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AUTHORITATIVE - RELEVANT - GLOBAL EXCELLENCE

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2012 Budget

THE MALAYSIA-US TAX TREATY – IS IT LONG OVERDUE?

MERGERS AND ACQUISITIONS – MALAYSIAN TAX ISSUES

OTHER BUSINESS DEDUCTIONS

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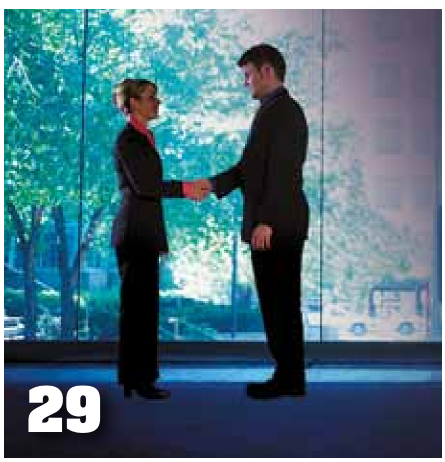

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The Institute welcomes original contributions which are of interest to tax professionals, lawyers and academicians. They may cover local or international tax developments. Article contributions should be written in UK English. All articles should be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

DATO' RAYMOND LIEW LEE LEONG

PREPARING FOR CHANGE

As we move into 2012, never before has the platitude that "change is the only constant" seemed more appropriate and applicable in the volatile and risky times that we live in.

As resources become scarcer, wealth erodes and the global middle classes slip slide towards the poverty line, governments are urgently searching for ways to increase growth and alleviate economic pain for their citizens. Indeed, thought leaders are even calling for a revamp in the way that we measure and strive for growth, given that the 20th-century protocol of improving lives through annual GDP growth no longer seems sustainable.

But while we wait for frameworks to be rejigged (with inspiration from models such as Bhutan's Gross National Happiness Index and the Happy Planet Index), the way forward for individual nations seems to be by cultivating new sources of sustainable growth and innovation in order to ensure inclusive prosperity and quality of life for all.

This is the route being taken by Malaysia under the blueprint for transformation into a highly-developed and high-income nation. As a key tool for remodeling our economic and social fates, the annual Budget comes under a great deal of scrutiny from all quarters. In this issue of *Tax Guardian*, we analyse the potential impact of 2012 Budget. Can it achieve its aims of fiscal prudence through balancing the budget and reducing tax leakages? Furthermore, can it incentivise the private sector sufficiently to urge them to economic partnership and leadership? And can it attract and retain the necessary talent through tax incentives for education and training and repatriation in order to alleviate the talent crunch?

In order to fund our ambitious transformation programme, Malaysia will need ample funds. We have been strongly urged to diversify our revenue and tax bases, and one means is through the implementation of the Goods and Services Tax (GST). Do take a look at our refresher article on GST in this issue to update yourselves on the challenges and learn how businesses can smooth the path for implementation.

Apart from prudence and innovation, alliance with partners is another way forward to pursue growth. In this issue, we look at the potential of a Malaysia-US tax treaty to improve bilateral relations through trade and security measures, among others. At the time of writing, Malaysia has a navigational tax treaty with the US which only deals with air and sea transport operations. Should we embark on a comprehensive tax treaty with the US? What are the benefits?

Speaking of the US, the global power has come up with the Foreign Account Tax Compliance Act (FATCA) which aims to counter tax evasion by US persons through foreign financial institutions. How will this affect Malaysian financial institutions?

Meanwhile, female empowerment is gaining strength as businesses and governments seek to harness the gentler sex to improve performance. How can companies leverage the feminisation of business to their advantage? Learn how to bring out the best in your female colleagues and employees.

Prudence, sustainability, teamwork, and feminisation are just a few of the larger key trends that look set to make a deep impact on the business environment as we move into the future. I strongly urge all tax professionals to learn all you can about these impactful trends and developments in order to be well-positioned in this 21st century of change. It is my sincere wish that *Tax Guardian* – and the CTIM – can be a vehicle for your professional and personal development and an instrument for change and transformation within the broader local landscape. Do feel free to give us your feedback on how you think *Tax Guardian* can be improved to serve you better.

On behalf of CTIM and *Tax Guardian*, I wish you a happy and prosperous new year.

Editor

Members' Dialogue & Annual Dinner Organised by East Coast Branch

On 22 October 2011, SM Thanneermalai (CTIM President) and Seah Siew Yun (Chairman, Education Committee) attended the Members' Dialogue and Annual Dinner organised by the East Coast Branch at the Grand Riverview Hotel, Kota Bharu. A short talk on "Transfer Pricing and How to Handle Tax Issues Arising Therefrom" was presented by the President before commencing with the Members' Dialogue where members were able to address issues of concern.

About 210 members attended the dinner including Mat Lazim Salleh (IRB State Director of Pahang), Hashim Sha'fiai (IRB State Director of Kelantan & Terengganu), Khairuddin Abdul Ghani (Director of IRB Kota Bharu Branch), senior staff of IRB, representatives from the Royal Customs Department Kelantan and Suruhanjaya Syarikat Malaysia (SSM) Kelantan. The Organising Committee of the dinner would like to record a special thanks to the visiting directors for their presence. On 23 October 2011, the President led the delegation from CTIM for a courtesy call to IRB Kota Bharu Branch.

CTIM Penang Branch Activities

The Northern Branch Chairman, Andrew Ewe was invited by the Inland Revenue Board to participate as a panellist at the 2012 post-Budget Seminars held in Penang on 18 October 2011 and in Alor Setar on 24 October 2011. Chang Kong Foo, a Northern Branch Committee Member of CTIM from Alor Setar was also invited as a panellist at the same seminar in Alor Setar.

CTIM Perak Branch Activities for First Half of 2011/2012

The first committee meeting for the term 2011/2012 was held on 5 August 2011 chaired by the new Branch Chairman, Chak Kong Keong and was widely covered by the Chinese press (Sin Chew Daily, Nanyang Siang Pau and China Press) in Perak.

A courtesy call to the Inland Revenue Board in Ipoh was held on 27 September 2011. CTIM Perak also paid a courtesy call to the Royal Malaysian Customs Department, Ipoh on 3 November 2011. Committee members and representatives from the professional bodies namely CTIM, CIMA, MACS, CPA Australia, ACCA and MIA had an informal dinner on 10 November 2011. CTIM Perak urges members to support the Perak Tax Forum 2012 which is scheduled to be held in March 2012.

CTIM Sabah Branch Activities

The Sabah Branch Committee and Members attended the Opening Ceremony of the 41st SGATAR (Study Group on Asian Tax Administration and Research) meeting which was held in Kota Kinabalu at IRB's invitation.

The event was officially launched by the Chief Minister of Sabah Datuk Seri Panglima Musa Haji Aman.

Members of SGATAR consists namely, Australia, China, Hong Kong SAR, Indonesia, Japan, Korea, Macau SAR, Mongolia, New Zealand, Papua New Guinea, Philippines, Singapore, Chinese Taipei, Thailand, Vietnam and Malaysia.

2012 Post-Budget Seminar

(joint collaboration with ACCA)

The Institute, once again, has jointly collaborated with ACCA Malaysia to organise Budget Seminars in smaller towns namely Kuantan, Kota Bharu, Kuala Terengganu, Labuan, Sibu and Miri. Members of both organisations benefited from the seminars in terms of knowledge as well as meeting the tax licensing requirements.

CTIM Sarawak Branch Activities

Between July and November 2011, four tax workshops have been held in Kuching. Workshops on the 2012 Budget were also held in Sibu, Miri and Bintulu apart from Kuching in October and early November. Regina Lau, Chairman of the Sarawak Branch, was panellist for the IROU's national tax seminar in Kuching and Sandakan, Sabah. In September, a career and tax talk was conducted by Regina Lau together with Thomas Law, Sarawak branch committee member, at the Swinburne University of Technology in Kuching. A tax talk was also conducted at Sunway College Kuching in October 2011.

2012 Budget Talk

On 17 October 2011, CTIM conducted its annual Budget Talk at the Hotel Istana, Kuala Lumpur. Gunaseelan Kunjan (Deputy-Under Secretary, Tax Analysis Division, Direct and Indirect Tax Section, Ministry of Finance) and Poon Yew Hoe (Chairman of the Technical and Public Practice Committee, CTIM) gave an in-depth perspective on the Budget proposals as well as their implications on the business community. There was also a panel discussion where pertinent issues were discussed. Lim Kah Fan (Deputy President of CTIM) was invited as a panellist in the forum discussion which was chaired by SM Thanneermalai (President of CTIM). The talk was attended by over 400 participants comprising tax practitioners and members from commerce and industry.

2012 Post-Budget Seminar

CTIM organised a series of 2012 Post-Budget Seminars in Kuala Lumpur, Subang, Ipoh, Melaka, Johor Bahru, Penang, Kuching and Kota Kinabalu. The speakers shared their views with the participants on the recent developments in tax, the implications of the Budget proposals and the various opportunities offered by the Budget incentives.

Workshop: New Public Rulings 2011

Due to an overwhelming response to the workshop on New Public Rulings 2011, CTIM organised re-runs of the workshop in Kuala Lumpur to meet members' requests. The speaker, Chow Chee Yen discussed the major Public Rulings issued by the Inland Revenue Board recently.

Workshop: Practical Guide: Malaysian Taxation Principles and Procedure

(joint collaboration with MAICSA)

The Institute, once again, conducted a series of workshops on "Practical Guide: Malaysian Taxation Principles and Procedure" in collaboration with MAICSA from 14 November 2011 to 8 December 2011. This popular compact 6-workshop course was held at MAISCA Auditorium and conducted by Vincent Josef. The workshops covered the relevant laws and necessary procedures to comply with the requirements of the Inland Revenue Board.

Workshop: Maximising on Capital Expenditure

Workshops were held in Kuala Lumpur, Penang, Melaka, Kuching and Johor Bahru from 10 November 2011 to 21 December 2011. The workshops covered issues on capital allowances claim on plant & machinery and other assets as well as industrial building allowance.

2012 Budget

By Yeo Eng Ping

GENERAL CONSENSUS HAS IT THAT THE WORLD HAS ONCE AGAIN ENTERED INTO AN AGE OF UNCERTAINTY - DEVELOPED NATIONS ARE STRUGGLING WITH A SLOWER THAN EXPECTED RECOVERY AND THE EUROPEAN SOVEREIGN DEBT ISSUES HAVE UNFOLDED DRAMATICALLY OVER THESE RECENT MONTHS. IN ITS SEPTEMBER 2011 REPORT, THE INTERNATIONAL MONETARY FUND STATED THAT THESE DEVELOPMENTS ARE WORRISOME, THEIR COMBINATION AND INTERACTIONS MORE SO, AND CALLED FOR STRONG POLICIES TO IMPROVE THE OUTLOOK AND REDUCE THE RISKS.

It was in this climate that Malaysia finalised its 2012 Budget proposals, announced on 7 October 2011. Clearly, there were tough choices for policy-makers as they weighed the need to undertake fiscal consolidation against the need to ensure that economic growth is not inadvertently stunted. For 2011, it has been reported that the government expects to collect RM97 billion in tax, depending on the economic condition (up from the earlier estimate of RM91 billion).

The 2012 Budget aims to reduce the budget deficit from the estimated 5.4% of GDP for 2011 to 4.7% for 2012. It is ambitious in that the deficit reduction will represent a large step towards a balanced budget, and bring Malaysia closer to the pre-2008 deficit levels (2008 budget deficit was 4.8%) after peaking at 7% in 2009 as a result of stimulus packages introduced to counter the effects of the global financial crisis. This would have a very positive effect on the perception of Malaysia, and is consonant with prudent financial management which is especially important in view of the uncertain global economic outlook for 2012.

The 2012 Budget has been termed an "election budget", and in some ways that was true, with a little something for everyone. Also, while there were a lot of discussions before the Budget about the imminence of the goods and services tax (GST), no new taxes were announced. Neither was there a significant increase in any of the existing taxes be it income tax, import duties, sales tax, excise duties, service tax or stamp duty.

The exception was the proposed increase in the real property gains tax (RPGT) rate from 5% to 10% for gains on disposals of real property

Currency: RM' billion	2008	2009	2010	2011RE	2012E
Revenue	159.8	158.6	159.7	183.4	187.0
Direct Taxes	82.1	78.4	79.0	96.5	102.1
-Companies	37.7	30.2	36.3	44.0	47.5
- Petroleum Income Tax	24.2	27.2	18.7	26.0	26.2
- Individual Tax	15.0	15.6	17.8	19.7	21.3
- Others	5.2	5.4	6.2	6.8	7.1
Indirect Taxes	30.8	28.1	30.5	32.7	33.5
- Service Tax	3.3	3.3	3.9	5.0	5.4
- Others	27.5	24.8	26.6	27.7	28.1
Operating Expenditure	153.5	157.1	151.6	180.3	181.6
Current Account Surplus	6.3	1.5	8.1	3.1	5.4
Development Expenditure	41.9	49.0	51.3	48.6	48.3
Overall Deficit	(35.6)	(47.5)	(43.2)	(45.5)	(43.0)
% to GDP	(4.8)	(7.0)	(5.6)	(5.4)	(4.7)

"E" denotes estimate, "RE" denotes revised estimate
Source: Economic Reports

interests held for 2 years or less. However, this was less of a revenue-generating measure than it was a tool to help curb speculation for properties – in this regard, the RPGT revenue for 2011 is expected to amount to a modest sum of RM369 million, compared to contributions from other taxes. It was a relief to many that the proposal did not disturb the current 0% RPGT on disposals of properties held for more than 5 years, and 5% RPGT in the case of properties held for more than 2 years and up to 5 years.

In tandem with the government's policy of encouraging the private sector to lead growth, with particular emphasis on growing the services segment of the economy, there were incentives announced for several key target sectors. At the same time, there were measures to reduce perceived tax leakages through tightening of the legislation – for example in the taxation of shipping profits, and life insurance funds. Also, there were proposals to enhance the powers of the Inland Revenue Board (IRB) through the tax administration framework

Looked broadly, these should support the overall objective of achieving Vision 2020, a goal to transform Malaysia into a developed, high-income nation by the year 2020.

THE GOVERNMENT'S CONTINUED COMMITMENT TOWARDS THE AREA OF HUMAN CAPITAL WAS ALSO EVIDENT IN THE 2012 BUDGET SPEECH BY THE PRIME MINISTER ON 7 OCTOBER 2011, WITH AN **ALLOCATION OF RM50.2BILLION TO BOOST THE NATION'S EDUCATION SECTOR**.

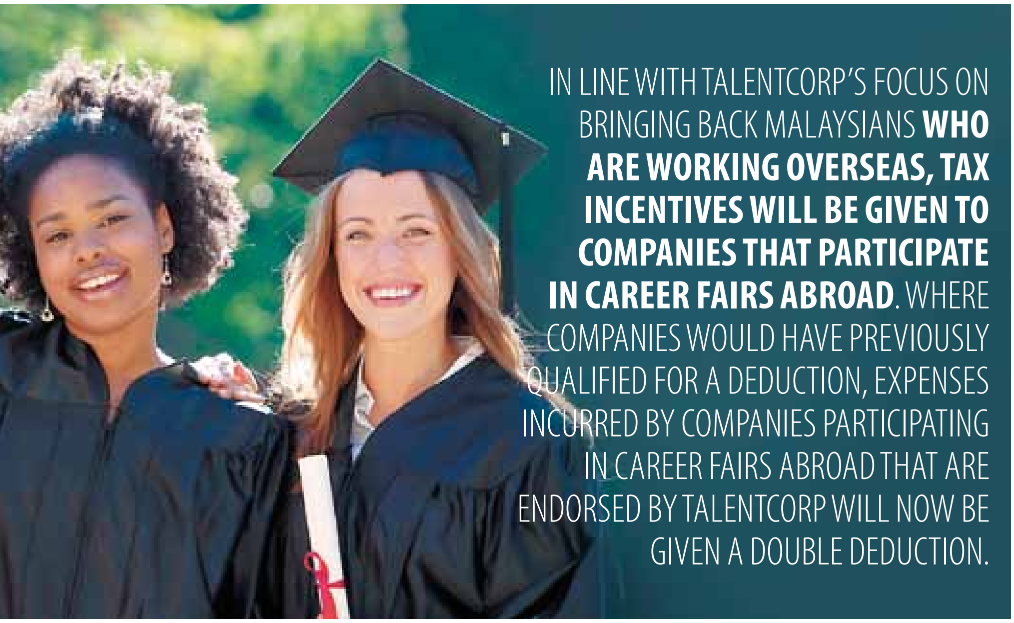
EDUCATION AND TALENT

The dialogue on developing, attracting and retaining talent has come up a lot more in recent years. One of the reasons for that has to do with Malaysia's vision of attaining high-income status by 2020, which is closely linked to the area of human capital. The government's focus on human capital was underscored by the establishment of Talent Corporation Malaysia (TalentCorp) under the Prime Minister's Department on 1 January 2011. The government's continued commitment towards the area of human capital was also evident in the 2012 Budget speech by the Prime Minister on 7 October 2011, with an allocation of RM50.2 billion to boost the nation's education sector.

The government has also proposed that private schools and international schools registered with the Ministry of Education be granted tax incentives in the form of:

- Income tax exemption (restricted to 70% of statutory income) for a period of 5 years or investment tax allowance (ITA) of 100% on qualifying capital expenditure incurred within a period of 5 years;
- Double deduction for overseas promotional expenses to attract more foreign students to Malaysia; and
- Import duty and sales tax exemption on all educational equipment.

These incentives are timely given the huge market potential and growing demand for private education. They may very well act as a catalyst of growth to the private and international school segments of the education market. Furthermore, the government aspires to establish Malaysia as a hub for education



and to attract foreign students into the country. These tax incentives should attract more foreign investments from other reputable international schools to set up establishments in Malaysia.

To encourage the private sector's involvement in the development of human capital, three other tax incentives have been proposed.

The Ministry of Higher Education in collaboration with TalentCorp will implement a structured internship programme which includes technical, communication and business skills.

1 This programme will provide students with the opportunity to experience real working environment and at the same time enable companies to identify potential employees. Companies will be given a double deduction on the expenses incurred to implement this programme. The internship programme would be required to run for a minimum of 10 weeks with a monthly allowance of not less than RM500.

2 The tax incentive for scholarships will also be enhanced to further support companies in carrying out their social responsibilities. Currently, scholarships awarded by companies to students are given a deduction when certain criteria are met. With the new proposal, companies will now be eligible for a double deduction on the scholarships awarded to Malaysian students pursuing study at diploma and bachelor's degree levels in local institutions of higher learning registered with the Ministry of Higher Education. With the availability of more scholarship funding from the private sector, students from families in the lower-income group can have more opportunities to pursue higher education.

3 In line with TalentCorp's focus on bringing back Malaysians who are working overseas, tax incentives will be given to companies that participate in career fairs abroad. Where companies would have previously qualified for a deduction, expenses incurred by companies participating in career fairs abroad that are endorsed by TalentCorp will now be given a double deduction. The joint effort by TalentCorp and the private sector will definitely help to attract more Malaysians to return to the country and contribute to spur the country into a high-income economy under the Economic Transformation Programme (ETP).

INNOVATION AND DESIGN, AND MALAYSIAN FRANCHISE

2012 was declared as the year of National Innovation Movement, and several strategic initiatives were introduced to promote innovation and enable Malaysia to move up the value chain. The government also proposed a new incentive for those providing industrial design services, with applications received by the Malaysian Industrial Development Authority from 8 October 2011 to 31 December 2016. The criteria for industrial service providers are:-

- New service providers who employ at least 50% Malaysian designers.
- Existing industrial service providers undertaking expansion and non-industrial design service

providers that would be carrying out industrial design activities:-
  - Upgrading their design facilities by increasing the capital investment by at least 50%; and
  - Employing an additional 50% qualified Malaysian designers
- The designers must be registered with the Malaysian Design Council.
- The industrial design service providers must be incorporated under the Companies Act 1965 or the Business Registration Act 1956, and provide industrial design services to non-related companies
- The industrial design services provided are meant for the purpose of mass production.

Eligible persons will be entitled to pioneer status with income tax exemption of 70% on statutory income for a period of 5 years.

There was also a proposal for franchise fees for local franchise brands, borne by local franchisees to be allowed a tax deduction, effective from the year of assessment (YA) 2012. It appears that this proposal was made on the understanding that franchise fees are “pre-commencement” expenses. Based on this, there may still be scope for non pre-commencement franchise fees to be tax deductible, depending on the factual circumstances surrounding the franchise fee.

FINANCIAL SERVICES

There are 12 National Key Economic Areas (NKEAs) identified as economic sectors that will drive the income levels over the next 10 years and facilitate the achievement of Vision 2020. The financial services sector is one of the NKEAs and is targeted to increase the total Gross National Income (GNI) contribution by RM121 billion to reach RM180 billion by 2020.

Given the strong targets set, there are various fiscal and non-fiscal incentives offered by the Malaysian government to spur investment and economic activity levels within the financial services sector.

