Vol.5/No.3/2012/Q3

Official Journal of the Chartered Tax Institute of Malaysia

Tax Guardian

AUTHORITATIVE - RELEVANT - GLOBAL EXCELLENCE

RM28.00

TAX-EFFICIENT SUPPLY CHAIN – MAKING IT HAPPEN

MEMORANDUM ON 2013 BUDGET PROPOSALS

With a Budget themed "Driving Transformation towards a Developed Nation", the rakyat can look forward to definitive steps taken by the government to improve the Malaysian economy.

SECTION 108 STRUCTURE – KEY LESSONS FROM THE AQQ CASE

BENEFITS OF APAs OUTWEIGH THE COSTS

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CHARTERED TAX INSTITUTE OF MALAYSIA

ISSN 0128-7583

9 770128 758008

KDN PP7829/05/2013(032660)

ORGANISED BY

LHDN MALAYSIA

CTIM CHARTERED TAX INSTITUTE OF MALAYSIA

PREMIER TAX EVENT OF THE YEAR

NATIONAL TAX CONFERENCE 2012

17 & 18 JULY 2012 (TUESDAY & WEDNESDAY) | KUALA LUMPUR CONVENTION CENTRE

Taxation Challenges in a Borderless Economy

Official Opening by

YAB Dato' Sri Mohd Najib bin Tun Haji Abdul Razak

Prime Minister / Finance Minister of Malaysia

PROGRAMME

DAY 1

7.30 – 9.00 am	**Registration & Arrival Of Guests**	
9.00 – 9.10 am	**Arrival Of Guest Of Honour** YAB Dato' Sri Mohd Najib bin Tun Haji Abdul Razak *Prime Minister / Finance Minister of Malaysia*	
9.10 – 9.20 am	**Welcoming Speech** Mr SM Thanneermalai *President* *Chartered Tax Institute of Malaysia*	
9.20 – 9.30 am	**Opening Address** YBhg Tan Sri Dr Mohd Shukor bin Hj Mahfar *Chief Executive Officer* *Lembaga Hasil Dalam Negeri Malaysia*	
9.30 – 10.00 am	**Keynote Address By Guest Of Honour** YAB Dato' Sri Mohd Najib bin Tun Haji Abdul Razak *Prime Minister / Finance Minister of Malaysia*	
10.00 – 11.00 am	**Morning Refreshments/ Press Conference/ Tour Of Exhibition Booths**	
11.00 – 12.15 pm	**An Economic Outlook For Malaysia In The Next 18 Months In A Global Economy** Chairman: YBhg Tan Sri Datuk Dr Sulaiman Mahbob *Chairman* *Malaysian Institute of Economic Research* Speaker: Dr Sundaran Annamalai *Secretary* *Economic Division* *Ministry of Finance Malaysia* Panelist: Dr Yeah Kim Leng *Senior General Manager/ Group Chief Economist* *Rating Agency of Malaysia Holdings Berhad*	
12.15 – 12.30 pm	**Question & Answer Session**	
12.30 – 2.00 pm	**Networking Lunch & Tour Of Exhibition Booths**	
2.00 – 3.00 pm	**Taxation Of E-Commerce Transactions** Chairman: Mr K Sandra Segaran *Council Member* *Chartered Tax Institute of Malaysia* Speaker: Mr Abdul Aziz Kechik *Director* *Schedular Tax Deduction Audit and Tracking Division* *(Former Director of E-Commerce)* *Compliance Department* *Lembaga Hasil Dalam Negeri Malaysia*	
3.00 – 3.15 pm	**Question & Answer Session**	
3.15 – 4.15 pm	**FRS & Its Impact On Taxation** Chairman: Mr Mohammad Faiz Azmi *Chairman* *Malaysian Accounting Standards Board* Speaker: Ms Halijah Bulat *Director* *Tax Policy Department* *Lembaga Hasil Dalam Negeri Malaysia* Panelist: Mr Lim Kah Fan *Deputy President* *Chartered Tax Institute of Malaysia*	
4.15 – 4.30 pm	**Question & Answer Session**	
4.30 – 5.30 pm	**End Of Day 1 & Refreshments**	

