Half-day Seminar: Transfer Pricing 1	Jan 18	8.45 a.m. - 12.45 p.m.	Kuala Lumpur	SM Thanneermalai	125 Subsidised fee	350	400	4 SE/002
Workshop: Recent Tax Cases	Jan 20	9a.m. - 5p.m.	Penang	Saravana Kumar	335	385	435	8 WS/013
Workshop: Limited Liability Partnership	Jan 22	9a.m. - 5p.m.	Melaka	Vincent Josef	335	385	435	8 WS/003
Workshop: Recent Tax Cases	Jan 23	9a.m. - 5p.m.	Kuala Lumpur	Saravana Kumar	350	400	460	8 WS/014
Half-day Seminar: Transfer Pricing	Jan 27	8.45 a.m. - 12.45 p.m.	Johor Bahru	SM Thanneermalai	125 Subsidised fee	350	400	4 SE/003
Workshop: Withholding Tax on Payments to Non-Residents	Jan 27	9a.m. - 5p.m.	CTIM Training Room	Richard & Thenesh	150 Subsidised fee	350	400	8 WS/008
Public Holiday *(New Year:1 Jan, Prophet Muhammad's Birthday: 14 Jan, Chinese New Year: 31 Jan)*								
FEBRUARY 2014								
Workshop: Tax Implications for Property Investors after the 2014 Budget	10 Feb	9a.m. - 5p.m.	CTIM Training Room	Richard & Thenesh	300	350	400	8 WS/009
Workshop: Limited Liability Partnership	11 Feb	9a.m. - 5p.m.	Penang	Vincent Josef	335	385	435	8 WS/004
Half-day Seminar (by Public Practice Committee)	11 Feb	9a.m. - 1p.m.	CTIM Training Room	PPC	50	N/A	N/A	4 SE/005
Seminar: Selected Common Tax Issues – Part 2 *TO BE CONFIRMED	12 Feb	9a.m. - 5p.m.	Kuala Lumpur	Various Speakers	Early Bird 400 Normal 450	Early Bird 450 Normal 500	Early Bird 500 Normal 570	8 SE/004
Workshop: Recent Tax Cases	13 Feb	9a.m. - 5p.m.	Ipoh	Saravana Kumar	335	385	435	8 WS/015
Workshop: Limited Liability Partnership	13 Feb	9a.m. - 5p.m.	Johor Bahru	Vincent Josef	335	385	435	8 WS/005

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: January - March 2014

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
FEBRUARY 2014								
Workshop: Understanding the Basics of Computing Corporate Income Tax -with 2014 Budget updates	18 - 19 Feb	9a.m. - 5p.m.	CTIM Training Room	Kularaj	600	700	800	8 WS/010
Workshop: Limited Liability Partnership	18 Feb	9a.m. - 5p.m.	Kota Kinabalu	Vincent Josef	335	385	435	8 WS/006
Workshop: Limited Liability Partnership	20 Feb	9a.m. - 5p.m.	Kuching	Vincent Josef	335	385	435	8 WS/007
Workshop: Recent Tax Cases	20 Feb	9a.m. - 5p.m.	Melaka	Saravana Kumar	335	385	435	8 WS/016
Workshop: Recent Tax Cases	21 Feb	9a.m. - 5p.m.	Johor Bahru	Saravana Kumar	335	385	435	8 WS/017
Workshop: Tax Planning for Individuals (in collaboration with MAICSA)	25 Feb	9a.m. - 5p.m.	MAICSA Training Room, KL	Vincent Josef	350	400	450	8 JV/002
Workshop: Capital Allowances on Plant, Machinery & Buildings	26 Feb	9a.m. - 5p.m.	CTIM Training Room	Richard & Thenesh	300	350	400	8 WS/011
Public Holiday ***(Chinese New Year: 1 Feb, Federal Territory's Day: 1 Feb)***								
MARCH 2014								
IRB - CTIM Roadshow	Proposed dates in March to be confirmed by IRBM	9a.m. - 1p.m.	Kuala Lumpur	Various Speakers	250	300	350	4 RS/001
IRB - CTIM Roadshow		9a.m. - 1p.m.	Johor Bahru	Various Speakers	250	300	350	4 RS/002
IRB - CTIM Roadshow		9a.m. - 1p.m.	Penang	Various Speakers	250	300	350	4 RS/003
IRB - CTIM Roadshow		9a.m. - 1p.m.	Kota Kinabalu	Various Speakers	250	300	350	4 RS/004
IRB - CTIM Roadshow		9a.m. - 1p.m.	Kuching	Various Speakers	250	300	350	4 RS/005
Workshop: Understanding Taxation of Real Properties, Income from Letting of Real Properties & Investment Holding Companies	10 - 11 Mar	9a.m. - 5p.m.	CTIM Training Room	Kularaj	600	700	800	16 WS/012
Workshop: Recent Tax Cases	17 Mar	9a.m. - 5p.m.	Kota Kinabalu	Saravana Kumar	335	385	435	8 WS/018
Workshop: Recent Tax Cases	19 Mar	9a.m. - 5p.m.	Kuching	Saravana Kumar	335	385	435	8 WS/019
Workshop: Return Forms B, C & R, E -Submission, Challenges & Implications (in collaboration with MAICSA)	20 Mar	9a.m. - 5p.m.	MAICSA Training Room, KL	Vincent Josef	350	400	450	8 JV/003
Workshop: Transfer Pricing (in collaboration with MAICSA)	25 Mar	9a.m. - 5p.m.	MAICSA Training Room, KL	Vincent Josef	350	400	450	8 JV/004

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.

GOODS AND SERVICES TAX (GST) Training Course

Course Dates		Examination Date	Event Code	Time:
24 January 2014	14 February 2014	25 February 2014	JV/001	9.00 am – 5.00 pm
25 January 2014	15 February 2014			
7 February 2014	20 February 2014			
8 February 2014	21 February 2014			
13 February 2014	22 February 2014	**Venue:** Putra World Trade Centre (PWTC), Kuala Lumpur		

GST is Happening. Be Prepared Now!

GST is an indirect tax that may affect all inputs and outputs of a business organisation and this tax will replace the existing sales and services tax regime. To ensure you are GST ready, a coordinated effort within the business organisation is essential. It is just not another tax issue to be left only with the Finance and Accounts Department. Rather, it is a "crossfunctional" issue that can affect the entire business structure and hence require input from all key business units.

CTIM is pleased to present to our members a 10-day modular course between 24 January 2014 to 22 February 2014 with the cooperation and support of the Royal Malaysian Customs Department. A 1-day examination will be conducted after the courses.

Attendance to all sessions is compulsory. The Royal Malaysian Customs Department will only issue a Certificate of Attendance to those participants who attend all sessions, sit for and pass the examination.

Key Course Contents

- Overview of GST in Malaysia
- Scope of GST
- Types of supply
- Accounting for GST
- Input tax credit
- Transitional rules
- Special scheme available

Who Should Attend

- Tax practitioners and agents
- Management
- Finance department staff
- Operations and Methods department staff

Why You Should Attend

- To prepare you and your organisation when GST is implemented and to ensure GST readiness
- To evaluate the impact of GST to the business
- To identify and deal with major GST issues

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