Treasury Management Centre

The Treasury Management Centre (TMC) incentive has been proposed to encourage multinational companies to establish treasury centres in Malaysia. Multinationals are finding new and innovative ways to continue to run more efficiently by centralising various end-market services at an area / regional level.

The incentive is a 5-year corporate tax exemption at 70% (effective tax rate of 7.5%) of the statutory income derived from providing qualifying services to related companies. This includes all fee and management income from providing qualifying services to related parties in Malaysia and overseas; interest income received from lending to related parties in Malaysia and overseas; interest income and gains from certain placements; foreign exchange gains from managing risks for the Group; and guarantee fees.

The qualifying services are:-

- Cash management services.
- Current account management services.
- Financing and debt management services.
- Investment services.
- Financial risk management services.
- Corporate and financial advisory services.

The effective tax rate of 7.5% places Malaysia in a competitive position against the backdrop of other investment-friendly countries in the region. Just to compare, Singapore offers an equivalent tax incentive (Finance and Treasury Centre incentive) with a preferential tax rate of 10% for a period of 5 to 10 years. On the other hand, Hong Kong with its inherent low tax regime, offers a 16.5% tax rate that attracts the setting up of treasury centres.

The TMC incentive also provides withholding tax exemption on interest payments related to funds raised as part of undertaking the qualifying activities as well as stamp duty exemption on all loan and service agreements executed by the TMC in Malaysia in relation to qualifying activities. Both these exemptions are expected to lower transaction costs and make it easier for TMCs to carry out their services.

It will be interesting to see how the “thin capitalisation” rules under Section

140A, Income Tax Act 1967 will be implemented in relation to TMCs, as TMCs may need additional flexibility in terms of their debt levels given the roles and functions they play.

Kuala Lumpur International Financial District

The other financial services incentives announced in the 2012 Budget pertain to the upcoming Kuala Lumpur International Financial District (KLIFD). Companies which are located in the KLIFD and hold KLIFD status are able to apply for a full (100%) corporate tax exemption for 10 years. Similar to the TMC incentive, the KLIFD incentive entitles the recipient to stamp duty exemption on all loan and service agreements entered into by KLIFD status companies.

KLIFD Marquee status companies can apply for accelerated capital allowances while property developers with projects in the KLIFD area can apply for partial (70%) tax exemption for five years.

TOURISM AND HOTELS

The development of new 4 and 5-star hotels in Peninsular Malaysia will be eligible for either pioneer status with income tax exemption of 70% of statutory income for 5 years or ITA of 60% on the qualifying capital expenditure incurred within a period of 5 years and may be set off against 70% of the statutory income. Applications must be received by MIDA from 8 October 2011 until 31 December 2013. This complements and completes the scope of incentives for hotels, where there are already similar existing incentives for 4 and 5 star hotels in the following categories:-

- Reinvestments for the expansion, modernisation and refurbishment of 4 and 5-star hotels.
- New investments in 4 and 5-star hotels in Sabah and Sarawak.

INDIVIDUALS

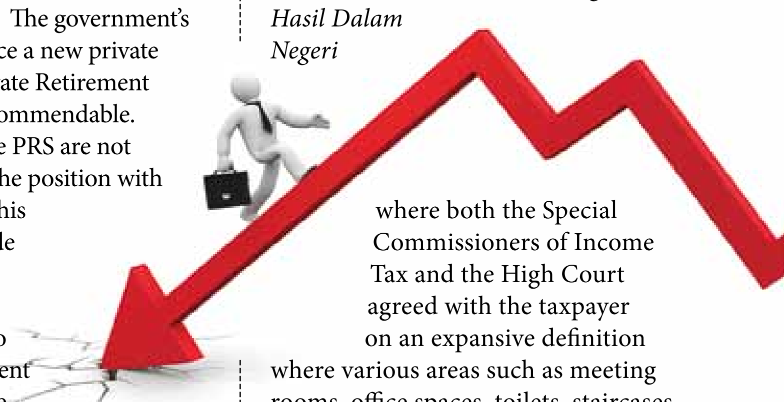
Private retirement schemes

Currently, the only approved private pension fund in Malaysia is the Employees Provident Fund (EPF). The government is aware that with improved life expectancy, EPF savings on retirement are inadequate. In addition, there is a large group of individuals who are self-employed (roughly 25% of the working population) and do not have any retirement savings. Further, the percentage of individuals with no form of insurance protection is said to be at approximately 59%. The government's proposal to introduce a new private pension fund – Private Retirement Scheme (PRS) - is commendable. Contributions to the PRS are not mandatory, unlike the position with the EPF. However, this new PRS will provide a viable alternative for extra voluntary long-term savings to supplement retirement savings and enhance post-retirement income.

Contributors to this new fund (and to annuity premiums) will be eligible to a tax relief of up to RM3,000. This relief will be in addition to the RM6,000 relief given to EPF contributions and life insurance premiums. To encourage employers to contribute to the PRS, deductions will be given for their contributions. The deductions for these contributions together with the employer's contributions to the EPF are collectively capped at 19% of the employees' remuneration. Similar to the position with the EPF, contributions received by individuals upon attaining the mandatory retirement age will be exempt from tax.

Returning experts

Individuals returning to Malaysia under the Returning Expert Programme administered by the Talent Corporation, and are employed in Malaysia will enjoy an income tax rate of 15% for a period of 5 years on employment income. The taxation of income from other sources will be determined by the Minister.



REINVESTMENT ALLOWANCE

A key change to be introduced in the legislation is the definition of "factory" for purposes of Schedule 7A, effective from YA 2012. This will bring to close many of the issues surrounding the scope of the word "factory", that have culminated in the case of *SETM Sdn Bhd* v *Ketua Pengarah Hasil Dalam Negeri* where both the Special Commissioners of Income Tax and the High Court agreed with the taxpayer on an expansive definition where various areas such as meeting rooms, office spaces, toilets, staircases, void areas, lift lobby, *surau* and even warehouse could also be included as qualifiying for reinvestment allowance (RA). The new definition is as follows:-

"factory" means portion of the floor areas of a building or an extension of a building used for the purposes of qualifying project **to place or install plant or machinery or to store any raw material, or goods or materials manufactured prior to sale**:

Provided that in respect of the portion of the building or extension of a building used for the storage of any raw material, or goods or materials, or both, it shall not be more than one-tenth of the total floor area of that building or extension." (emphasis by author).

There is also an amendment to "complete" the move made last year, to prevent RA being claimed by a company in the same basis period where it also enjoys incentives i.e. pioneer status and ITA.

INCREASE IN TAX ADMINISTRATIVE POWERS

Looking at the 2012 Budget estimates, the government expects a growth in tax revenues amidst an uncertain global economic outlook, and at the same time, expects to maintain, more or less, the level of expenditure into 2012. Hence, in order to achieve the goal of a 4.7% deficit, without new taxes and direct measures to increase taxes, we can expect a lot more attention to be given on increasing the effectiveness and efficiency of the current tax administration.

The Prime Minister said this in his speech: "…an effective and efficient tax administrative system is a precondition to widen the tax base and increase compliance by taxpayers. Apart from strengthening the ICT systems of revenue collection agencies, enforcement measures will be enhanced through the implementation of integrated operations with other relevant agencies."

It is no surprise therefore to see in the Finance Bill, several key changes which enhance the powers for tax enforcement, including:-

- Extending the Director General of Inland Revenue (DGIR)'s powers of access to computerised data - Tax payers must provide information such as passwords, encryption codes, decryption codes, software or hardware and any other means required to enable comprehension of the computerised data.
- Extending the DGIR's powers of access to information that is within the "control" of the person from whom the information is requested. Hence, it will not be possible for a person to decline provision of information where the information is in the possession of another, over whom the person has control.
- Providing the DGIR with the power to disregard any information provided by a person where such information is provided late, after the expiry of the time specified in the DGIR's notice demanding such information. Such information will also be barred from being used to appeal against a tax assessment before the Special Commissioners of Income Tax or court. Presumably, this proposal is to ensure a speedier finalisation of tax returns, but the implementation of this proposal needs to be even-handed and reasonable, lest taxpayers' basic rights are unfairly eroded.
- Requiring specified information on payments made to agents, dealers and distributors to be disclosed in a prescribed form and provided to the payees for tax purposes. One reason for this is to facilitate better monitoring of income reporting, but notably, this will result in additional record-keeping for affected persons.
- Permitting the DGIR to impose tax payments by instalments on account of tax which may be payable, where a taxpayer has failed to furnish a tax return or where the DGIR has reason to believe that a return is incorrect. The scheme is novel in that the DGIR will have the power to collect taxes even before a "best estimate" tax assessment is issued.

These measures are consistent with the trend observed in the last decade where the IRB's powers of access, enforcement and collections have been enhanced. The challenge is to ensure the right balance is struck in the exercise of these powers by the relevant authorities. It should be recalled that very recently (effective from 1 October 2011, following appeals for a deferral from the original implementation date of 1 June 2011), the IRB significantly enhanced the penalty for late filing of tax returns - taxpayers will incur a minimum penalty rate of 20% of the tax payable in the late return, before any set-off, relief or repayment based on the length of the delay.

It would not be complete without mention of several positive developments for taxpayers in the area of tax administration including:-

- Compensation of 2% on the amount of tax refunded late by the IRB, from YA 2013
- Reduction in the time bar for tax audits to 5 years, from the current 6 years, from YA 2013
- Enhancement of the e-filing system to allow furnishing or returns via mobile devices, and pre-filling of certain information into the e-forms

This was an inclusive budget and has the interests of many needy sections of our society. The achievement of the goals would partly rely on an efficient tax administration, and there are strong indications that this will be a focus area to help increase tax revenues. It is hoped that more details will be provided on how these proposals will be implemented, in the interest of transparency and greater certainty for taxpayers.

This article was written by Yeo Eng Ping, the National Tax Leader of Ernst & Young Tax Consultants Sdn Bhd, with contributions from Bernard Yap, Partner, Amarjeet Singh, Partner, Julie Thong, Partner, Lydia Thiagarajah, Director. 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.

THE MALAYSIA-US TAX TREATY —IS IT LONG OVERDUE?

By Tan Hooi Beng

THE "NAJIB-OBAMA" FACTOR

On 19 November 2011, it was reported in one of the Malaysian press that trade, investment and security were among the issues discussed in a high-level bilateral meeting between Prime Minister Datuk Seri Najib Tun Razak and the United States (US) President Barack Obama. Both leaders also highlighted their intention to improve bilateral ties during a 30-minute meeting held on the sidelines of the Asean Summit in Bali. President Obama told reporters that although the bilateral relationship between the two countries was strong, he foresaw more cooperation when the Trans-Pacific Partnership (TPP) came into effect. The TPP is a proposed multilateral trade forum with possible members accounting for up to 40% of the global gross domestic product (GDP).

"We will discuss how to best use the East Asian Summit to ensure shared prosperity and assure security across the region. I appreciate this extraordinary cooperation we received on a whole range of issues. We want to be a strong partner with Malaysia," Obama told reporters before the meeting.

Datuk Seri Najib said he was looking forward to expanding trade and investment linkages with the US, which is Malaysia's fourth largest trading partner, via the TPP. "Hopefully, we can meet the deadline next year. We see great prospects in terms of enhancing trade and investment," he said. He added that Malaysia was also keen to cooperate in other areas such as security and education. "We are very committed to ensuring eastern stability. In the area of nuclear non-proliferation, we are doing our part in ensuring Malaysia does not become a transit point for illicit goods that can be used for this," he said.

THE PRESENT MALAYSIA-US TIES[1]

Malaysia and the US share a diverse and expanding partnership. Economic ties are robust. Based on statistics of the State Department, the US is one of Malaysia's largest trading partners and Malaysia is the eighteenth-largest trading partner of the US. Annual two-way trade amounts to $33 billion. In October 2010, Malaysia joined negotiations for a TPP free trade agreement. The US companies are particularly active in the electronics, manufacturing, and oil and

[1] *Statistics/Data from the US State Department*

gas sectors. According to Malaysian data, US direct investment in the manufacturing sector in Malaysia as of year-end 2009 was $15.1 billion, with billions of dollars in additional investment in the oil and gas and financial services sectors of the economy.

Moreover, Malaysia and the US cooperate closely on security matters, including counterterrorism, maritime domain awareness, and regional stability. The relationship between the Malaysian and the US militaries is also strong with numerous exchanges, training, joint exercises, and visits. Malaysia and the US signed a Mutual Legal Assistance Treaty (MLAT) in July 2006 during the visit to Kuala Lumpur by Secretary of State Condoleezza Rice.

Malaysia and the US have a long history of people-to-people exchanges. Well over 100,000 Malaysians have studied in the US. At any one time, there are over 7,000 Malaysians studying at US universities. Last year approximately 130 Malaysians took part in US government-sponsored exchange programmes for professional development and study. Each year, about 50 Americans travel to Malaysia under the US government auspices to share their experience as visiting academics or speakers. In November 2010, Malaysia and the US signed a bilateral Memorandum of Understanding on Science and Technology Cooperation.

IS THERE A COMPREHENSIVE TAX TREATY BETWEEN MALAYSIA AND THE US?

Against the above background, there is no doubt that Malaysia and the US have very solid ties, in economy in particular. Under normal circumstances, a tax-savvy person would expect that a comprehensive tax treaty between both nations is already in place. As at the point of writing this article, Malaysia has entered into a navigational tax treaty with the US which only deals with income from air and sea transport operations as opposed to the comprehensive tax treaties that Malaysia has entered into with more than 60 jurisdictions. Even Singapore has not inked a comprehensive tax convention with the US thus far.

WHAT ARE THE OBJECTIVES OF A TAX TREATY?

Before one says that a tax treaty between Malaysia and the US is long overdue, it is crucial to understand the objectives of a tax treaty.

As economies go borderless, one of the most important aspects is international or cross-border transactions. For example, if Malaysian companies sell products to customers in the United Kingdom, which country has the taxing right on the trading profits of the sellers? Is it Malaysia, the United Kingdom or another country? In terms of inbound activities, if a Dutch company sends its consultants to Malaysia to render technical services to Malaysian customers, which country has the taxing right on the service income? Is it Malaysia, the Netherlands or another country? These are some of the many issues that can arise in a cross-border transaction or investment.

It goes without saying that each nation would seek to protect its revenue base within the four corners of its domestic tax law. In so doing, where a tax treaty exists between two nations, a tax treaty normally prevails over the domestic tax law. Even with the existence of a comprehensive tax treaty, certain areas remain unclear and litigation on international tax matters have become a norm these days. The case of *Vadofone*[2] is one of the most controversial ones in the history of international taxation.

In the simplest manner, A. McKie has aptly summarised the purposes of a tax treaty at the 22nd Tax Conference of the Canadian Tax Foundation where he said:

> *"The taxpayer hopes that the treaty will prevent double taxation of his income, the tax gatherer hopes the treaty will prevent fiscal evasion and the politician just hopes."*

Paragraph 16 of the Introduction to the Organisation for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital (OECD MTC) states that:

> *"In both the 1963 Draft Convention and the 1977 Model Convention, the title of the Model Convention included a reference to the elimination of double*

[2] Presently, the Supreme Court of India is considering its decision in respect of the taxation of indirect transfer of shares of an Indian entity.

taxation. In recognition of the fact that the Model Convention does not deal exclusively with the elimination of double taxation but also addresses other issues, such as the prevention of tax evasion and non-discrimination, it was subsequently decided to use a shorter title which did not include this reference. This change has been made both on the cover page of this publication and in the Model Convention itself. However, it is understood that the practice of many member countries is still to include in the title a reference to either the elimination of double taxation or to both the elimination of double taxation and the prevention of fiscal evasion".

Malaysian treaties generally follow the present practices of the OECD member countries. Let's look at the title and preamble to the tax treaty concluded between Malaysia and Singapore;

"Agreement between the government of Malaysia and the government of the Republic of Singapore for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income"

"The government of Malaysia and the government of the Republic of Singapore desiring to conclude an Agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, have agreed as follows:.."

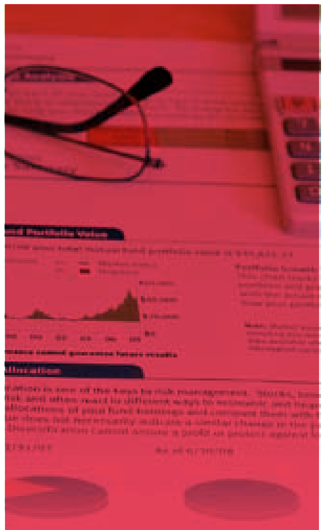
Generally speaking, the tax treaty has four key objectives:

- Avoiding double taxation of the same income.
- Facilitating cross-border/international trade and investment.
- Providing fair treatment to residents of different jurisdictions.
- Preventing tax evasion and fiscal fraud.

WHAT ARE THE PRACTICAL ISSUES THAT WOULD ARISE IN THE ABSENCE OF A COMPREHENSIVE MALAYSIA-US TAX TREATY?

There would be a host of issues and ramifications for the residents of both countries if no comprehensive tax treaty is in place. Whilst it is not possible to discuss all issues, some of the common ones are discussed below. In particular, the issues are discussed mainly from the eye of the US investors doing business in Malaysia in respect of Malaysian taxation.

One of the key issues is concerning a taxable presence of a US resident in Malaysia. Section 3 of the Malaysian Income Tax Act, 1967 (MITA) read together with paragraph 28, Schedule 6 clearly places Malaysia as a taxing jurisdiction that adopts a territorial regime, with certain exceptions. Now, this simply means only Malaysia sourced or derived income is subject to Malaysian income tax. Section 12 basically endorses the operation test as far as business income is concerned. This is as far as it goes for business income. Of course, several Malaysian and foreign case law precedents do shed some light along the way. Unlike jurisdictions such as Australia, the UK etc. where the concept of permanent establishment (PE) can be found in their domestic tax laws which are similar to that of the tax treaty, this is not the case for Malaysia.



THEREFORE, IN THE ABSENCE OF ANY COMPREHENSIVE TAX TREATY BETWEEN MALAYSIA AND THE US, **THE RELEVANT PROVISIONS IN THE MITA COUPLED WITH THE PRINCIPLES LAID DOWN** IN THE CASE LAWS HAVE TO BE RELIED UPON IN ASCERTAINING WHETHER A US RESIDENT RECEIVING, SAY TECHNICAL FEES FROM A MALAYSIAN CLIENT, IS DERIVING A MALAYSIA SOURCED INCOME.

Therefore, in the absence of any comprehensive tax treaty between Malaysia and the US, the relevant provisions in the MITA coupled with the principles laid down in the case laws have to be relied upon in ascertaining whether a US resident receiving, say technical fees from a Malaysian client, is deriving a Malaysia sourced income. As a net result, the concept of taxable presence is used instead. An acid test is whether the US entrepreneurs are viewed as trading in Malaysia or trading with Malaysia. If it is the former, the profits derived therefrom would fall within the Malaysian income tax net.

It goes without saying, that there is no universal rule to determine whether a non-resident is having a taxable presence in Malaysia or otherwise. However, where a treaty exists, the tax position is much clearer as triggering points of a PE in Malaysia are systematically set out. Whilst I am not saying that the determination of a PE in a treaty scenario is a simple one, this is certainly easier compared to the test used in ascertaining the existence of a taxable presence.

From the perspective of the Malaysian service recipient, it is crucial to determine whether the US resident creates a taxable presence here. Where the US resident renders services to Malaysian residents through a taxable presence in Malaysia, the appropriate

Malaysian withholding tax rate is 10% plus 3% pursuant to Section 107A of the MITA. This has been the acceptable practice for a while now although one could argue that the MITA does not preclude a final withholding tax at 10% under Section 109B to be applied even with the existence of a taxable presence. As a matter of practice, Section 109B withholding tax will kick in where the US resident renders services in Malaysia without creating a taxable presence.

In addition, as far as the US companies are concerned, they are obliged to lodge Malaysian corporate tax returns with Section 107A withholding tax being an interim tax if they have taxable presence here. On the other hand, generally, Section 109B withholding tax is a final tax. Whilst paying full Malaysian corporate tax may not be the real issue to the US taxpayers, perhaps the real issue is the cumbersome nature of filing Malaysian tax returns as well as the determination of the profits attributable to the taxable presence in Malaysia.

Another issue is the preferential withholding tax rate.

ONE OF THE MOST IMPORTANT OBJECTIVES OF INKING A TAX TREATY IS TO **ENABLE THE AUTHORITIES OF BOTH COUNTRIES** TO PREVENT TAX EVASION AND FISCAL FRAUD.

Given that there is no comprehensive treaty between Malaysia and the US, the relevant outbound payments from Malaysia such as royalty and interest would attract Malaysian withholding tax at the highest rate pursuant to the MITA. A higher Malaysian withholding tax rate may adversely impact the cash flow position of the recipient. To a certain degree, in a group scenario, this may promote treaty shopping or various avoidance schemes to reduce the Malaysian withholding tax. Otherwise, a high outbound withholding tax could deter or dampen the transfer of technology, investment etc.

As mentioned above, one of the most important objectives of inking a tax treaty is to enable the authorities of both countries to prevent tax evasion and fiscal fraud. Normally, this objective can be achieved through the provisions in the tax treaty, namely the Article on the Exchange of Information (EOI). In Malaysia, the Income Tax (Exchange of Information) Rules 2011 were gazetted recently which provide that the competent authority of a jurisdiction that has entered into a double taxation arrangement with the government of Malaysia may request information on any person from the Director General of Inland Revenue (DGIR). Therefore, without a tax treaty proper, the cooperation between the tax authorities of both nations would be very challenging unless a special tax information exchange arrangement is made.

The above are only several of many other key issues that could arise. Briefly, other potential issues are as follows:

- The dual residence issues.
- An effective way of eliminating double taxation.
- Ability to maximise the foreign tax credit.
- Ability to resolve tax disputes through Mutual Agreement Procedures.
- Tax exemptions for short-term consultants/employees.
- Ability to resolve the non-discrimination issues etc.

WHAT ARE THE STUMBLING BLOCKS?

One would concur that the robust economic ties between Malaysia and the US is important. In my younger days in the tax practice, I could not help but to wonder why no comprehensive tax treaty between both nations had been concluded.

This is an interesting point. It could easily be argued that the US has one of the most complex fiscal regimes in the world. Hence, it is certainly not surprising to note that some of the leading tax advisers in the US are from the legal firms as the US tax laws can be extremely difficult to understand. The complexities are at times, unintended. For example, the US "check the box" rules which were introduced years ago were meant to ease the tax administration of US groups of companies operating outside the US. What is meant to be an administrative tax law has turned into one of the most widely used international tax planning tools, and to a certain degree, abused by the international tax advisers globally to defer US taxation. The Obama administration has sought to plug this loophole but the effort has proven futile so far due to various economic and political reasons.

The complexity of the US tax laws also evidenced by various anti-abuse/avoidance laws found in the US domestic tax code as well as the tax treaties it has concluded. Perhaps it is all these complexities that continue to deter the inking of a comprehensive tax treaty with Malaysia.

US tax treaties can be complex and challenging documents to read and understand. Most of the recent US treaties were modelled after the 2006 US Model Income Tax Treaty. On the other hand, Malaysian treaties are predominantly based on the Organisation of Economic Cooperation and Development (OECD) model coupled with some modifications to follow the United Nations (UN) Model.

There is one significant feature in the US tax treaties, namely the "saving clause," which provides that the treaty does not limit the US taxation of US citizens or US residents, with certain exceptions. Moreover, the US is well known for inserting a robust and comprehensive clause on Limitation on Benefits (LOB). This clause itself could run into pages. Broadly speaking, the LOB article is intended to prevent "treaty shopping," which is the inappropriate use of tax treaties by residents of third states. The LOB article denies the benefits of the tax treaty to residents that do not meet additional tests. The LOB articles vary widely from treaty to treaty, and are often quite complex.[3]

The US treaty negotiators are also very particular and strict on the EOI and they are inclined to incorporate a robust provision. One may recall that sometime in April 2009, the OECD had placed Labuan on a tax haven blacklist along with three other countries. The reason given then was that Costa Rica, Labuan, the Philippines and Uruguay had not yet committed to the internationally-agreed standard on EOI. Subsequently, Labuan has been re-designated as being among financial centres committed to the internationally-agreed tax standard

by the OECD. In any case, over the last one year or so, various protocols have been signed between Malaysia and its various treaty partners pertaining to the article on EOI. The new articles on EOI are in line with the EOI provision of Article 26 of the OECD Model Convention. This simply demonstrates Malaysia's commitment towards the effort in combating international tax evasion. Therefore, one major stumbling block to a Malaysia-US tax treaty rightfully would have been removed by now, hopefully.

THE WAY FORWARD

It is hoped that a comprehensive tax treaty between Malaysia and the US would be initiated soon. The earlier, the better for the Malaysian and US business communities given the importance of treaty protection and benefits. In addition, a robust tax treaty between both countries will enhance the cooperation between both tax authorities in preventing fiscal evasion. It goes without saying that for the tax treaty to crystallise, the negotiators need to fully understand the tax regime and policy of both countries and the major barriers need to be removed over time, if not immediately.

IT IS HOPED THAT A COMPREHENSIVE TAX TREATY BETWEEN MALAYSIA AND THE US WOULD BE INITIATED SOON. **THE EARLIER, THE BETTER** FOR THE MALAYSIAN AND US BUSINESS COMMUNITIES GIVEN THE IMPORTANCE OF TREATY PROTECTION AND BENEFITS.

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3 Whilst some US treaties provide that treaty benefits apply if a "derivative benefits" test is met, other US treaties provide that the benefits of the treaty apply if a "headquarters company" test is met. A good example is the proposed income tax treaty between the US and Hungary. In this respect, the LOB article provides that the resident company will only be eligible for treaty benefits if it qualifies under one of the following:

- *The publicly traded test (including subsidiaries of publicly traded entities);*
- *The ownership-base erosion test;*
- *The active trade or business test;*
- *The derivative benefits test;*
- *The headquarters company test; or*
- *A competent authority determination*

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Goods and Services Tax (GST)

By Dr. Morni Hayati Jaafar Sidik and Ng Kean Kok

Much has been commented about the coming introduction of the Goods and Services Tax (GST) in Malaysia over the last few years. The government had on several occasions in the past, announced its intention to introduce GST into the Malaysian tax framework and the GST legislation was to have been enacted as law. However, its introduction has been deferred pending further studies by the government.[1]

Nonetheless, the expectation is still that the government will introduce GST in the not too distant future as there is a need for an alternative sustainable source of tax revenue, given the previous steps taken by the government to reduce the corporate tax rate.

WHAT IS GST?

Goods and Services Tax (GST) is a type of broad-based consumption tax that covers all sectors of the economy. It is imposed on a wide range of local and imported goods and services. GST is only paid when one consumes the goods or products. It is a form of indirect tax because the tax collection will be done by the sellers. The sellers will be the third party that will collect the tax and will pass it to the government. In other words, it is a kind of tax that will be borne by the end consumers rather than producers or suppliers (Pinto, 2001).

GST is proposed to replace the current consumption tax i.e. the sales and service tax (SST). It represents part of the government's tax reform programme to enhance the efficiency and effectiveness of the existing taxation system.

HOW DOES GST WORK?

Businesses making taxable supplies are required to be registered under GST if their annual sales turnover has exceeded the prescribed threshold. Only a registered entity can charge and collect GST on the taxable supplies of goods and services made by the entity.

GST shall be charged on the value (selling price) of the products. The amount of GST incurred on input (input tax) can be deducted from the

[1] The Malaysian government first announced that it intended to introduce GST in 2004. However, it was postponed thereafter due to mixed responses from the public, tax practitioners and businesses. On 16 December 2009, the government introduced the GST Bill 2009 for its first reading in Malaysia's parliament and had proposed to commence in 2011. It has however been indefinitely deferred until further decision by the government.

amount of GST charged (output tax) by the registered person.

If the amount of output tax is more than the input tax in the relevant taxable period, the difference shall be remitted to the government. However, if the input tax is more than the output tax, the difference will be refunded by the government.

SCOPE AND CHARGE

GST shall be levied and charged on the taxable supply of goods and services made in the course or furtherance of business in Malaysia by a taxable person. GST is also charged on the importation of goods and services.

A taxable supply is a supply which is standard rated or zero rated. Exempt and out of scope supplies are not taxable supplies.

GST is to be levied and charged at the proposed rate of 4% on the value of the supply.

GST can only to be levied and charged if the business is registered under GST. A business is not liable to be registered if its annual turnover of taxable supplies does not reach the prescribed threshold. Therefore, such businesses cannot charge and collect GST on the supply of goods and services made to their customers. Nevertheless, businesses can apply to be registered voluntarily.

The tax computations involved depends on the type of supply of goods or services involved, classified as follows:

Standard-rated supplies

Standard-rated supplies are taxable supplies of goods and services which are subject to a proposed rate of 4%. A taxable entity that is registered under GST has to collect GST on the supply and is eligible to claim input tax credit on its business inputs in making taxable supplies.

Zero-rated supplies

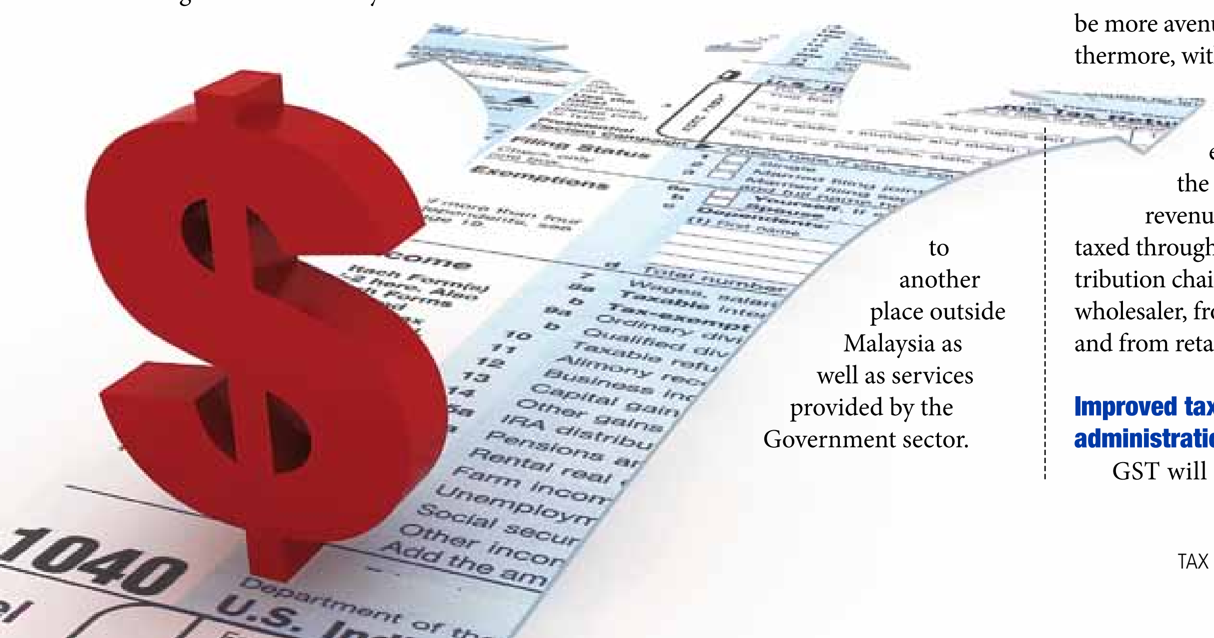
Zero-rated supplies are taxable supplies of goods and services which are subject to GST at 0% rate. Businesses do not collect any GST on their supplies but are entitled to claim credit on inputs used in the course or furtherance of the business.

Exempt supplies

Exempt supplies are supplies of goods or services that are not subject to GST. Businesses under this category do not collect any GST on their supplies and are not entitled to claim credit on business inputs.

Supplies not within the scope of GST

Supplies which do not fall within the charging provision of the GST Act include non-business transactions, sale of goods from a place outside Malaysia to another place outside Malaysia as well as services provided by the Government sector.



BENEFITS OF GST

GST has been proven to be a better tax system as it is more effective, efficient, transparent and business friendly and could spur economic growth as well as increase competitiveness in the global market.

The benefits of GST are as follows:

Better tax system

As noted by (Palil and Ibrahim 2011), the move to introduce GST is in line with the government policy to follow ASEAN Free Trade Area (AFTA). It represents part of the government's tax reform programme to enhance the efficiency and effectiveness of the existing taxation system. According to the Ministry of Finance, GST can overcome the weaknesses of the SST. Among the weaknesses are the cascading tax, double tax and pyramiding tax, tax erosion and leakages through transfer pricing and other means. Experience from other countries such as UK and New Zealand showed that the introduction of GST had improved their tax revenues and efficiency (Palil and Ibrahim, 2011).

Fairer tax system

In addition, by having GST, the tax system will be fairer as everyone who consumes products or services will contribute revenue to the government. This is in contrast to the other forms of taxes like income tax where there may be more avenues for tax planning. Furthermore, with SST, the tax is collected at a single point, the seller. Thus, if the sellers evade the tax revenue, the government loses its revenue. GST in contrast, will be taxed throughout the production-distribution chain, from manufacturer to wholesaler, from wholesaler to retailers and from retailers to the end consumers.

Improved tax compliance and easy administration

GST will also improve tax

compliance for the government. According to the Ministry of Finance, GST is easier to administer due to its self-policing feature. This is because businesses will collect taxes when sales are made and at the same time they will make claim from the government on purchases made.

GST shall be levied on the supply of goods and services at each stage of the supply chain from the supplier up to

the retail stage of the distribution. Even though GST is imposed at each level of the supply chain, the tax element does not become part of the cost of the product. This is because GST that is paid on the business inputs is claimable. Hence, it does not matter how many stages a particular good or service goes through the supply chain. The input tax incurred at the previous stage is always deducted by the businesses at the next step in the supply chain.

Overall, the above eases the administrative procedures for the government and businesses, thus enhancing the government's delivery system.

OTHER BENEFITS

Improved standard of living

The revenue from GST could be used for development purposes for social infrastructure like health facilities and institutions, educational infrastructures and public facilities to further improve the standard of living.

Lower cost of doing business

As explained earlier, with GST, businesses can benefit from recovering input tax, thus reducing cost of doing business.

Nation-building

GST is a better and more efficient method of revenue collection for the government. More funds can be channelled into nation-building projects for progress towards achieving a high income nation.

Increased Global Competitiveness

No GST shall be imposed on exported goods and services, thus the prices of Malaysian exports will become more competitive on the global stage. Also, GST incurred on inputs can be recovered along the supply chain. This will strengthen Malaysia's export industry.

Reduce red tape

Under the present SST, businesses must apply for approval to get tax-free materials and also for special exemption for capital goods. Under GST, this system will be abolished as businesses can offset the GST on inputs in their returns.

Fair pricing to consumers

Given the earlier argument that GST represents a fairer tax system where GST eliminates double taxation under SST, consumers can also expect to pay fairer prices for most goods and services compared to SST.

Greater transparency

Consumers would also benefit under GST as they will know exactly whether the goods they consume are subject to tax and the amount they would have to pay.

STEPS TO TAKE TO PREPARE FOR GST

The implementation of GST is expected to result in a major overhaul in the way businesses operate and function. Accordingly, it is important for entities to start preparing for GST now. Many businesses should not fall into the trap of assuming that the transition is easy and hence, do very little or worse, nothing at all at this present point in time.

The following steps are recommended:

- Start with 'what if' questions. This allows for businesses to start thinking of and identifying the various outcomes and solutions.
- Businesses should attempt to categorise their business transactions. This allows businesses to identify what goods and/or services will be liable to GST or otherwise.
- Accountants can analyse critical transaction issues to identify areas to be looked at, such as GST system codes and timing when GST needs to be collected, tabulated and paid.
- Discuss payment terms and timing with customers
- Consider impact on pricing policies of the goods or services of the businesses, price structure and price labelling.
- The earlier mentioned steps allow businesses to define a proper

strategy to plan and tackle the GST issue properly and adequately.
- Businesses should also devise an implementation plan and plot the timeline (Gantt Chart).
- When going through the above-mentioned steps, top management should involve people from various departments so that all relevant 'stakeholders' understand the effects of GST and their respective roles in ensuring its compliance.
- Businesses that have relations with foreign businesses, especially multinational firms can leverage on the experience of their group firms in other countries that have already implemented GST, to learn from them.

A suggested checklist that businesses may use is:
- Has a GST project team been set up?
- Has the value chain of the business been studied? How will GST impact the value chain?
- Has the business prepared and allocated a budget that covers the implementation costs of GST?
- Have the existing agreements been reviewed to identify whether the clauses contained in the agreements concerned require modification / amendments? Renegotiated and changed?
- Have the potential tax implications arising from GST on the existing tax incentives enjoyed by the businesses been analysed?
- What are the areas of businesses that require the entity to appeal to the government in respect of GST?
- What are the training needs in respect of GST that employees require?
- What shall be the documentation requirements of the businesses? Are revisions necessary?
- Has the extent of the use of information technology been considered and planned for? Issues that may arise?

CONCLUSION

GST is not a new system and it will replace the sales and services tax. Experience from other countries has shown that GST is a good system; in particular it will result in a better taxation system in Malaysia. As explained earlier, GST indeed will bring many benefits to Malaysia, especially where it will facilitate the government by creating 'fiscal space' for the government. In turn, many of the government's ambitious plans under the Economic Transformation Programme may then be implemented monetarily.

However, to make GST a successful system, the government must ensure that GST is well accepted by the consumers and the business world. Towards this end, more promotional efforts should be undertaken by the government to explain GST and its workings, its scope and coverage, the importance for businesses to have the necessary systems in place and the risks (plus penalties) of properly preparing for and complying with the requirements of GST. Finally, businesses should start preparing early as those that prepare early tend to come off best.

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FATCA AND ITS IMPLICATIONS ON MALAYSIAN FINANCIAL INSTITUTIONS

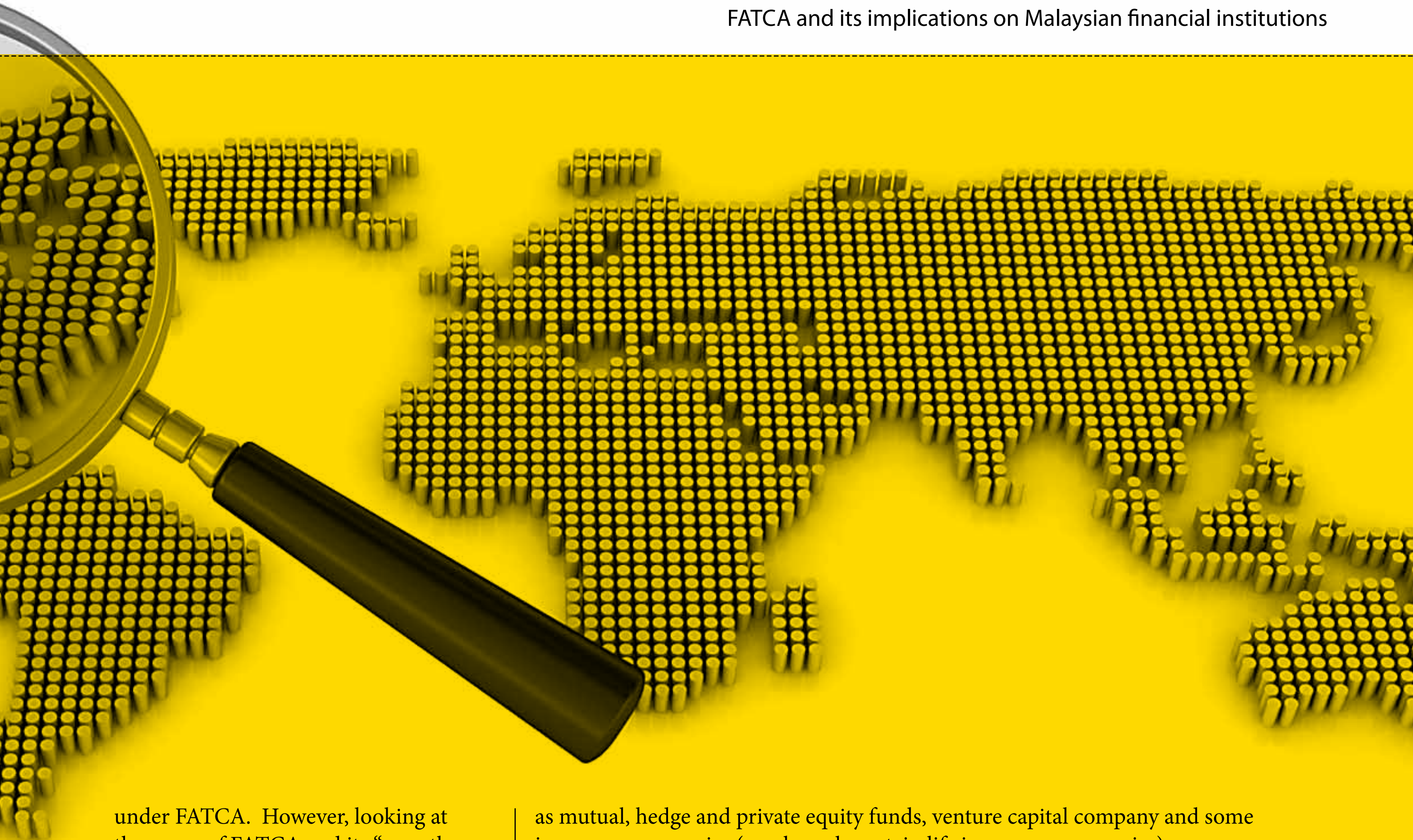
By Azura Othman

For countries that taxed its citizens on a world scope basis, the tracking of the tax revenue due to the country arising from its citizens working abroad is a challenge in this era of globalisation. The United States of America (US) is an example of such a country which taxes US persons (citizens, green cardholders, permanent and temporary residents, etc.) on income earned worldwide. As increasing numbers of US citizens living and working abroad may potentially escape their US tax, the government of the United States has stepped up its pace to track the outflow of funds that represent loss in tax revenue.

Realising this fact, the Foreign Account Tax Compliance Act (FATCA) was introduced on 12 March 2010 by the government of the United States (US) to counter tax evasion by US persons, who use foreign financial institutions and corporations to hide their identities and avoid US tax on investment income. FATCA is a law that requires all financial institutions wherever based, to operate a system that produces information that enables the US to impose its tax laws on US persons who use these foreign vehicles and accounts to hide their income offshore. This will mean that the financial institutions would have to comply with the US tax information reporting requirements, otherwise, they will suffer a 30% US withholding tax on their US income (and possibly some non-US income). The information reporting requirements are burdensome and will require extensive systems, process and controls modifications.

SCOPE OF FATCA

One might think that being remote from the US or dealings with any US persons and investments would rule out the possibility of being caught



under FATCA. However, looking at the scope of FATCA and its "pass-thru payment" rules (explained below), one has to think again. FATCA applies to Foreign Financial Institutions (FFI) and certain non-financial foreign entities (NFFEs). Definition of a FFI is quite extensive. It includes any foreign entity that:

- Accepts deposits in the ordinary course of a banking or similar business;
- Engaged in the business of holding financial assets for the account of others; or
- Engaged primarily in the business of investing or trading in securities, commodities or any interest (including a futures or forward contracts or options) in such securities or commodities.

Therefore, FFIs are any non-US bank, securities broker/dealer, asset management company, funds such as mutual, hedge and private equity funds, venture capital company and some insurance companies (maybe only certain life insurance companies).

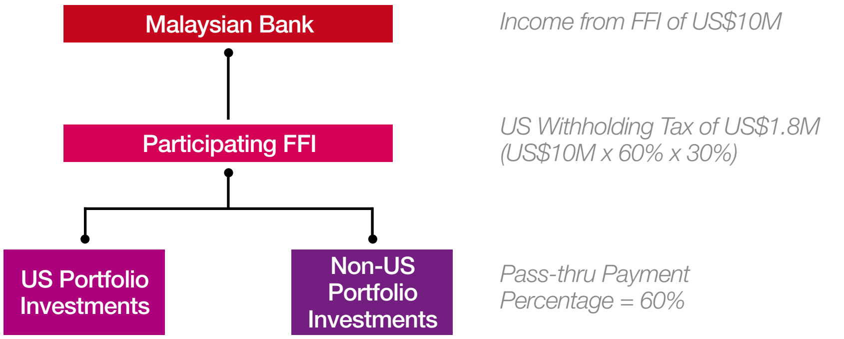
A Malaysian financial institution does not necessarily need to have a direct or indirect US investment, or act on behalf of a US person, to be caught under FATCA. A transaction with a local or foreign financial institution, which is registered under FATCA, is all it takes to fall within the reporting requirements. For example, a FFI may not have any investments in the US or any US persons as their customers but if the FFI has any transactions - such as money market placements - with another financial institutions or entities which has a FFI Agreement[1], it will be affected by FATCA. Based on the scope, it is likely that more Malaysian financial institutions will be impacted by FATCA than expected.

WHAT ARE THE FATCA WITHHOLDING AND REPORTING RULES?

Once caught under the scope of FATCA, these financial institutions will be compelled to enter into an FFI Agreement with the US Treasury Department. Under the agreement, the entities have to observe a number of requirements:

- Obtain detailed information on US account holders.
- Comply with verification and due diligence procedures as specified by the

[1] *FFI Agreement is an agreement entered with the US Treasury Department which commits the FFI to certain documentation, verification, due diligence and reporting obligations.*



US Treasury Department and the IRS's information requests.

- Deduct and withhold 30% US tax on certain" pass-thru" payments.
- File an annual Information Report with the US Treasury Department.

IT'S EITHER THIS, OR BEAR THE 30% WITHHOLDING TAX.

A "pass-thru payment" is any withholdable payments from direct US investment and other payments from an indirect US investment through a Participating FFI (PFFI)[2]. The "pass-thru" payment rule is an anti-abuse rule designed to prevent PFFIs from being used as a blocker for non-participating FFIs (NPFFI). An illustration of a "pass-thru payment" is shown above:

In the above illustration, the Malaysian bank makes an investment in a PFFI, which in turn invests in various US and non-US portfolio investments that generate US and non-US source investment income respectively, and eventually proceeds from the exit. The PFFI must compute its Pass-Thru Payment Percentage (PPP) which is defined as:

PPP = Total US Assets / Total Worldwide Assets

If the Malaysian bank does not enter into an FFI Agreement, 30% tax would be withheld on payments from PFFI to the Malaysian bank "related" to US investments of the PFFI determined as a function of US over total assets ratio of the PFFI. This applies regardless of whether the PFFI is in Malaysia or other counties.

The 30% US withholding tax will apply to:

- gross proceeds from the sale of US stocks and securities;
- US source dividends and interest;
- payments under certain swaps, hedges and derivatives; and
- certain other "withholdable payments".[3]

The withholding tax is levied when those payments above are made to:

- Any offshore bank, fund or other type of FFI (unless the FFI has already entered into an FFI Agreement with the US Treasury Department).
- NFFE unless the NFFE identifies each "substantial" US owner that owns a direct or indirect interest in it, or certifies that it does not have any substantial US owners.

The bad news is, for non-compliance with FATCA, it is the financial institution that will suffer withholding tax on its income from US sources, and not its US customers. In countries which do not have a double tax treaty with the US like Malaysia, this tax will be final and reductions or exemptions will not be given.

With the introduction of FATCA, many financial institutions in Malaysia will be left with little choice but to comply unless they fall under the category of exempted or deemed compliant entity under FATCA. Exemptions are given to entities such as foreign government, political subdivisions and wholly owned foreign government agencies, foreign central bank such as Bank Negara Malaysia, US Branches of a FFI and FFI which hold US account holders of US$50,000 (average monthly balances on aggregate basis) or less.

Deemed-compliant status for certain "local banks" only applies if various strict conditions (which are difficult to satisfy) are met.

[2] *PFFI is any FFI which has entered into a written agreement with the IRS to report and withhold under FATCA. A PFFI will not suffer withholding tax on its US source income.*

[3] *Withholdable payment means any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments and other fixed or determinable annual payments from sources within the US, and any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the US.*

ISSUES TO CONSIDER

The extent of the breadth and scope of FATCA would mean that Malaysian financial institutions have little choice but to face the impending law. As such, they have to consider and evaluate the issues that arise out of FATCA compliance.

US TAX LIABILITY AND WITHHOLDING RESPONSIBILITY

FATCA will increase the number of entities that may have direct liability for US tax (either through own holding or those of others, and with either direct or indirect interests in US investments) and expand the types of direct or indirect payments, which could be subject to US withholding tax (e.g. gross proceeds, certain swap payments, "pass-thru payments", etc.). Financial institutions may also find themselves holding the role of withholding agent in addition to the reporting responsibilities which could pose them with financial exposures.

INCREASE IN BUSINESS RISKS

Financial institutions would now have to consider the status of the counterparties they are dealing with in respect of funds given or transferred to ensure reporting requirements and FATCA compliance are met and the risks involved from certain types of investments (e.g. investment targets that are potential FFIs under FATCA) are considered properly.

COST OF COMPLIANCE

FATCA will present substantial business and operational challenges, from identification and documentation of investors representing US persons to the financial institution's portfolio and IT system. The costs involved in reviewing all pre-existing individual accounts could well exceed the business from US persons which is an excessive financial burden considering a customer base that is predominantly made up of non-US persons and those with no US connections. In addition, these changes may spill over and affect multiple other functions including tax, legal, back-office administration, operations and IT. It forces affected financial institutions to modify internal systems, control frameworks, processes and procedures to meet FATCA compliance requirements - all of which cost significant time and money.

LOCAL PRIVACY OR BANK SECRECY LAWS

The new reporting requirements may conflict with existing legislation. Local privacy laws (or other such laws) in Malaysia prohibit Malaysian financial institutions from disclosing information to a third party such as the US Treasury unless they seek a waiver from the account holder. Financial institutions have no legal right to demand or coerce a customer to authorise sharing of their account information to a third party. If the account holder refuses to provide the waiver, the financial institution may have to close the account. The challenge would be whether Malaysian financial institutions can comply with FATCA without infringing any local law. Will an institution be considered non-compliant if it is unable to disclose customer information in a jurisdiction where the laws prohibit such disclosure? Alternatively, will it have to decline certain customers or avoid some transactions in order to comply with FATCA? This could have significant implication to the financial institution's business.

PREPARING FOR FATCA

So how should affected Malaysian financial institutions prepare themselves for this change? For a start, they can take these steps:

- Search for specific investor attributes within their information repositories and assign tentative FATCA relevant classifications.
- Contact existing clients to request additional information, a process which will require careful coordination and tracking.
- Identify and prepare additional systems capabilities and infrastructure to track transactions which produce withholdable or "pass-thru payments".
- Begin upfront information gathering and tracking of various data elements to address the new reporting requirements.
- Amend any necessary internal business rules, which may affect customers.
- Consider creating new or modified roles and responsibilities within the organisation to deal with changes to policies, procedures and governance structures.
- Prepare preliminary estimate of costs of compliance versus withholding costs.

Once all the information is available, the decision would be whether to sign or not to sign the FFI Agreement. Decision factors that need to be taken into account are compliance costs and the amount of US source income potentially subject to withholding tax. If the financial institution decides to comply, it will have to make significant systems and controls modifications to capture necessary information and to have the ability to verify information. The systems and controls need to be in place and operating well before the various effective dates.

If however the financial institution decides not to comply, then it needs to evaluate the potential withholding tax cost and may want to limit future US investments as well as plan ahead for its own cash management function.

Due to the complexity of the reporting requirements of FATCA and the noises made by many FFIs on its implementation, the original effective date for all aspects of FATCA which was originally slated for January 1, 2013 has now been delayed to a new timeline. Below are effective dates and timelines to watch out for:

- 1 January 2014 – Withholding on interest, dividends and other income paid to NPFFIs
- 1 January 2015 – Withholding on Gross Proceeds and pass-thru payments
- 30 June 2013 – FFI Agreement must be filed to avoid withholding on 1 January 2014

CONCLUSION

It is clear that the effects of FATCA implementation will be far reaching. FATCA is not only a tax issue but it is an operational and compliance issue caused by the US Tax Laws which will impact multiple business and operational areas. Concerns regarding FATCA have to be ironed out such as the local privacy laws currently in place which may hinder proper compliance with FATCA. Discussions need to be done not only at the financial services industry level but also engagement at the regulatory level on how to overcome the conflicting laws. The other major concern is the significant costs involved in complying with something which comes about through no fault of the local financial institutions. As the chances of dismissing FATCA altogether are rather slim, Malaysian financial institutions should start assessing the impact of FATCA on their organisations from now as by 30 June 2013 they have to decide whether to sign on the dotted line.

Azura Othman is an Executive Director at PwC Taxation Services Sdn.Bhd.

MERGERS & ACQUISITIONS – MALAYSIAN TAX ISSUES

By **Tai Lai Kok**

Companies seeking growth by acquisition in the wake of the financial crisis and amidst gradual improvements in investor confidence coupled with encouraging signs of economic recovery, have set the scene for Mergers & Acquisitions (M&A) opportunities in Malaysia. While M&A deals are driven by commercial considerations, tax planning can play a vital role in determining the success (or failure) of a deal from both the purchaser's and vendor's perspective. It is thus imperative that tax issues are scrutinised from the outset alongside financial, regulatory and operational considerations. Indeed, the essential ingredients of a successful M&A transaction such as pricing the deal appropriately, avoiding unforeseen costs and maximising the upside potential for the transaction parties, may all involve aspects of tax.

CHOICE BETWEEN AN ASSET DEAL AND A SHARE DEAL

As there is generally no legal concept of a merger in Malaysia, M&A transactions are typically implemented by acquiring the target company's assets or shares. The competing objectives of the purchaser and vendor are factors which may influence the decision as to whether the transaction will be an asset or share deal.

Generally, asset deals would be attractive for purchasers wishing to distance themselves from undisclosed liabilities of the target company, or where only certain parts of the business are to be acquired. In an asset deal, the purchaser may be able to recover a significant portion of its acquisition costs by claiming capital allowances on the stepped-up tax base of qualifying assets as well as deductions for trading stock acquired.

The above advantages for the purchaser may, however, be overshadowed by the drawbacks of an asset deal, including higher stamp duties and the inability to access unutilised losses and capital allowances of the target company. There may be the additional administrative burden, costs and uncertainty arising from the need to reapply for tax incentives and indirect tax licences for the target company.

In an asset deal, a vendor's principal tax concerns include its potential exposure to real property gains tax (RPGT) on the disposal of real property assets, balancing charges on the disposal of qualifying assets and income tax on gains on the sale of inventory. From the vendor's perspective, as gains on the disposal of shares held as long-term investments generally fall outside the scope of income tax (although they may be subject to RPGT), a share deal may be preferred. In addition, a share deal may offer relative simplicity and freedom from having to unwind, liquidate or maintain the retained portion of a post asset deal structure.

INCOME TAX ISSUES

In the absence of specific legislation governing the tax treatment of M&A transactions, the general tax principles laid down in the Malaysian Income Tax Act, 1967 (ITA) are applicable.

> ALTHOUGH THE ACQUISITION COSTS AND ACCOUNTING DEPRECIATION ATTRIBUTABLE TO FIXED ASSETS ARE NON-DEDUCTIBLE, **A PURCHASER WOULD BE ABLE TO CLAIM INITIAL AND ANNUAL CAPITAL ALLOWANCES** BASED ON THE ACQUISITION COST OF QUALIFYING ASSETS (E.G. PLANT AND MACHINERY, OFFICE EQUIPMENT AND INDUSTRIAL BUILDINGS, AMONGST OTHERS) AT PRESCRIBED RATES.

Tax Treatment of the Sales / Purchase Consideration

ASSET DEAL

For tax purposes, an asset deal necessitates the allocation of the total sales consideration amongst the assets transferred. The residual amount not attributable to tangible assets and intellectual property will normally represent the goodwill of the acquired business and will not be deductible by the purchaser for tax purposes. It may therefore be advisable for the sales and purchase agreement to specify the agreed allocation for the individual assets acquired.

The specific income tax treatment of assets commonly transferred in an asset deal is as follows:

Fixed Assets

Although the acquisition costs and accounting depreciation attributable to fixed assets are non-deductible, a purchaser would be able to claim initial and annual capital allowances based on the acquisition cost of qualifying assets (e.g. plant and machinery, office equipment and industrial buildings, amongst others) at prescribed rates. The capital allowances claimed may be deducted from the adjusted income of the purchaser from that particular business source. Over time, the purchaser would have effectively obtained a full deduction for the acquisition cost of a qualifying asset when its tax written down value (TWDV) (i.e. cost less capital allowances claimed) is reduced to nil.

A vendor may wish to note that where the sales consideration received exceeds the TWDV of a qualifying asset, a taxable "balancing charge" (limited to capital allowances previously claimed on that particular asset) will be triggered. However, this taxable amount may be offset by any unutilised tax losses or unabsorbed capital allowances which the vendor may have. Conversely, where the TWDV of the qualifying asset sold exceeds the sales consideration received for the same, a deductible "balancing allowance" will arise.

The vendor may also be subject to the clawback provision if qualifying assets are disposed of within two years from their date of acquisition. However, this is generally limited to disposals of luxury goods (e.g. cars). In such a situation, all the capital allowances previously claimed on such assets will be withdrawn.

However, in a "controlled transfer" situation where one party to the transaction controls the other, or both parties are controlled by a third party, assets are deemed to be transferred at their TWDVs regardless of the actual sales consideration. As a result, no balancing charges or allowances will arise for the vendor and the annual capital allowances available to the purchaser will be based on the qualifying assets' original costs to the vendor, but restricted to their TWDVs broadly at the time of the transfer.

Trading Stock

With regards to the valuation of trading stock, Section 35(5) of the ITA provides that where the vendor's business permanently ceases, the actual sales consideration apportioned to the trading stock will be taken as the value of closing stock at the time of cessation. This is provided that the stock acquired will be used in the purchaser's business and its cost is deductible in computing the purchaser's adjusted income. The purchaser is also required to bring in the trading stock into its business at this same value.

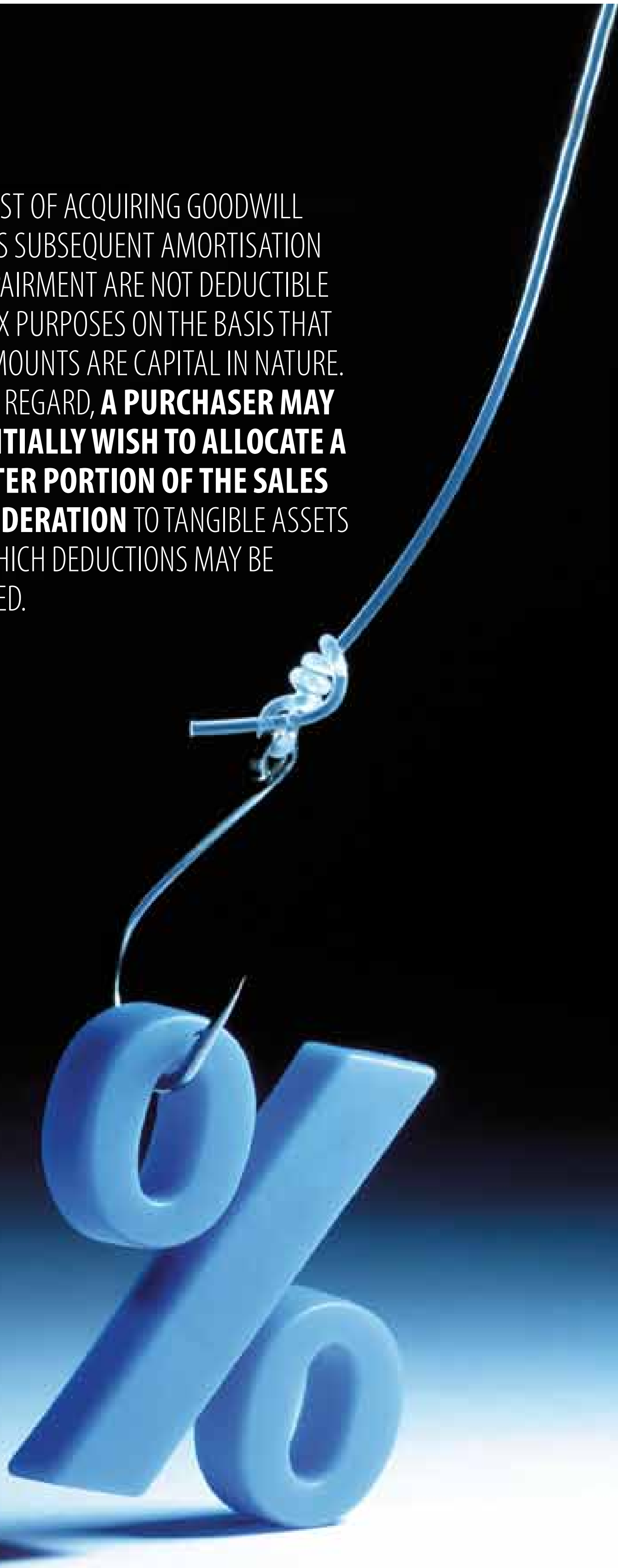
Trade Receivables

Tax deductions are not available on the acquisition of trade receivables, on the basis that these would be viewed as capital assets in the purchaser's accounts. Consequently, any post-acquisition provisions or write-downs of the acquired debts are not tax deductible as the corresponding sales income giving rise to the debts would not have been brought to tax in the purchasing entity. Similarly, any subsequent recoveries would not be taxable.

Goodwill

The cost of acquiring goodwill and its subsequent amortisation or impairment are not deductible for tax purposes on the basis that the amounts are capital in nature. In this regard, a purchaser may essentially wish to allocate a greater portion of the sales consideration to tangible assets for which deductions may be claimed. In contrast, a vendor may prefer a greater allocation of the sales consideration to goodwill, which is not subject to income tax.

THE COST OF ACQUIRING GOODWILL AND ITS SUBSEQUENT AMORTISATION OR IMPAIRMENT ARE NOT DEDUCTIBLE FOR TAX PURPOSES ON THE BASIS THAT THE AMOUNTS ARE CAPITAL IN NATURE. IN THIS REGARD, **A PURCHASER MAY ESSENTIALLY WISH TO ALLOCATE A GREATER PORTION OF THE SALES CONSIDERATION** TO TANGIBLE ASSETS FOR WHICH DEDUCTIONS MAY BE CLAIMED.



SHARE DEAL

No deductions are available to the purchaser for the cost of acquiring shares as a long-term investment as this would normally be capital in nature. There is no opportunity to "allocate" the consideration given for the shares amongst the assets and liabilities of the acquired company and hence the tax base of the underlying assets remains unchanged.

From the vendor's perspective, disposal of shares which have been held as long-term investments are viewed as capital transactions and are thus not subject to income tax (although they may be subject to RPGT) unless the vendor has a history of trading in shares or the shares in question were acquired with the intention to be disposed of at a profit.

Professional Fees and Implementation Costs

Regardless of whether the transaction is an asset or share deal, transaction costs such as advisory and legal fees, due diligence expenses, costs incurred to execute new contracts, stamp duty and incidental costs of raising loans to finance the acquisition (e.g. rating fees, guarantee fees) are generally non-deductible as they are not incurred in the production of gross income. There are limited tax breaks in relation to certain types of Islamic financing.

Financing Considerations

Where a specific loan is taken out for the purposes of acquiring assets used in the purchaser's business, the interest expense incurred will generally be tax deductible where it is wholly and exclusively incurred in the production of gross income. However, where the loan is for the purpose of acquiring shares, the interest expenditure is tax deductible against taxable dividend income, which, with the move to the single tier system, is being phased out.

The primary considerations with regard to financing the transaction and limitations to the tax deductibility of interest relate to the following:

Interest Restriction

Section 33(2) of the ITA restricts the deductibility of interest incurred in cases where the taxpayer has borrowed money to finance its business as well as to finance, directly or indirectly, investment activities. The portion of interest attributable to business activities is deductible against business source income while the portion of interest attributable to investment activities is only deductible against investment source income. If there is nil or insufficient taxable investment income to be set off against such attributed interest, the excess interest will be permanently lost.

Thin Capitalisation

Section 140A(4) of the ITA provides that where the value of all financial assistance to an associated person (resident or non-resident) is excessive in comparison to the fixed capital of the recipient, the interest payable on the excessive portion of financial assistance shall not be deductible. Although effective from 1 January 2009, the Ministry of Finance has deferred the implementation of the thin capitalisation rules to the end of December 2012.

Withholding Tax on Interest

Where a Malaysian resident purchaser takes out a loan from a non-resident lender to finance the acquisition, interest paid or credited to the non-resident is generally subject to Malaysian withholding tax at 15% of the gross amount unless a lower rate applies under the relevant Double Tax Agreement concluded between Malaysia and the recipient's country of residence. Further opportunities to overcome interest withholding tax may be offered by Labuan structures, approved non-convertible Islamic bonds issued in Ringgit Malaysia, or securities issued by the government of Malaysia, amongst others.

Tax Losses and Capital Allowances

Under an asset deal, a purchaser would be unable to benefit from any unabsorbed tax losses and capital allowances in the target company as these tax benefits remain with the target company. Such benefits, if any, would be preserved in a share deal provided that the change in the majority shareholding of a company does not occur in a dormant target company.

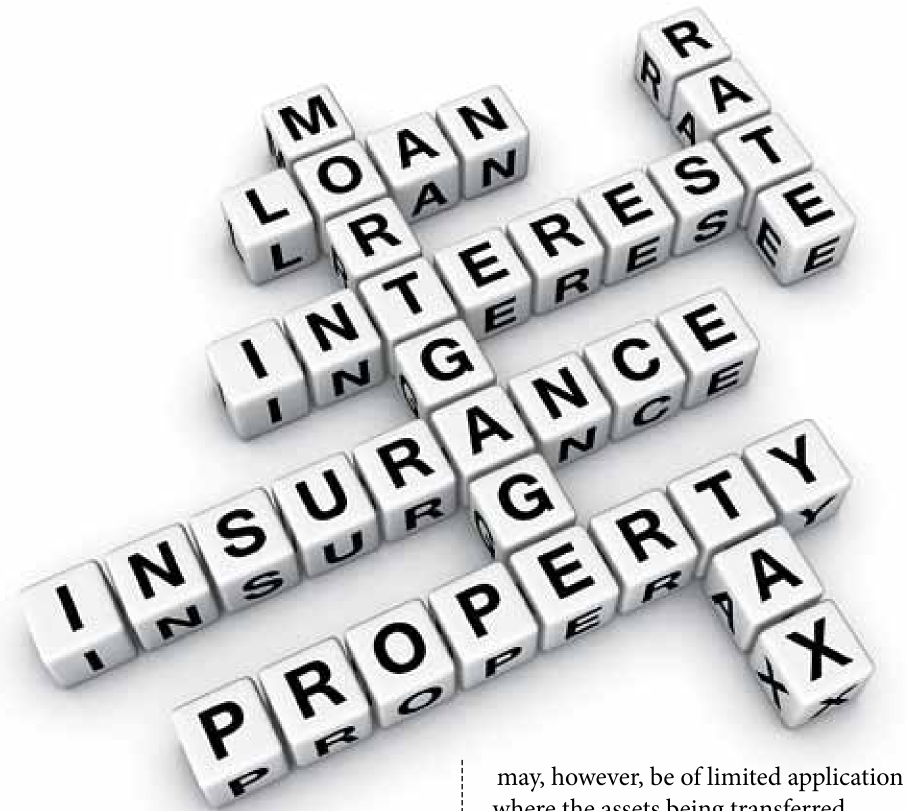
Tax Incentives

Existing tax incentives (e.g. pioneer status, investment tax allowance) enjoyed by the target company are not transferred with the business to the purchaser pursuant to an asset deal. The purchaser would thus be required to submit new applications to the relevant approving authorities.

Under a share deal, tax incentives may remain undisturbed by a change in ownership. It is advisable, however, that the terms and conditions attached to any incentives awarded be reviewed to confirm their availability post the change in ownership.

It should be noted that where the target company is currently claiming Reinvestment Allowance (RA) on fixed assets (e.g. factories, plant and machinery) used in qualifying manufacturing or agricultural activities, the RA previously claimed will be clawed-back if the assets are disposed of within 5 years. It may however be considered whether the purchaser could claim RA in respect of the assets acquired (subject to conditions), although this would not be possible in a controlled transfer situation.

Similarly, where the target company is enjoying and claiming investment tax allowance on qualifying assets (e.g. factory, plant, machinery or building) used in qualifying activities, the investment tax allowance claimed previously in respect of the assets acquired would be withdrawn if the assets are disposed of at any time within a period of 2 years from the date of acquisition.



STAMP DUTY

In the absence of applicable reliefs (as discussed below), stamp duty may represent a significant cost to be borne by the purchaser (unless negotiated otherwise).

Asset Deal

Pursuant to Item 32(a) of the First Schedule of the Stamp Act 1949 (SA), an instrument for the conveyance, assignment or transfer on sale of any property (with certain exceptions) will be subject to *ad valorem* stamp duty at rates of up to 3% (calculated by reference to the higher of the sales consideration or market value of the assets transferred).

Depending on how the contract is drafted and the type of assets to be acquired, the stamp duty exposure may be reduced by transferring certain movable assets (e.g. machinery) by way of delivery without the need for an instrument of transfer. This method may, however, be of limited application where the assets being transferred comprise primarily land and buildings.

Share Deal

In general, a share deal is associated with lower stamp duties as the rate levied on instruments transferring shares in an unlisted Malaysian company is 0.3% (based on the higher of the sales consideration or the market value of shares as determined by the Stamp Office).

Further, contract notes relating to the sale of shares that are listed on Bursa Malaysia are subject to a maximum stamp duty of RM200 per contract.

Stamp Duty Reliefs

In managing the stamp duty exposure arising from M&A transactions, the stamp duty reliefs accorded under Sections 15 and 15A of the SA should be considered. Broadly, relief from stamp duty may be applied for in the following circumstances:

- Transfers in connection with reconstruction or amalgamation schemes where, amongst other things, at least 90% of the consideration for the acquisition comprises of shares in the purchaser company; or
- Transfers of interests in property (including shares) between associated companies, where one company owns at least 90% of the share capital of the other or a third company owns at least 90% of the share capital of both companies. This 90% requirement may be fulfilled by either direct or indirect ownership. The transfer must not be executed in pursuance or in connection with an arrangement whereby the companies will cease to be associated.

The applicability of the above reliefs may be limited by the various conditions and anti-avoidance provisions laid down in Sections 15 and 15A.

RPGT

With the reinstatement of RPGT by the government with effect from 1 January 2010, due consideration should be given to the implications arising from disposals or transfers of real property. RPGT applies to gains on disposals in respect of real property (i.e. land and buildings) in Malaysia and shares in a Real Property Company (RPC). Generally, an RPC is a company that has 75% or more of its total tangible assets comprising of real property in Malaysia or shares in other RPCs.

RPGT is currently at an effective rate of 5% on gains from the disposal of real property or RPC shares held for 5 years or less. With effect from 1 January 2012, chargeable gains arising on assets disposed of within 2 years of acquisition will be subject to RPGT at the rate of 10%, whilst disposals within 2 – 5 years will be subject to RPGT at the rate of 5%. Disposals after 5 years of acquisition are exempt from RPGT.

Where RPGT is applicable, the purchaser is required to withhold the lower of 2% of the total sales consideration or the whole consideration which consists of money and remit this amount to the Malaysian Inland Revenue Board within 60 days from the date of the disposal or transfer. There may be certain situations where the aforementioned withholding will not be required.

A vendor may apply for an exemption from RPGT in certain situations pursuant to a transfer of assets between Malaysian companies within the same group to bring about greater efficiency in operations or as part of a reorganisation, reconstruction or amalgamation scheme. For the RPGT exemption to apply, certain conditions must be fulfilled and prior approval from the Director General must be obtained.

INDIRECT TAXES

At present, the indirect tax regime in Malaysia encompasses consumption taxes (sales tax and service tax) and various customs duties. Based on the current legislation, asset deals may involve the following indirect tax issues:

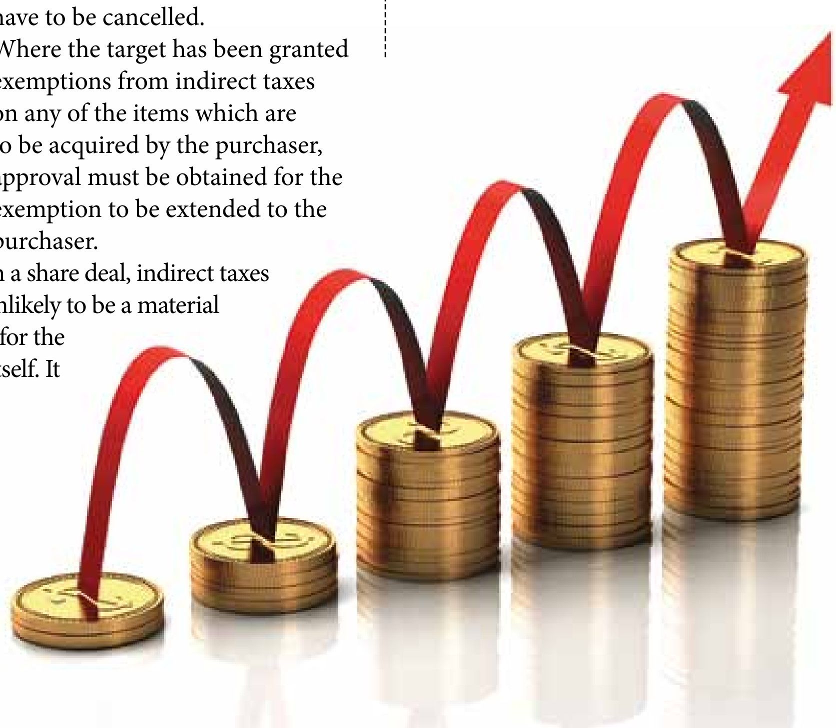
- The purchaser may have to apply for new indirect tax licences and the target's existing licences would have to be cancelled.
- Where the target has been granted exemptions from indirect taxes on any of the items which are to be acquired by the purchaser, approval must be obtained for the exemption to be extended to the purchaser.

In a share deal, indirect taxes are unlikely to be a material issue for the sale itself. It would also be appropriate to consider whether any post-deal intra-group services between the purchaser and target company are subject to service tax.

CONCLUSION

The complexity and intertwinement of the various tax issues impacting M&A deals provide opportunities and challenges for vendors and purchasers seeking to derive greater value from their investments. By identifying the parties' material tax exposures from the outset and structuring the deal appropriately, unnecessary costs and risks can be significantly reduced. The availability of tax reliefs and applicable exemptions should also be considered and these may ultimately influence the choice of acquisition mode.

Tai Lai Kok is an Executive Director, KPMG Tax Services Sdn Bhd. This article outlines a number of the material tax issues for corporate entities contemplating merger & acquisition (M&A) transactions in Malaysia. Comments and opinions in this article are personal viewpoints of the author and are not reflective of KPMG Tax Services Sdn Bhd's perspective on the subject matter.



The technical updates published here are summarised from selected government gazette notifications published between 1 August 2011 and 31 October 2011 including Public Rulings and guidelines issued by the Inland Revenue Board (IRB), The Royal Customs Department and other regulatory authorities for the same period.

INCOME TAX

Public Ruling No.7/2011– Notification of change in the accounting period of a company/trust body/co-operative society

The Public Ruling (PR) was issued on 23 August 2011 to explain the procedures for informing the Inland Revenue Board of Malaysia (IRB) of a change in the accounting period of a company, trust body or co-operative society (collectively referred to as 'applicable taxpayers'). The PR covers the provisions in Section 107C of the Income Tax Act 1967 (ITA 1967).

Section 107C requires the 'applicable taxpayers' to pay their taxes in monthly instalments during the basis period for a year of assessment, based on the estimated tax payable for that year of assessment (YA). The procedures to be undertaken by the 'applicable taxpayers' whenever there is a change in their accounting period are explained and illustrated with examples in the PR.

Notification of new penalty rates for late filing of tax returns

Pursuant to Section 112(1), failure to furnish a tax return by the due date is an offence and a person shall on conviction be liable to either a fine of not less than RM200 and not more than RM2,000, or imprisonment of a term not exceeding 6 months, or both. Where no prosecution has been instituted under Section 112(1), pursuant to Section 112(3), the Director General of Inland Revenue may impose a penalty equal to treble the amount of tax payable before any set-off, repayment or relief. As an administration concession, the IRB imposes much lower penalties than those provided under the law.

A new penalty rate schedule that was introduced by the IRB took effect from 1 June 2011. Penalty rates between 20 – 35% of the tax payable will be imposed based on the length of delay as follows:-

Period of delay	Penalty rate
Submission within 12 months after the due date	20%
Submission within 24 months after the due date	25%
Submission within 36 months after the due date	30%
Submission later than 36 months after the due date	35%

In response to the appeal made by the CTIM President on 6 September 2011, the IRB agreed to defer the implementation of the new penalty rate to 30 September 2011. For those taxpayers who have been imposed the new penalty rates prior to 30 September 2011, an appeal can be made to the respective branches, the Information Processing Department or the Tax Operation Department to have their penalties revised to the old penalty rates.

Expenditure for obtaining the Green Building Index Certificate

Income Tax (Exemption) (No.5) Order 2011 (P.U. (A) 325) was gazetted

on 21 September 2011 and takes effect from year of assessment (YA) 2009. The order replaces the Income Tax (Exemption) (No. 8) Order 2009 (P.U. (A) 414/2009).

Under the Order, an amount equal to the qualifying expenditure (QE) incurred by a resident person, including a resident company incorporated under the Companies Act 1965, for the purpose of obtaining a Green Building Index Certificate (GBIC) for a building used for the purpose of a business, is exempt from the payment of income tax on the statutory income of that person.

The Order applies to a person who has obtained his first GBIC issued by the Board of Architects Malaysia between 24 October 2009 and 31 December 2014 in respect of:-

- any building constructed, owned and used by the person for the purpose of his business
- any building constructed under a privatisation project and private financing initiatives approved by the Privatisation/PFI Committee of the Prime Minister's Department
- any building constructed pursuant to an agreement entered into between the person and the government of Malaysia or a statutory authority on a build-lease-transfer basis, build-lease-maintain-transfer or any other similar arrangements and for which no consideration has been paid by the government or statutory authority to that person

Qualifying expenditure means additional expenditure incurred in relation to the construction of a building, alteration, renovation, extension or improvement of an existing building, or plant or machinery for the purpose of obtaining GBIC.

Deduction for expenditure on issuance of Islamic securities

The Income Tax (Deduction for Expenditure on Issuance of Islamic Securities Pursuant to Principles of *Murabahah* and *Bai' Bithaman Ajil*) Rules 2011 (P.U.(A) 355), published in the Federal Government Gazette on 20 October 2011, gives effect to the Budget 2010 announcements to allow Malaysian resident companies an income tax deduction on expenses incurred in the issuance of Islamic securities under the principles of *murabahah* (forward sale) and *bai' bithaman ajil* (deferred payment sale) based on the concept of *tawarruq* (reverse murabahah or monetization).

The issuance of such Islamic securities must be approved by the Securities Commission or the Labuan Financial Services Authority and the effective period for the incentive is from year of assessment (YA) 2011 until YA 2015.

Clubs and associations – Transactions with non-members

Income Tax (Deduction Relating To Transaction With Non-Members for Club, Association or Similar Institution) Rules 2011 (P.U.(A) 360) were published in the Federal Government Gazette on 27 October 2011. Where there are expenses and capital allowances that shall be made to that body of persons in respect of income relating to transactions with both members and non-members, Section 53A(5) provides that the expenses and capital allowances should be apportioned by a method prescribed under the Act. The Rules provide the formula for the apportionment and takes effect from the year of assessment 2009.

CUSTOMS AND EXCISE

Customs (Prohibition of Imports) (Amendment) (No. 2) Order 2011, Customs Act 1967 (P.U. (A) 312/2011)

Effective from 1 September 2011, importation of goods (from all countries) listed below is to be accompanied with an import licence issued by the Ministry of International Trade and Industry:-

1. Used brakes and servo-brakes and parts thereof, used brake pads and brake linings (under HS Heading/Subheading 68.13/8708.30), for motor vehicles of headings 87.01, 87.02, 87.03, 87.04, 87.05, 87.09 and 87.11; and
2. All kinds of used batteries (accumulators) (under HS Heading 85.07) for motor vehicles of headings 87.01, 87.02, 87.03, 87.04, 87.05, 87.09 and 87.11.

Customs (Prohibition of Imports) (Amendment) (No. 3) Order 2011, Customs Act 1967 (P.U. (A) 332/2011)

Effective from 1 November 2011, importation of goods (from all countries) listed below is to be accompanied with a certificate of approval or a letter of exemption issued by or on behalf of the Chief Executive Officer of the Construction Industry Development Board for the construction sector or SIRIM for the non-construction sector:-

1. Aluminium plates, sheets and strip (under HS Heading 76.06) of a thickness exceeding 0.2 mm, whether or not alloyed; and
2. Aluminium foil of a thickness not exceeding 0.2 mm, not backed:
   a. Rolled but not further worked (HS Heading 7607.11 000);
   b. Other (HS Heading 7607.19 000)

*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.*

Deductibility of Entertainment Expenses: Is NV Alliance the last case?

THE LEGISLATION

Section 33(1) of the Income Act 1967 (the Act) lays down the basic yardstick for deductibility of expenses against a taxpayer's adjusted income. The subsection reads:-

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

It is also trite that Section 39(1) of the Act contains a number of overriding exceptions to the general rule laid down by Sections 33(1). The nexus between Section 33 and 39 is best summed up by Lee Hun Hoe CJ in the case of *Director-General of Inland Revenue v Rakyat Berjaya Sdn Bhd* [1984] 1 MLJ 248 when he stated (on page 254):

> *"The relationship between the deduction allowing provisions of Section 33 and the deductions disallowing provisions of Section 39 is explained by Chang Min Tat, J., as he then was, in DGIR v LTS [1974] 1 MLJ 187. To be deductible a payment must (i) be authorised as a deduction by Section 33(1), and (ii) not be disallowed by Section 39."*

The same point is made by the Court of Appeal in *Margaret Luping & Ors v. Ketua Pengarah Hasil Dalam Negeri* [2003] 3 CLJ 409 at page 414.

The particular exception which is relevant to this Article is Section 39(1)(l). This subsection (prior to amendment to the Finance Act 2003 (Act 631)) reads:-

> *"Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment, no deduction from the gross income from that source for that period shall be allowed in respect of-*

(a–k) [not applicable]

(l) any expenses incurred in the provision of entertainment including any sums paid to an employee of that person for the purpose of defraying expenses incurred by that employee in the provision of entertainment:

Provided that ..."

The word "entertainment" used in Section 39 (1)(l) of the Act is defined in Section 18 of the Act to read as follows:-

"entertainment" includes –

a. the provision of food, drink, recreation or hospitality of any kind; or

b. the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in paragraph (a);

by a person or an employee of his in connection with a trade or business carried on by that person."

The statutory interpretation of "entertainment" expenses

The statutory interpretation of what constitute "entertainment" expenses has haunted taxpayers since year of assessment 1989 when Section 39(1)(l) was first introduced by Section 6 of the Finance Act 1988 (Act 364). Although the subsequent amendment to Section 9(a) of the Finance Act 2003 (Act 631) allows for half of the entertainment expenses to be deductible from the year of assessment 2004, but it still boils down to the issue of what constitutes "entertainment" expenses in the first place.

The inconsistent treatments by the Courts on this issue can be demonstrated, *inter alia*, in the following cases:-

- **United Detergent Industries Sdn Bhd v Director General of Inland Revenue** [1999] 1 AMR 462 (High Court);
- **Aspac Lubricants (Malaysia) Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri** [2007] 5 CLJ 353 (Court of Appeal);
- **Ketua Pengarah Hasil Dalam Negeri v Eli Lili (Malaysia) Sdn Bhd**, Appeal No. R1-14-02-2009 (High Court);
- **Ketua Pengarah Hasil Dalam Negeri v NV Alliance Sdn Bhd**, Appeal No. R1-14-04-2009 (High Court);
- **Pensonic Sales & Service Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri**, Appeal No. R1-14-09-2010 (High Court);

The inconsistence does not arise from the words "the provision of food, drink, recreation" but from the meaning of "hospitality of any kind" in Section 18 of the Act.

The recent Court of Appeal's judgement of *NV Alliance Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (W-01-149-2010) delivered on 4 November 2011 has put this issue to rest, hopefully once and for all. Mohd Hishamudin Yunus JCA applied the rule of statutory interpretation of "noscitur a sociis" in interpreting the meaning of "hospitality of any kind" in Section 18 of the Act and held:-

"With respect, on our part, we are unable to agree with the decision and reasoning of the learned High Court Judge. In our judgement, the cash incentive payments are not hospitality expenses, and, hence, are not entertainment expenses. In other words, the cash incentive payments do not come under item (I) of subsection (1) of Section 39 of the Act. It follows then that the appellant is entitled to the deductions claimed in respect of the cash incentive payments. We are in agreement with the submission of the learned counsel for the appellant that this is a case where the "noscitur a sociis" rule of statutory interpretation is applicable. According to this rule of interpretation, where two or more words which are susceptible of analogous meaning are coupled together in a statutory provision, they are understood to be used in their cognate sense. They take as it were, their colour from each other, the meaning of the more general being restricted to a sense analogous to that of the less general (Maxwell on The Interpretation of Statutes, 12th edn. p.

289). It follows then that in the present case the meaning of the more general words 'or hospitality of any kind' must be restricted to a sense analogous to that of the less general words, namely, 'food, drink, recreation'. In other words, in determining as to whether or not the cash incentive expenses come within the meaning of 'or hospitality of any kind', we have to take into account the words preceding that word, that is to say, the words 'food, drink, recreation'. In our view, if the meaning to be given to the words 'or hospitality of any kind' is limited accordingly, then, the cash incentives expenses clearly cannot come within the meaning of these words, ('or hospitality of any kind')."

In the alternative, Mohd Hishamudin Yunus JCA applied "ejusdem generis" rule and held as follows:-

"Alternatively, we would arrive at the same finding if we were to apply the related ejusdem generis rule. According to this related rule of statutory interpretation , the meaning to be given to the general words 'or hospitality of any kind' must be restricted to the same genus as 'food, drink, recreation' (Maxwell on The Interpretation of Statutes, p. 297). In other words, the words 'or hospitality of any kind' must be given a meaning that is ejusdem generis with 'food, drink, recreation'. If the meaning to the expression, 'or hospitality of any kind' is so confined, clearly, it would exclude the payments of cash incentive.

We, accordingly, set aside the Order of the High Court and restored the Deciding Order of the Special Commissioners."

The significance of the Court of Appeal's judgement of NV Alliance in adopting the "noscitur a sociis" and "ejusdem generis" rules is not only confined to the interpretation of this particular provision but the rules can be applied to other provisions of the Act as well. For instance, it is our view that such rules may be applicable to Section 4(f) of the Act where the "gains or profits not falling under any of the foregoing paragraphs" ought to take its meaning from the specific words in Section 4 (a) – (e) to wit gains or profits from a business, an employment, dividends, interest or discounts, rents, royalties or premium, pensions or annuities and it is presumed to be restricted to the same genus as these words.

Penalty imposed under Section 113(2) of the Act and the Defence of good faith

The Court of Appeal's judgement of NV Alliance also shed new light on the defence of good faith under Section 113(2) of the Act. The Court of Appeal restored the deciding orders of the Special Commissioners of Income Tax (SCIT) which held that penalty under Section 113(2) of the Act should not be imposed in instances where the taxpayer had acted in good faith:-

"Regarding the penalty under Section 113(2) of the Act imposed on the appellant in this case, we are of the opinion that the imposition of that penalty is wrong in law as even assuming that the expenses claimed are not allowable. Based on the facts of this case the claim was made base on the appellant's interpretation in good faith. Therefore the penalty shall not be imposed."

This position is consistent with the High Court's decisions in *Ketua Pengarah Hasil Dalam Negeri v Viva Life Science Sdn. Bhd.*, Appeal No. R1-14-06-11 and *Office Park Development Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (2011) MSTC 30-023. In Office Park Development Sdn Bhd, Alizatul J (now JCA) held as follows:-

"As regards item (ii) of the Special Commissioner's decision ie— "whether Inland Revenue was correct in imposing a penalty under Section 113(2) of the Income Tax Act (ITA) on the taxpayer for the year of assessment 1999?"

I agree with the Special Commissioners finding that as the incorrect return or incorrect information was made in good faith, the penalty imposed should accordingly be waived.

It is worth noting that the Canadian Court of Appeal in *Yarrows vs Frowde Ltd* (1934) 3D.L.R. 711 held that "a penalty is a sum of money of which the law exacts payment by way of punishment for doing some act that is prohibited or omitted to do some act that is required to be done. The term involves the idea of punishment, either corporal of pecuniary …" The penalty provision in Sections 113(1) and 113(2) is to punish taxpayers who deliberately submit incorrect tax return and information. It cannot be the intention of Parliament to punish taxpayers who innocently submit incorrect tax returns or those taxpayers who engage professional tax agents to prepare and submit their tax returns.

Further it is not mandatory for the respondent to impose penalty in all tax audits. I agree that the fact that the respondent has a discretion amplifies the appellant's submission that a penalty should not be imposed in this case as the appellant had acted in good faith and made full disclosure of information.

In light of what has been stated above and in view of the clear decision of the Supreme Court in Kim Thye, the respondent's appeal in relation to the penalty i.e. item (ii) is without any legal basis and is therefore dismissed."

a. The onus is on the taxpayers to prove that they have acted in good faith. To do so, they need to show that they have:-
b. made full and frank disclosure in the tax returns submitted to the Director General of Inland Revenue ("DGIR") (see **SETM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri** (2010) MSTC 10-000);
c. engaged or had sought proper and competent advice from professional tax agents and/or tax lawyers to prepare and submit the tax returns (see **SETM Sdn Bhd and Office Park Development Sdn Bhd**); and
d. complied with the duty to keep all the relevant documents, invoices and receipts in relation to the tax return, and to produce the same for inspection, if necessary (see, for example, Section 82 & 82A of the Act).

If there is a dispute with the IRB on the issue of penalty, the DGIR is unlikely to entertain the taxpayers' plea of defence of good faith in raising additional assessments. As such, the only way available for the taxpayers is to file a formal appeal to the SCIT pursuant to Section 99 of the Act and to adduce the requisite evidence supporting good faith before the SCIT. To illustrate this point, we wish to refer to the SCIT case of *BN v Ketua Pengarah Hasil Dalam Negeri* (2009) MSTC 3828. This case clearly illustrates when the unreasonable exercise of power by the DGIR can and should be corrected. In this case, the SCIT held at page 3832:-

"Since RW1 (assessor) admitted that he just followed the guideline of the Director General of Inland Revenue on penalty, it means RW1 did not apply his mind to the facts and circumstances of the case before imposing the 60% penalty. Therefore we are of the opinion that the respondent failed to use their discretion properly when they imposed the penalty concerned."

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International**News**

This column only covers selected developments from countries identified by CTIM and relates to the period 15 July 2011 to 31 October 2011.

CHINA (PEOPLE'S REP.)

Enterprise income tax – several issues clarified

The State Administration of Taxation (SAT) issued Gong Gao [2011] No.34 on 9 June 2011 clarifying several issues on enterprise income tax. The Announcement applies from 1 July 2011 and is summarised below:

Deductibility of interest on loan to a non-financial enterprise

The interest charged by a non-financial enterprise on loans granted to another non-financial enterprise is deductible if it does not exceed the interest rate charged by an official financial institution on the same or similar loan and under the same or similar conditions. To be eligible for the deduction, the enterprise is required to present a statement proving that the interest rate charged is equal to or less than that of a local official financial institution (which could be a bank, asset management company or a trust company).

Deductibility of employee's uniform

Expenses for employee's uniforms are deductible provided that the uniforms are made by the enterprise collectively and the employees are required to wear the uniforms during the working hours.

Deductibility of training expenses in the aviation industry

Expenses incurred in connection with the training in the airplane are deductible.

Depreciation of the re-constructed and expanded houses and buildings

The balance of historical cost and depreciation of a house or building, which is not fully written-off, has to be added to the tax base for depreciation if the house or building is demolished and reconstructed. In the case of expansion or improvement, the expenses incurred have to be added to the tax base of the fixed asset. If the remaining useful life of the asset after expansion or improvement is less than the minimum useful life prescribed by law, the depreciation may be based on the remaining useful life of the asset.

Withdrawal or reduction of investment

If an investor withdraws or reduces its investments in an enterprise, only the part of the original contributed capital is considered to be repayment of the capital. A distribution from the retained earnings or cumulated profit reserve must be treated as dividend. Other funds received must be treated as gain on transfer of invested assets. If the invested enterprise suffers losses, the losses have to be carried over to the following years. The invested enterprise is neither allowed to reduce the capital due to the losses nor to recognise the losses as investment.

Timing of presenting accounting documents

Costs and expenses may be brought into account when calculating the quarterly advance payment of enterprise income tax even in the absence, for whatever reasons, of accounting/supporting documents provided these documents are available/provided by the annual tax settlement.

Tax incentives for western regions clarified

The Ministry of Finance, the General Administration of Customs and the SAT jointly issued Cai Shui [2011] No. 58 on tax incentives for the western regions of China. The Notice retroactively applies from 1 January 2011 and is summarised below:

Enterprise income tax - From 1 January 2011 to 31 December 2020, the enterprises which are situated in western regions and engaged in the encouraged industries are subject to enterprise income tax at a rate of 15%.

Customs duty - Import of equipment used by the Chinese or foreign investment enterprises engaged in the encouraged industries or privileged projects is exempt from customs duty provided that the amount of import does not exceed the total capital of the importing enterprise.

Western regions – the Notice provides a comprehensive list of the qualifying regions.

Transitional measures - Enterprises established before 31 December 2010 may continue to enjoy the "two years exemption and three years 50% reduction" incentives until they expire. These incentives were granted by the Notice Cai Shui [2001] No. 202.

Other notices relating to incentives for western regions are herewith terminated.

Chinese overseas investment enterprises – administrative rules published

The SAT issued Gong Gao [2011] No. 45 on 27 July 2011 regulating Chinese overseas investment enterprises (COIEs) which is, among others, partially based on an earlier issued Notice on the same subject (Guo Shui

Fa [2009] No. 82). The Announcement applies from 1 September 2011, and is summarised below:

A COIE is an enterprise which is incorporated by a Chinese enterprise under the laws of a foreign jurisdiction (including Hong Kong, Macau and Taiwan) and which is regarded as a Chinese resident enterprise on the grounds that its place of effective management is in China.

A COIE may determine its Chinese residence status according to the criteria referred in Art. 2 of the Notice Guo Shui Fa [2009] No. 82 such as: (i) location of senior managers' homes; (ii) location where decisions on financial and human resource matters are made; (iii) location of its main property; and (iv) location where accounting records, official seals and minutes of the shareholders'/directors' meetings are kept. If so determined, the COIE has to submit an application to the relevant tax authority to be formally considered as such. The COIE may also, on its own accord, grant the COIE the status of a Chinese resident even though the COIE has not submitted an application to be considered as such.

Once the residence status of a COIE is determined, the enterprise is required to:(i) register with the relevant tax authority; (ii) maintain accounting records (in Chinese); (iii) file the enterprise income tax return; (iv) remit the tax payment; and (v) withhold taxes on relevant income.

However, subject to certain conditions, the dividends distributed by a COIE may be exempt from enterprise income tax as it is considered to be a resident enterprise.

Further, the Announcement provides that: (i) gains derived by a non-resident enterprise on transfer of shares in a COIE are subject to enterprise income tax in China. The COIE, whose shares are transferred, has the obligation to report the transfer to the tax authority; (ii) a COIE is required to report the transactions of related enterprises and maintain transfer pricing contemporaneous documentation; (iii) the Chinese invoice system applies to the transactions between a COIE and Chinese enterprises or individuals; and (iv) tax treaties concluded by China may apply to a COIE if its Chinese residence status is also ascertained by the applicable tax treaty provisions and may, where necessary, apply for mutual agreement procedure.

Provisional implementation rules on participation in social security system by foreign workers published

The Ministry of Human Resources and Social Security published the Provisional Implementation Rules on participation in social security insurances by foreigners working in China on 6 September 2011 and applies from 15 October 2011. According to the Rules, foreigners employed by the lawfully incorporated enterprises, foundations, law firms, accounting firms and other organisations in China, and their employers, have to contribute to basic old age pension insurance, medical insurance, unemployment insurance, maternity insurance and occupational injury insurance.

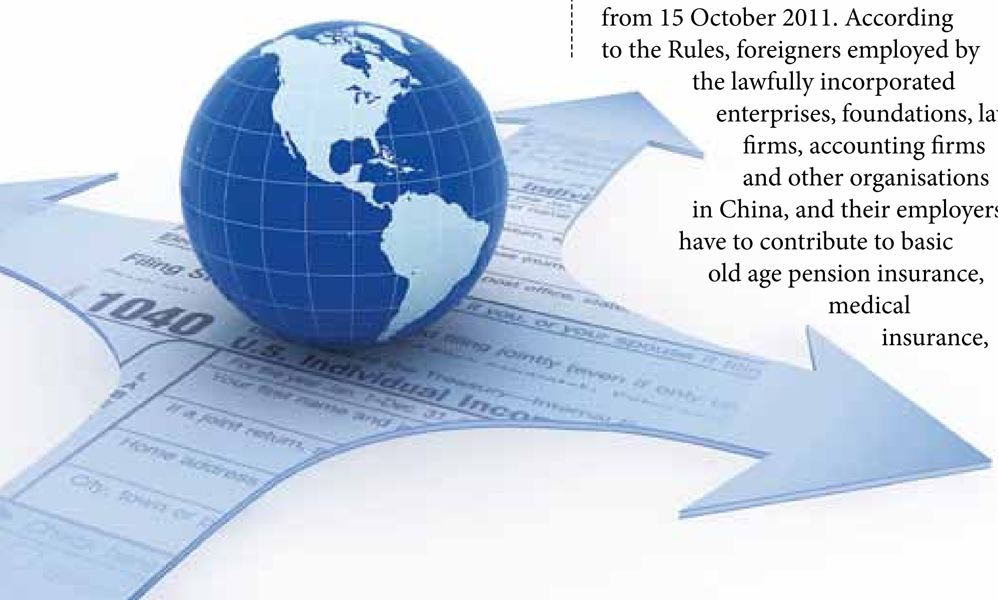
The current rates for employees range from 1% to 8%, whereas rates for employers range from 0.5% to 12%.

For these compulsory contributions, it is irrelevant whether a foreign worker is recruited in China or seconded by the head office from abroad. Employees from Hong Kong, Macau and Taiwan are not regarded as "foreigners" for the Rules and therefore do not fall within the scope of the social security system. Further, the Rules state that the social security insurances is for foreigners from countries which have concluded a Social Security Agreement with China.

Resource tax on oil and gas – amended

The State Council decided to amend the resource tax on 30 September 2011 (Ling of the State Council [2011] No.605). The amendments, which apply as from 1 November 2011, are mainly concerned with the new tax base for crude oil and natural gas, higher rates for coking coal and rare earth and tax liability for joint venture projects with foreign companies in the oil and gas industry.

New tax base for crude oil and natural gas - resource tax on crude oil and natural gas will be imposed *ad valorem* rather than on the basis of the amount of production. Crude oil and natural gas are subject to resource tax at a rate of 5%-10% of sale proceeds. The exact rate will be determined by the Ministry of Finance according to the quality of the resource and other conditions. As a trial project, the State Council introduced the resource tax *ad valorem* in Xinjiang in June last year and lately extended it to 11 other provinces. As from 1 November 2011, the new tax calculation method for crude oil and natural gas will apply throughout the country.



Rates for coking coal and rare earth - The resource tax rates for coking coal and rare earth are specified as separate taxable items and will be increased to CNY 8-20 per ton and, CNY 0.4-60 per ton respectively.

Joint ventures with foreign companies subject to resource tax - The State Council amended Ling of the State Council [2011] No. 606 and Ling of the State Council [2011] No.607 in respect of the oil and gas industry, and as a consequence the joint ventures with foreign companies in the oil and gas industry are subject to resource tax as from 1 November 2011. Currently these joint ventures are only subject to a fee imposed on mining activities.

INDONESIA

Branch profits tax exemption – administrative guidance

The Tax Office issued Regulation PER-16/PJ/2011 dated 6 June 2011 which provides the administrative requirements of the exemption from branch profits tax as provided by Regulation No. 14/PMK.03/2011.

The Regulation states that effective 6 June 2011, a branch must prepare and submit a written reinvestment notification in order to claim the exemption. The written notification must contain amongst others, information such as the preferred form of reinvestment, its realisation, and the start of commercial production. Failure to meet these administrative requirements will result in the imposition of the 20% branch profits tax (or reduced treaty rate).

New tax incentive for pioneer industries

The government issued the Ministry of Finance Decree No. 130/ PMK.011/2011 dated 15 August 2011, which offers tax incentives to taxpayers in 5 pioneer industries namely,(i) base metals, (ii) oil refining and petrochemicals, (iii) renewable resources, (iv) machinery, and (v) telecommunications equipment.

Under the incentive, a new company is eligible for a tax holiday for 5 to 10 years provided it meets the following conditions: (i) invests at least IDR 1 trillion in the above-mentioned pioneer industries; (ii) places funds with an Indonesian bank amounting to at least 10% of the total investment amount, which cannot be withdrawn prior to the taxpayer beginning to implement the realisation of his investment; and (iii) has been incorporated for at least 12 months prior to the regulation taking effect.

The incentive can be utilised once the taxpayer has commenced commercial operations, which is to be determined in accordance to existing tax rules.

Tax treatment of Syariah-based business activities – implementing Regulations issued

The Ministry of Finance issued Regulations No. 136/PMK.03/2011 (Reg-136) and No. 137/PMK.03/2011 (Reg-137) on 19 August 2011, on the income tax treatment of *Syariah*-based financing activities of banks and financial institutions. The Regulations took effect on 19 August 2011.

The salient points of Reg-136 are as follows: (i) the provisions regarding income, expenses, deductions or the taxation of Islamic banking businesses is as per the provisions of the Income Tax Law ((ITL) Law No. 36 of 2008); (ii) income of any name and kind received or accrued in Islamic banking, including bonuses, profit sharing, profit margins and other rewards are taxable objects; (iii) *Syariah* principles are defined as Islamic law principles based on a *fatwa* that is issued by an institution that is authorised to issue a *Syariah fatwa;* (iv) bonus, profit sharing and profit margins received by the bank are to be treated as interest income if received from a debtor, or in accordance with normal income tax rules if received from non-debtors; (v) bonus, profit sharing and any income from funds placed with an Indonesian *Syariah* bank or an Indonesian branch of an offshore *Syariah* bank are treated as interest in the hands of the investor/ depositor, whereas any other income received is to be treated in accordance with normal income tax rules; and (vi) deductible expenses for *Syariah* banks are set out in Arts. 6 and 9 of the ITL and include bonus, profit sharing and other fees payable by the bank to their investors under the *Syariah* agreement, with the exception of depreciation expenditure incurred under the *Ijarah Muntahiyah Bittamlik* principle.

Reg-137 stipulates the tax treatment of specific Islamic financing transactions, as follows: (i) the tax treatment of an *Ijarah* transaction is similar to that of an operating lease; (ii) an *Ijarah Muntahiyah Bittamlik* transaction is to be treated like a financial lease; (iii) gains or fees from *Wakalah* transactions are to be treated as interest; (iv) gains or profit margins from *Murabahah*, *Salam* and *Istisna* transactions are to be treated as interest; (v) gains or profit margins derived by financiers from *Mudharabah* and *Musyarakah* transactions are to be treated as interest; and (vi) any income and fees earned from other unspecified *Syariah*-based financing is to be taxed in accordance with the ITL.

In addition, the transfer or lease of an asset from a third party to the bank, that is carried out merely as part of a *Syariah* arrangement is to be disregarded for tax purposes. Instead, the asset is deemed to be transferred directly from the third party to the customer, and therefore subject to normal income tax rules.

MIDDLE-EAST

Israel - New rules on tax treatment of hybrid financial instruments

On 11 August 2011, Israel published an amendment to the Income Tax Ordinance (ITO) addressing the tax treatment of hybrid financial instruments in the domestic and cross-border contexts.

The main features of the amendment are:(i) regarding financing related parties in a cross-border context, specific conditions have been set under which a loan from a controlling non-resident shareholder is considered as equity and thus not subject to transfer pricing requirements under Sec. 85A ITO; and (ii) regarding financing related parties in a domestic context, the obligation under Sec. 3 ITO to report a fixed 4% interest rate on loans from a controlling corporate resident shareholder no longer applies.

The amendments are applicable as of the current fiscal year, and applies with retroactive effect for certain loans issued as of 2008. Transitional measures are available.

Egypt - New tax measures – approved

The President of the military council approved on 26 June 2011 the Budget for the financial year 2011/2012 by Decree-Law 51 for 2011. The Budget has been published in the Official Gazette dated 28 June 2011. From the measures initially proposed, only those relating to the increase of the corporate tax rate and the top marginal personal tax rate have been approved. The new 25% tax rate applies to resident companies and individuals for taxable income exceeding EGP10 million and earned as of 1 January 2011.

SINGAPORE

Budget for 2011 – Employee equity-based remuneration scheme administered by SPV: IRAS Circular

The Inland Revenue Authority of Singapore (IRAS) issued a Circular on 8 July 2011, which provides details of the Employee Equity-Based Remuneration (EEBR) Scheme administered by a special purpose vehicle (SPV), as introduced in the Budget for 2011.

Currently, a tax deduction is given to a company on the cost incurred to acquire its own shares (i.e. treasury shares), if such shares are transferred to its employees under an EEBR scheme. Similarly, if a holding company transfers treasury shares to employees of its subsidiary under an EEBR scheme and recharges the subsidiary for the cost incurred, a tax deduction is available to the subsidiary.

In practice, the EEBR scheme may be administered through an SPV, whereby the SPV acquires shares of the company or its holding company and transfers them to employees of the group companies according to the terms of the scheme. Shares under such an arrangement are not treasury shares, therefore no deduction is currently available. However, beginning from the year of assessment 2012, the cost of the shares acquired is deductible by the SPV, provided the following conditions are met: (i) the SPV is a legal person acting as the EEBR scheme's trustee, and holding the shares acquired for the benefit of the employees under the EEBR scheme; (ii) the SPV can be a registered person within or outside Singapore, related or unrelated to the companies of the corporate group. If the SPV performs other functions, they should not create any conflict of interest with its duties as trustee of the EEBR trust; and (iii) the SPV should not carry on any business and must be set up solely for holding shares to be used for the EEBR scheme.

Details of the deductible amounts are provided in the Circular.

Budget for 2010 – Mergers and acquisitions scheme: IRAS Circular

The IRAS issued a Circular on 8 July 2011, which provides details of the Mergers and Acquisitions (M&A) scheme introduced in the Budget for 2010.

Under the M&A scheme, a tax allowance is granted to qualifying ordinary share acquisitions executed between 1 April 2010 to 31 March 2015. The allowance is given to the acquiring company for any year of assessment (YA), at 5% of the value of the acquisition, subject to a cap of SGD5 million per YA, which is written down equally over 5 years. Stamp duty on the transfer of unlisted shares for qualifying M&A deals during this period is also remitted, subject to a cap of SGD200,000 per year. Further details such as the qualifying conditions and other features of the scheme may be found in the Circular.

Budget for 2011 – Concession for enterprise development: IRAS Circular

IRAS issued a Circular on 8 July 2011, which provides details of the concession for companies to deduct pre-commencement expenses as introduced in the Budget for 2011.

The concession which takes effect from the year of assessment 2012 allows businesses to claim a tax deduction for revenue expenses incurred in the accounting year immediately before the deemed date of commencement of the enterprise. These expenses are treated as being incurred on the deemed date of commencement, and are deductible against the business income derived in the basis period in which the business derives its first dollar of business receipt. Excess deductions for a year of assessment are treated as a trade loss, and subject to the normal trade loss utilisation rules.

The Circular also prescribes the administrative procedures in relation to the concession and supersedes the IRAS' e-tax Guide dated 14 March 2003 on the same matter.

Tax treatment of Islamic finance

The Monetary Authority of Singapore (MAS) issued Circular No. FDD 05/2011 dated 8 June 2011, which prescribes the tax treatment of specific Islamic financing transactions namely *Murabahah, Musharaka, Istisna* and *Wakalah.*

Provided these transactions meet the commercial conditions laid down by MAS, the tax treatment will be as follows:

- Where the effective return or mark-up derived by the financial institution is economically similar to interest in conventional financing, such return or mark-up will be regarded as interest for tax purposes.
- Where such return or mark-up falls under the definition of "interest" under the Interest Article in a tax treaty, the tax treatment in that Article of the tax treaty should prevail, subject to the conditions being met.
- The supply of goods undertaken in a prescribed Islamic financing arrangement (such as the transfer of non-residential properties, leasing/sub-leasing of non-residential properties) which would not have otherwise arisen under a conventional financing arrangement, would be exempt from GST.
- Stamp duties payable in respect of transfers of real properties required in a prescribed Islamic financing arrangement would be remitted. The amount of stamp duty remitted depends on the type of prescribed Islamic financing arrangement that is entered into; either the full amount or amounts in excess of SGD500, would be remitted.

GAAR: Income Tax Board of Review decision on financing arrangement

The Income Tax Board of Review gave its decision on 12 April 2011 in the case of *AQQ v. The Comptroller of Income Tax* ([2011] SGITBR1, recently available) on the application of Singapore's general anti-avoidance rule. Details of the decision are summarised below.

(A) FACTS.

A Malaysian public-listed company (M) with subsidiaries in Singapore decided to set up an intermediate holding company in Singapore, AQQ (the Appellant), in order to streamline the Singapore operations. As part of the restructuring, the Appellant entered into a financing arrangement involving the following steps:

- The Appellant issued SGD225 million of fixed rate convertible notes to a third party bank in Singapore (N Singapore);
- The Appellant used the proceeds to acquire 4 existing Singaporean subsidiaries for SGD75 million each. The notes carried an interest rate of 8.85% per annum, for a period of 10 years;
- *N* Singapore stripped the interest component (Interest Notes) of SGD205 million from the principal component (Principal Notes);
- *N* Singapore sold the Principal Notes at their par value of SGD205 million under a conditional payment obligation (CPO) to N Mauritius, under which N Mauritius agreed to pay an amount equivalent to 8.845%, upon N Singapore receiving payments under the Interest Notes from the Appellant;
- *N* Singapore entered into a forward sale agreement with N Mauritius for the remaining SGD20 million of the Principal Notes;
- *N* Mauritius on-sold the SGD205 million Principal Notes to a Malaysian subsidiary of M (C), by entering into another CPO, under which N Mauritius agreed to pay 8.84% upon receiving interest payments from N Singapore;

N Mauritius entered into a forward sale agreement with C for the remaining SGD20 million Principal Notes; and

C financed the acquisition via its own funds and inter-company borrowings arising from the proceeds from the sale of the subsidiaries to the Appellant.

After the restructuring, the Appellant received dividends that carried franking credits from its Singapore subsidiaries for the years of assessment (YAs) 2004 to 2007. These YAs fell between the 5-year transitional period before Singapore's full imputation system was replaced by the one-tier corporate tax system (under which franking credits are not available).

The Appellant also claimed tax deductions on the interest paid on the notes against the franked dividend income from its subsidiaries. This resulted in a tax refund of approximately SGD9.5 million for YAs 2004 to 2007.

The Comptroller invoked Section 33 of the Income Tax Act (ITA) (the general anti-avoidance rule) and revised the assessments for YAs 2004 to 2006, on the basis that there was no commercial justification for the financing arrangement, and that the main purpose of the arrangement was to obtain a tax advantage.

The Comptroller also disregarded the dividend income and interest expense for YA 2007, resulting in a revised assessment of tax payable. The Comptroller's specific contention was that the interest deduction claimed by the Appellant altered the incidence of tax payable or avoided the tax payable in addition to obtaining cash refunds of the franking credits. This interest was not incurred to produce income but to create a structure in which a tax refund could be created on the dividends to be paid out, and thus did not qualify for deduction.

A combination of other factors (such as the fact that all the transactions took place on the same day, lack of documentary evidence for the commercial reasons of the loan, lack of valuation for the price of the shares and lack of credit risk by N Bank as the lender) also pointed to one of the main purposes of the financing arrangement as being one to reduce or avoid tax.

The Appellant argued the following:

- the payment of the dividends was a commercial decision and the receipt of dividend income came with the entitlement to dividend franking credits as provided under Singapore's dividend imputation rules;
- the restructuring exercise and the financing arrangement were carried out for bona fide commercial reasons, and actual funds were used and transmitted in the arrangement;
- a number of Singaporean companies declared special bonus dividends with rights issues before the expiry of the 5-year transitional period, in order to be able to pass on the franking credits to their shareholders, and there was no difference in principle with those cases; and
- the Comptroller's concept and assertion of artificiality was vague.

(B) ISSUE.

The issue was whether the financing arrangement was a scheme of tax avoidance covered by Section 33 of the ITA.

(C) DECISION.

The Board of Review held that the financing arrangement had the purpose or effect to avoid tax, and was contrived or artificially structured so as to obtain a tax refund through the utilisation of tax credits. There was no evidence that the arrangement was carried out for bona fide commercial reasons. On the contrary, there was evidence showing that the scheme was undertaken for tax avoidance purposes, such as:

- the absence of meeting minutes or other discussion records for a loan of this magnitude;
- the existence of an undated discussion paper of the bank which revealed that the purpose of the financing arrangement and the loan in particular was to obtain tax benefits;
- no documentary evidence to show how the financing arrangement would result in M achieving its objective to streamline its operations in Singapore;
- the fact that all the transactions in the financing arrangement took place on the same day lent an element of artificiality to the scheme, and there was no evidence on how their occurrence on the same day supported the objectives of the reorganisation; and
- the absence of a true lending arrangement between the N Bank and the group, as well as the lack of commercial justification for interposing N Mauritius, other than to take advantage of a withholding tax exemption on interest.

In respect of the deductibility of the interest expense, the Board held that although there was a direct link between the loan undertaken and the dividend income received, they did not think that the deduction is intended to be available where the link was artificially created, such as this.

The case is currently under appeal in the High Court.

THAILAND

Thailand's cabinet has approved the proposal to cut corporate tax starting from 2012 as follows:(i) to 23% (from 30%) in 2012; and (ii) to 20% in 2013.

VIETNAM

Foreign contractor tax – Bonded warehouses

The General Department of Taxation (GDT) issued OL1749/TCT-CS on 23 May 2011, providing guidelines on foreign contractor tax (FCT) applicable to foreign enterprise(s) trading goods through a bonded warehouse. Where a foreign enterprise rents a bonded warehouse in Vietnam to store goods purchased from another foreign supplier for sales to its Vietnamese parties, the former's permanent establishment (PE) exposure is determined as follows:

If the bonded warehouse in Vietnam is rented only to store goods purchased from another foreign supplier for direct sales to its Vietnamese parties, it shall not be deemed to have a PE in Vietnam.

If, however, the goods stored in the bonded warehouse are sold to its Vietnamese parties through a foreign enterprise's representative in Vietnam (such as an office, local staff or another organisation in Vietnam) or the sale of goods is actually related to a service agreement between the foreign enterprise and its Vietnamese parties, it shall be deemed to have created a PE in Vietnam.

Payment for medical treatment received by employee

The Ministry of Finance (MoF) issued Circular 78/2011/TT-BTC on 8 June 2011, on payments made by an employer to his employee for the medical treatment of fatal diseases. Such payments are tax exempt benefits if the payment is made out of after-tax profits or a welfare/reward fund as maintained by the enterprise. "Qualifying enterprises" are: (i) enterprises established under the laws of Vietnam; (ii) foreign firms (with/without permanent establishments in Vietnam); (iii) organisations established and operating under the Cooperative Law; and (iv) organisations having income from business activities.

The entitled recipients are employees who are diagnosed with a fatal disease, and the benefit may also be extended to include their relatives (i.e. father and mother, spouse, blood child or adopted child). The above medical payment/allowance shall not exceed the actual medical expenses incurred for the employee or their relatives.

Corporate income tax and personal income tax – clarifications

CIT: Other taxable income - Official Letter 2474/TCT-CTS issued on 19 July 2011 (OL2474) clarified that income derived from donations and gifts, income received from discounted payments or promotional sales and other supports in cash or in kind which does not arise from licensed business activities, are considered as other taxable income for corporate income tax (CIT) purposes. Thus, these forms of income shall not be eligible for CIT incentives.

PIT: Circular 113 - Circular 113/2011/TT-BTC was issued on 4 August 2011 and contained the following personal income tax (PIT) amendments which are effective from 19 September 2011:

(A) CHANGES TO WITHHOLDING TAX ON COMMISSIONS AND REMUNERATION

A 10% withholding tax rate shall apply to commissions paid to sale agents, and on salaries, wages, and other remuneration or other sums of money paid to individuals performing services exceeding VND1,000,000/occurence where the recipients have a tax number. Where the above payments are made to individuals without tax numbers, a 20% withholding tax shall apply unless otherwise provided by the Ministry of Finance (MoF) (such as specific temporary rates).

Additionally where an individual has only one source of income which is subject to PIT at either 10% or 20%, and the individual's total annual income is less than the threshold amount (e.g. annual income of less than VND48 million per year with no dependants) he may have his PIT withholding waived if he provides a written statement (confirming he fulfils the above conditions) to the payee.

(B) PROPERTY TRANSFER

Circular 113/2011/TT-BTC clarifies that the taxable income of an individual in respect of the transfer price of land use rights, houses, and condominiums with land use right or ownership certificates, is the higher of actual price stated in the transfer contract or the deemed price as prescribed in the price table issued by the provincial-level People's Committees.

The appropriate rate tax shall be 25% on the difference between the transfer price and the cost of the property (where there are valid supporting documents) or 2% on the transfer proceeds where there are no valid supporting documents to prove the purchase price.

MALAYSIA – TREATY DEVELOPMENTS

The amending protocol, signed on 24 February 2010, to the income tax treaty between Malaysia and Australia of 20 August 1980, as amended by the 1999 and 2002 protocols, entered into force on 8 August 2011.

On 20 October 2011, Malaysia and Indonesia signed an amending protocol to the income tax treaty of 12 September 1991, as amended by the 2006 protocol.

Lee Joo Fong is a Research Associate at 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.

Investing in Women

By Nazatul Izma

Gender diversity can be good for business, but most companies face the challenge of promoting more able women to top management and boards.

Declaring that gender equality in the private sector is "good for business", 167 chief executives from around the world have signed the Women's Empowerment Principles — Equality Means Business as of March 2011. The Women's Empowerment Principles are championed by UN Women and UN Global Compact.

While commitment from the world's top corporate echelons brings even more visibility to the cause of empowering women at work, UN Secretary-General Ban Ki-moon challenged business leaders to do much more. "When you embrace these principles, you join a great and gathering movement to unleash the power of women and change the world. This is critical," the Secretary-General said.

Research has shown a rapidly developing business case for gender diversity and equality. Among Fortune 500 companies, those in the top quartile, when it comes to women's representation on their boards, outperform those in the lowest quartile by at least 53 per cent on return on equity, said the UN.

Ginka Toegel, Professor of Organisational Behavior and Leadership at IMD Business School in Lausanne, Switzerland and Director of the Strategies for Leadership programme, which is open only to women, wrote in Businessweek in 2010 that "companies with more than three women in senior management positions tend to have better returns on equity and assets. Those companies also typically score higher on measures of organisational effectiveness. Equally, female board members tend to be particularly well-prepared for meetings, which raises the benchmark for others. This leads to better discussions—and better decisions."

While such findings should persuade more companies to put more women at the top, in reality business remains very much a man's world. "Despite significant corporate commitment to the advancement of women's careers, progress appears to have stalled. The percentage of women on boards and senior executive teams remains stuck at around 15 per cent in many countries, and just 3 per cent of Fortune 500 CEOs are women," wrote Joanna Barsh, a director in McKinsey's New York office, and Lareina Yee, a principal in the McKinsey San Francisco office, in "Changing Companies' Minds About Women", which was published in September 2011 in the McKinsey Quarterly.

However, there are some inspiring corporate role models. According to examples cited in the McKinsey Quarterly, the honour roll includes Pitney Bowes, where 38 per cent of vice-presidents are women; Shell, where more than a quarter of all supervisors and professional staff worldwide are women; and Time Warner, where more than 40 per cent of the senior executives in its operating divisions are women and where the share of women in senior roles has jumped 30 per cent in the past six years, noted Barsh and Yee.

CHANGING CORPORATE CULTURE

Many executives acknowledge that it is difficult to change corporate cultures to fully integrate gender equality, however. While 72 per cent of executives surveyed in 2010 by McKinsey & Co. agreed that there is a correlation between gender diversity and business success, only 28 per cent said it is a top ten priority for senior leadership.

However, championing women's empowerment must come from the top if there is to be change in the workplace. Ample support must be provided for women who want to move to the top. Importantly, there

72% of executives surveyed in 2010 by McKinsey & Co. agreed that there is a correlation between gender diversity and business success, only 28% said it is a top ten priority for senior leadership.

must also be mindset change among both men and women, and women too must be fully engaged with leveraging these new opportunities in order to contribute their full potential to business.

Below are a few key strategies that business should consider adopting in order to make full use of female strengths:

SETTING QUOTAS

Quotas, whether set internally by the company or externally by regulators, can be a big push for getting more women to the top. Toegel cites Norway as a role model where about 44.2 per cent of board members are women. "This has not come about by chance; in 2008 the country passed a law requiring publicly listed companies to have boards composed at least 40 per cent of women," she wrote. Malaysia too has jumped on the bandwagon; the government recently mandated that the corporate sector must have at least 30 per cent female representation at the boardroom level by 2016.

Businesses too can set their own challenging goals for pushing up the number of women in senior management. For example, Deutsche Telecom announced in 2010 that it aimed to fill 30 per cent of its mid-to-top-level management positions with women within the next four years, said Toegel.

DO NOT ACT LIKE MEN

Women may mistakenly believe that they have to behave like men in order to be good leaders and legitimise their roles. This can backfire. "Male leaders tend to be more given to "agentic" behaviour, meaning that they are proactive, assertive, dominant, and in control of situations. Because of male dominance in the workplace, the agentic approach is more associated with leadership.

Female leaders, by contrast, show what we call "communal values," such as friendliness, support, warmth, and a caring attitude," noted Toegel. Therefore, "if women simply act like men, they violate the gender stereotype, which creates a perception that they are being phony. This can cause them to be penalised for being inauthentic leaders."

Instead, Toegel recommends that women should instead "blend both sets of characteristics", and make the best of both sexes' strengths. Toegel cites Indra Nooyi, the Chairman and Chief Executive of PepsiCo (PEP) as an excellent model of blended leadership. "While she can make tough decisions and is very assertive in negotiations, her direct reports describe her as extremely warm and caring."

Recent ACCA research on Female Perspectives in the Global Economy has also shown that the different sexes respond differently to economic events and news, perhaps precipitating different styles of decision-making that impacts business. "There is a business case for better diversity in the boardroom as both genders react differently to economic situations. For instance, men tend to react more strongly to news flow and rapid changes in economic conditions than women, and in a downturn they tend to lose confidence faster. Hopefully with the implementation of this latest policy (on boardroom quotas), we will see a new era of confident women participating in the boardroom dialogue, and thereby enabling the development of more sustainable business strategies," said Jennifer Lopez, Country Head, ACCA Malaysia.

ENABLE INTERNATIONAL EXPERIENCE

Too few women are working abroad compared to men despite being equally keen to go, according to new research into global mobility among high-achieving professionals by specialist recruitment company Hydrogen Group together with ESCP Europe, one of the oldest business schools in the world.

In March 2011, Hydrogen highlighted international experience as a significant advantage to climbing the career ladder for any senior manager in today's global marketplace, but men still outnumber women four to one in making this move.

The Global Professionals on the Move Report 2011 revealed that women were still hampered by family commitments and biases. For instance, double the number of women already working abroad were single – 51 per cent compared with 23 per cent of men - whereas the opposite was the case for men, 65 per cent of whom were married.

...companies need to provide more international exposure for women in order to prepare them better for top corporate positions. At the same time, ample support systems have to be in place for women to take up these positions, whether they are married or single.

Generally, women working abroad didn't have children, whereas men were equally likely to have children, regardless of whether they worked overseas or not. In addition, women were less satisfied than men regarding pay. While 84 per cent of men said moving abroad had improved their salary, only 74 per cent of women reported the same. Similarly, 78 per cent of men said their living conditions had improved, while that was the case for only 68 per cent of women.

"It has been repeatedly shown that women face particular hurdles on the way to the top that men simply don't have to face," said Dr. Claudia Jonczyk of ESCP Europe.

The bottomline is that companies need to provide more international exposure for women in order to prepare them better for top corporate positions. At the same time, ample support systems have to be in place for women to take up these positions, whether they are married or single.

OFFERING GENUINE SPONSORSHIP AND SUPPORT

Effective sponsorship, mentoring and guidance can make corporate careers or cause them to sputter out long before hitting the glass ceiling, both for men and women.

To ensure that more women make it to the top it is essential to make sure that they are promoted to roles that stretch their capabilities, while offering them the necessary sponsorship and support.

Of course, it can't be denied that "many male executives feel more comfortable sponsoring men or simply don't know how to be effective sponsors for women," noted Barsh and Yee. Male executives may also need to tailor their coaching styles to suit feminine personalities. The duo give the example of "the "relentless coach" who pushes the sponsoree to the breaking point. While many men recall this gruelling experience with gratitude and even affection for the sponsor, it doesn't work well for many women, especially those who carry the burden of responsibility at home in addition to their work."

"Devil's advocacy" may also be a style more fitted to coaching men rather than women. Barsh and Yee say that "many women find that constant questioning drains their confidence and energy," even if the questioning is meant to challenge them.

CHANGING CORPORATE MINDSETS

According to Barsh and Yee, "the next frontier is toppling invisible barriers: mindsets widely held by managers, men and women alike, that are rarely acknowledged but block the way."

They note that although senior leaders may be genuinely committed to gender diversity, "deeply entrenched beliefs" and mindsets may be impeding effective implementation. "All too often in our experience, executives perceive women as a greater risk for senior positions, fail to give women tough feedback that would help them grow, or hesitate to offer working mothers opportunities that come with more travel and stress," they wrote.

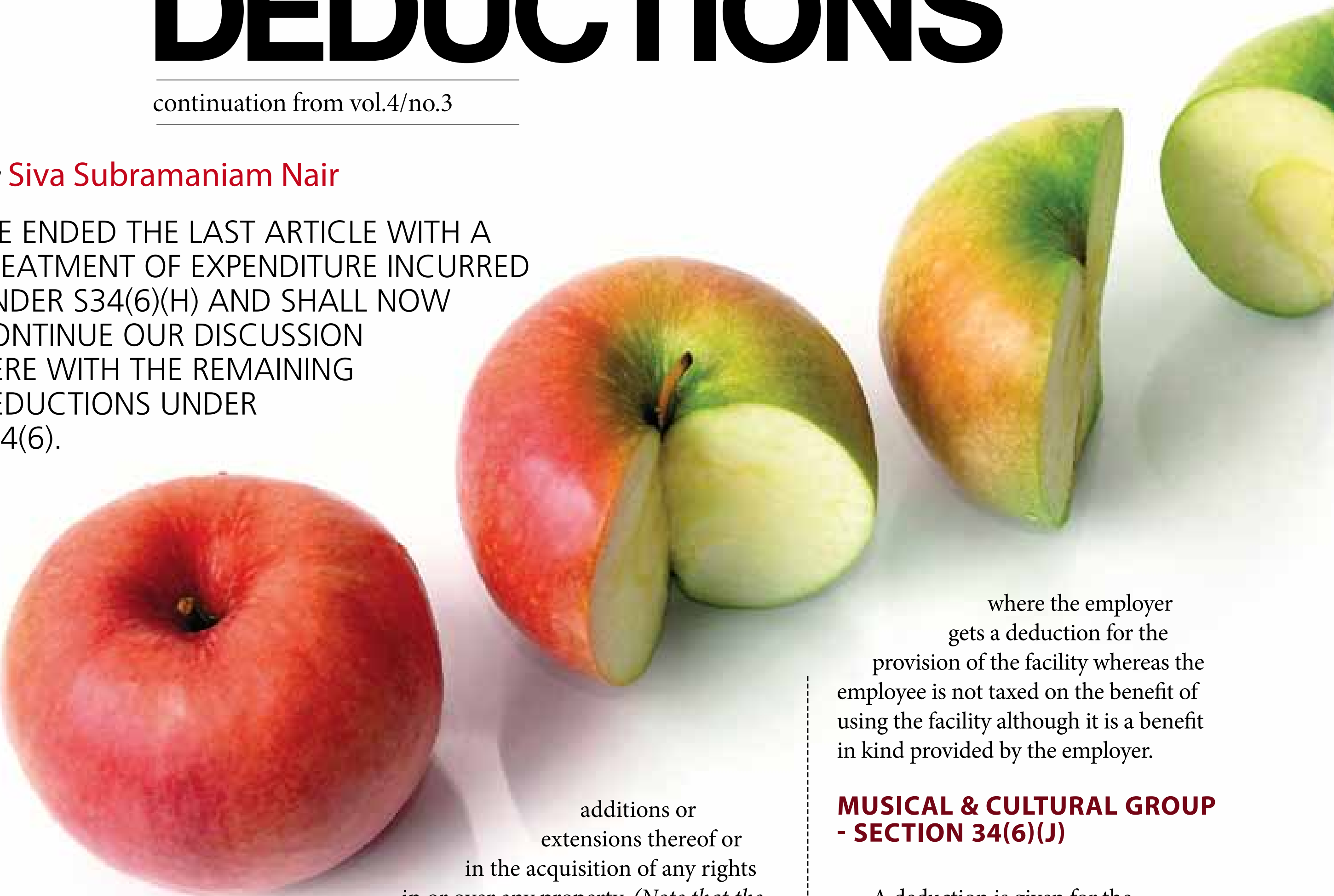
So how can these be overcome? While each company must determine their own approach that fits their own particular circumstances, "Real progress requires system-wide change driven by a hard-edged approach, including targets ensuring that women are at least considered for advancement, the rigorous application of data in performance dialogues to overcome problematic mindsets, and genuine sponsorship. Committed senior leaders are of course central to such efforts, which can take many years," wrote Barsh and Yee. To achieve change, the duo hoped that companies will "stir up their thinking about how to confront the silent but potent beliefs that probably are undermining women in their organisation right now."

OTHER BUSINESS DEDUCTIONS

continuation from vol.4/no.3

By Siva Subramaniam Nair

WE ENDED THE LAST ARTICLE WITH A TREATMENT OF EXPENDITURE INCURRED UNDER S34(6)(H) AND SHALL NOW CONTINUE OUR DISCUSSION HERE WITH THE REMAINING DEDUCTIONS UNDER S34(6).



CHILD CARE CENTRES - SECTION 34(6)(I)

An amount equal to the expenditure incurred by a business on the provision and maintenance of a child care centre for the benefit of its employees is deductible.

This only includes revenue expenditure and specifically excludes capital expenditure on land, premises, buildings, structures or works of a permanent nature or on alterations, additions or extensions thereof or in the acquisition of any rights in or over any property. *(Note that the building if purchased or constructed will qualify for IBA at a special rate of 10% per year of assessment.)*

This is in line with the government's efforts to reduce the shortage of workers in the country by facilitating an opportunity for both parents to be gainfully employed whilst not worrying about who would take care of their children.

Candidates will also remember that the employees using the benefit of a child care centre will not be taxed as this is a benefit specifically excluded under S13(1)(b). So it is a win-win situation where the employer gets a deduction for the provision of the facility whereas the employee is not taxed on the benefit of using the facility although it is a benefit in kind provided by the employer.

MUSICAL & CULTURAL GROUP - SECTION 34(6)(J)

A deduction is given for the expenditure incurred by a business in establishing and managing a musical or cultural group approved by the Minister. This illustrates the encouragement given by the government to cultivate greater private sector participation to promote national arts and culture.

SPONSOR OF ARTS OR CULTURAL ACTIVITIES - SECTION 34(6)(K)

Expenditure incurred for sponsoring any arts, cultural or heritage activity approved by the Ministry of Information, Communications and Culture would rank for a deduction. However, this deduction is restricted to a maximum of RM500,000 per year, of which expenditure incurred in sponsoring foreign arts, cultural or heritage activity shall not exceed RM200,000.

A historical note for candidates attempting past year questions; prior to year of assessment 2007, the total amount deductible was limited to RM300,000 and the amount in respect of foreign activities was capped at RM200,000; and before year of assessment 2004 the total claim for both local and foreign was limited to a maximum of RM200,000

The increase in the maximum amounts deductible was consistent with the government efforts to promote and contribute to the advancement and quality of the local arts and cultural activities.

EXAMPLE 1

Perlis S/B incurred RM480,000 on sponsoring arts, cultural or heritage activity approved by the Ministry of Information, Communications and Culture for the year ended 31 December 2011 of which RM250,000 relates to local activities.

Solution.

Since RM250,000 relates to local activities obviously RM230,000 (480,000 – 250,000) refers to foreign arts or cultural activities. Therefore, since foreign activities is restricted to RM200,000, RM30,000 will be added back to the profit before tax figure in arriving at the adjusted income.

SCHOLARSHIPS - SECTION 34(6)(L)

The provision of scholarships to students does not fulfill the "wholly & exclusively incurred in the production of income" rule in S33(1) and in consequence does not rank for a business deduction.

However, with the rising costs of education the government decided to enlist the help of companies in providing higher education opportunities to our nation's youths by enacting this special provision. The features of this deduction are:

EXAMPLE 2

Kedah Manufacturing Sdn. Bhd. commenced a scholarship scheme for students in 2011. The following candidates qualified to be the pioneer recipients of the scholarship (RM5,000 p.a. each).

Chin Ann is undertaking a MSc at University of Malaya. He is a full-time student. His parents are earning RM4,000 each.

Theinmozhi is doing a degree in Engineering at University Kebangsaan Malaysia. In addition, she also receives an annual allowance of RM2,000 p.m. for accommodation at the Bangi Hotel. Her parents earn RM2,500 per month each.

Iskandar who is reading law at Brickfields College is an enterprising lad who earns RM500 per month, giving tuition in his spare time to supplement his widowed mothers meagre earnings of RM1,200 per month.

Marianne, an orphan, is taken care of by her uncle who has an annual income of RM50,000. She is studying pharmacy at Universiti Sains Malaysia.

Jaswinder's parents earn RM4,000 per month. He is pursuing a degree in Ophthalmology at the National University of Singapore.

Required

Determine whether Kedah Manufacturing Sdn. Bhd can claim a tax deduction for the scholarship given to each of the above recipients giving reasons for your answer.

Solution.

Recipient- Kedah Manufacturing Sdn. Bhd:-

Chin Ann *will not qualify for a deduction since his parents are earning RM4,000 each i.e. a combined income of RM8,000 per month which exceeds RM5,000.*

Theinmozhi *will qualify for a deduction for the scholarship but not for the additional allowance of RM2,000 p.m. for accommodation*

at the Bangi Hotel, since living at a hotel does not constitute reasonable cost of living.

***Iskandar** will not qualify for a deduction as he is earning RM500 per month.*

***Marianne** will qualify for a deduction since her uncle's annual income is RM50,000 i.e. not exceeding RM5,000 per month.*

***Jaswinder** will not qualify for a deduction as the National University of Singapore is not registered under the Universities and University Colleges Act 1971 of Malaysia*

EXPENDITURE FOR OBTAINING ACCREDITATION FOR A LABORATORY OR AS A CERTIFICATION BODY - SECTION 34(6)(M)

This was introduced to encourage companies to set up an accredited laboratory or become a certification body to stimulate the growth of research and development in Malaysia. The salient features of this deduction are:

- it is in respect of revenue expenditure, not capital expenditure
- it must be incurred by a company
- it is for the purpose of obtaining accreditation for a laboratory or as a certification body, :
- it must be evidenced by a certificate issued by the Department of Standards Malaysia

The expenditure is deemed to be incurred in the basis period for the year of assessment in which the certificate is issued and not when incurred.

In CTIM TAX II DECEMBER 2007 QUESTION 1 the following scenario was presented;

Kin Teck Sdn Bhd with a financial year ended 31 March 2007 incurs the ISO fees of RM41,200 in respect of SIRIM certification for water pipes - application fees, testing fees, audit fees for MS1058 & ISO4427. The certificates were issued on 15 April 2007.

Solution

The costs relating to the SIRIM certification for water pipes although incurred in year of assessment 2007 can only be claimed when the certificates are issued i.e. in year of assessment 2008. Therefore, for year of assessment 2007 tax computation it has to be added back to the profit before tax figure in arriving at the adjusted income.

QUALITY SYSTEMS AND STANDARDS, AND *HALAL* CERTIFICATION - SECTION 34(6)(M)

Expenditure, not being capital expenditure, incurred by a company in the relevant period for the purpose of obtaining certification for recognised quality systems and standards, and *halal* certification, evidence by a certificate issued by a certification body as determined by the Minister, will rank for a double deduction.

Bodies for the *halal* certification are:

- Malaysian Islamic Development Department (JAKIM)
- State Islamic Religious Departments
- State Islamic Religious Council

Provided that the expenditure incurred in the relevant period shall be deemed to be incurred by that company in the basis period for the year of assessment in which the certificate is issued;

EXAMPLE 3

Perak Sdn. Bhd. (with year-end 31 May 2011) has incurred the following *halal* certification expenditure:

	RM'000
Capital expenditure	300
Revenue expenditure	550
	850

The certificate was issued to the company on 10 April 2011.

Solution

Expenditure incurred on halal certification enjoys a double deduction for year of assessment 2011 since the certificate was issued in that year of assessment. However, it is restricted to the revenue expenditure only; therefore we should add back the RM300,000. However, since *the revenue expenditure has already enjoyed a deduction in the income statement, we should only less the RM550,000 in the tax computation which commences with the profit before tax figure.*

PRACTICAL TRAINING - SECTION 34(6)(N)

This deduction was introduced to encourage employers to provide practical training to enhance manpower skills which in turn will increase the supply of a skilled and trained Malaysian workforce to enhance productivity and competitiveness. This deduction is given to all employers; i.e. companies, partnerships and sole proprietors

The conditions to qualify for this deduction are:

- it must be provision of practical training
- in relation to his business in Malaysia
- to an individual who is not an employee but who is a Malaysian resident

EXAMPLE 4

An information technology company incurred practical training expenses amounting to RM140,000 to organise simple computer repair and formatting training sessions for retrenched workers so that they would be able to obtain some form of employment in future. Half the trainees were resident in Malaysia.

Solution

Expenses incurred on practical training are deductible. However, the amount spent for non-residents of RM 70,000 does not rank for a deduction and has to be added back to the profit before tax figure in arriving at the adjusted income

PARTICIPATING IN INTERNATIONAL STANDARDISATION ACTIVITIES - SECTION 34(6)(O)

To enhance Malaysian companies competitiveness to face the challenges of globalisation, an amount equal to the expenditure incurred by a company in the relevant period for participating in international standardisation activities approved by the Department of Standards Malaysia would rank for a deduction. These activities include conferences, workshops, seminars or meetings overseas.

That concludes the discussion on deductions under S34(6) of the Income Tax Act 1967.

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

FURTHER READING

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CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: January 2012 – March 2012

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
JANUARY 2012								
Workshop: Tax Audits & Investigations: Implications of 2012 Budget Proposals	4 Jan	9a.m. - 5p.m.	Kuala Lumpur	Harvindar Singh	350	400	460	8
Workshop: Recent Tax Cases: Successes and Surprises in Court **(postponed from 14 Dec 2011)*	5 Jan	9a.m. - 5p.m.	Ipoh	Saravana Kumar	335	385	435	8
Workshop: Tax Deductible Expenses – Latest Developments & Practical Issues	9 - 10 Jan	9a.m. - 5p.m.	Johor Bahru	Chow Chee Yen	600	700	800	16
Workshop: Tax Planning on Individuals' Income from Employment & Statutory Requirements by Employers	10 Jan	9a.m. - 5p.m.	Kuala Lumpur	Sivaram Nagappan	350	400	460	8
Workshop: Tax Audits & Investigations: Implications of 2012 Budget Proposals	11 Jan	9a.m. - 5p.m.	Kota Kinabalu	Harvindar Singh	335	385	435	8
Workshop: Tax Deductible Expenses – Latest Developments & Practical Issues	11 - 12 Jan	9a.m. - 5p.m.	Kuala Lumpur	Chow Chee Yen	630	730	830	16
Workshop: Tax Audits & Investigations: Implications of 2012 Budget Proposals	12 Jan	9a.m. - 5p.m.	Kuching	Harvindar Singh	335	385	435	8
Workshop: Tax Audits & Investigations: Implications of 2012 Budget Proposals	16 Jan	9a.m. - 5p.m.	Kota Bharu	Vincent Josef	300	350	500	8
Workshop: Tax Audits & Investigations: Implications of 2012 Budget Proposals	17 Jan	9a.m. - 5p.m.	Melaka	Harvindar Singh	335	385	435	8
Workshop: Tax Audits & Investigations: Implications of 2012 Budget Proposals	18 Jan	9a.m. - 5p.m.	Ipoh	Harvindar Singh	335	385	435	8
Public Holidays *(1 Jan: New Year, 23 & 24 Jan: Chinese New Year)*								
FEBRUARY 2012								
Workshop: Tax Audits & Investigations: Implications of 2012 Budget Proposals	9 Feb	9a.m. - 5p.m.	Johor Bahru	Harvindar Singh	335	385	435	8
Workshop: Tax Audits & Investigations: Implications of 2012 Budget Proposals	13 Feb	9a.m. - 5p.m.	Penang	Harvindar Singh	335	385	435	8
Workshop: Tax Planning on Individuals' Income from Employment & Statutory Requirements by Employers	13 Feb	9a.m. - 5p.m.	Ipoh	Sivaram Nagappan	335	385	435	8
Workshop: Tax Deductible Expenses – Latest Developments & Practical Issues	13 - 14 Feb	9a.m. - 5p.m.	Kuching	Chow Chee Yen	600	700	800	16
Workshop: Individual Tax Planning (in collaboration with MAICSA)	15 Feb	9a.m. - 5p.m.	Kuala Lumpur	Vincent Josef	350	NA	450	8

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non-Member	
FEBRUARY 2012								
Workshop: Tax Planning on Individuals' Income from Employment & Statutory Requirements by Employers	16 Feb	9a.m. - 5p.m.	Melaka	Sivaram Nagappan	335	385	435	8
Workshop: Tax Audits & Investigations	20 Feb	9a.m. - 5p.m.	Kuantan	Vincent Josef	300	350	500	8
Workshop: Tax Planning on Individuals' Income from Employment & Statutory Requirements by Employers	21 Feb	9a.m. - 5p.m.	Johor Bahru	Sivaram Nagappan	335	385	435	8
Workshop: Tax Deductible Expenses - Latest Developments & Practical Issues	21 - 22 Feb	9a.m. - 5p.m.	Kota Kinabalu	Chow Chee Yen	600	700	800	16
Seminar: To Be Advised	23 Feb	9a.m. - 5p.m.	Kuala Lumpur	Various Speakers	Early Bird 375 / Normal 425	Early Bird 425 / Normal 475	Early Bird 475 / Normal 545	8
Workshop: Tax Planning on Individuals' Income from Employment & Statutory Requirements by Employers	28 Feb	9a.m. - 5p.m.	Penang	Sivaram Nagappan	335	385	435	8
Public Holidays ***(1 Feb: Federal Territory Day, 5 Feb: Prophet Muhammad's Birthday, 7 Feb: Thaipusam)***								
MARCH 2012								
Workshop: Tax Deductible Expenses – Latest Developments & Practical Issues	1 - 2 Mar	9a.m. - 5p.m.	Ipoh	Chow Chee Yen	600	700	800	16
Workshop: Tax Planning on Individuals' Income from Employment & Statutory Requirements by Employers	6 Mar	9a.m. - 5p.m.	Kota Kinabalu	Sivaram Nagappan	335	385	435	8
Workshop: Tax Planning on Individuals' Income from Employment & Statutory Requirements by Employers	7 Mar	9a.m. - 5p.m.	Kuching	Sivaram Nagappan	335	385	435	8
Workshop: Tax Deductible Expenses – Latest Developments & Practical Issues	7 - 8 Mar	9a.m. - 5p.m.	Penang	Chow Chee Yen	600	700	800	16
Workshop: Minimising on the Exposure of Withholding Tax & Effectiveness of Double Taxation Agreements in Cross Border Transactions	22 Mar	9a.m. - 5p.m.	Kuala Lumpur	Sivaram Nagappan	350	400	460	8
Workshop: Tax Deductible Expenses – Latest Developments & Practical Issues	27 - 28 Mar	9a.m. - 5p.m.	Melaka	Chow Chee Yen	600	700	800	16
Workshop: Making the Most of Doube Tax Agreements	29 Mar	9a.m. - 5p.m.	Kuala Lumpur	Tan Hooi Beng	350	400	460	8

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

ENQUIRIES : Please call Ridzuan, Fadeah, Yus or Nur at 03-2162 8989 ext 108, 113, 121 and 106 respectively or refer to CTIM's website ***www.ctim.org.my*** for more information on the CPD events.