DAY 2

9.00 – 10.30 am	**Substance Versus Form In The Context Of Anti Avoidance** Chairman: Mr Khoo Chin Guan *Council Member* *Chartered Tax Institute of Malaysia* Speaker: Mr Bart Kosters *Senior Principal Research Associate* *International Bureau of Fiscal Documentation (IBFD)* Panelist: Mr Mohd Nizom bin Sairi *Director* *Investigation Department* *Lembaga Hasil Dalam Negeri Malaysia*	
10.15 – 10.30 am	**Question & Answer Session**	
10.30 – 11.00 am	**Morning Refreshments/ Tour Of Exhibition Booths**	
11.00 – 12.30 pm	**Tax Cases Update** Chairman: YBhg Datuk Abdul Karim bin Abdul Jalil *Director General of Insolvency* *Malaysia Department of Insolvency* Speaker: Mr Abu Tariq bin Jamaluddin *Director* *Tax Appeal Division, Legal Department* *Lembaga Hasil Dalam Negeri Malaysia* Panelist: Mr S Saravana Kumar *Partner* *Lee Hishammuddin Allen & Gledhill*	
12.30 – 12.45 pm	**Question & Answer Session**	
12.45 – 2.15 pm	**Networking Lunch & Tour Of Exhibition Booths**	
2.15 – 3.30 pm	**Transfer Pricing – The Future Landscape** Chairman: YBhg Tan Sri Dr Mohd Shukor bin Haji Mahfar *Chief Executive Officer* *Lembaga Hasil Dalam Negeri Malaysia* Speaker: Mr Joe Andrus *Head of the Transfer Pricing Unit* *Tax Treaty, Transfer Pricing and Financial Transactions Division* *Organisation for Economic Cooperation and Development (OECD)* Panelist: Mr SM Thanneermalai *President* *Chartered Tax Institute of Malaysia*	
3.30 – 3.45 pm	**Question & Answer Session**	
3.45 – 4.30 pm	**Round Table Discussion Between LHDNM And CTIM** - How to overcome issues of concern to both LHDNM and taxpayers Moderator: YBhg Dato' Syed Amin Aljeffri *Executive Chairman* *Aljeffridean* Panelists: YBhg Dato Mohammad Sait bin Ahmad *Deputy Chief Executive Officer (Tax Operations)* *Lembaga Hasil Dalam Negeri Malaysia* Mr Poon Yew Hoe *Council Member* *Chartered Tax Institute of Malaysia*	
4.30 – 4.45 pm	**Question & Answer Session**	
4.45 - 5.45 pm	**End Of Conference & Refreshments**	

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Heartiest Congratulations

YBHG TAN SRI DATO' DR. MOHD SHUKOR BIN HJ. MAHFAR

P.S.M., D.P.T.J., J.S.M., B.C.M.

Chief Executive Officer of the Inland Revenue Board Malaysia

on being conferred the

Darjah Panglima Setia Mahkota (P.S.M.)

by

DYMM SERI PADUKA BAGINDA YANG DI- PERTUAN AGONG

in conjunction with

His Majesty's Birthday Celebration

on 2 June 2012

From

ctim

CHARTERED TAX INSTITUTE OF MALAYSIA

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

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Tax Guardian

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Tax Guardian

VOL.5/NO.3/2012/Q3
JULY 2012

INVITATION TO WRITE

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.

Contributions may be sent to:
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Email: *publications@ctim.org.my*

From the President's Desk

SM THANNEERMALAI

The 20th Annual General Meeting of the Institute was held on 16 June 2012 at the Seri Pacific Hotel, Kuala Lumpur. It was well attended by our members and we had a robust discussion on matters covering the accounts for the year ended 31 December 2011 and other matters pertaining to the Institute.

At that meeting I was re-elected to the Council for another term together with three new Council Members : Prof. Dr. Jeyapalan Kasipillai , Phan Wai Kuan and Ong Chong Chee. I would also like to say a special thanks to the retiring Council Members whose contributions over the years have been immense : Dr. Ahmad Faisal Zakaria, Aruljothi Kanagaretnam and Assoc. Prof. Faridah Ahmad.

At the AGM, I explained that in the year ahead with the help of the Council Members and the Secretariat together with the cooperation of the members across the country , CTIM should focus on the following:

- Public Practice matters : The Public Practice Committee(PPC) needs to focus on many important issues concerning public practitioners and some of the more important ones that need urgent attention are: recommendations on minimum fees for various aspects of tax compliance services , protocols on the engagement of clients such as letters of engagement , letters of client acceptance , identifying insurance companies or insurance brokers to assist our members in obtaining indemnity insurance at reasonable premiums , managing risks within the practice environment etc..
- Increasing the number of CPD events across the country providing seminars and workshops on new developments and issues of interest. I hope we can find more speakers at the various locations where the seminars are organised as it is becoming difficult to persuade the speakers from Kuala Lumpur to travel across the country due to their busy schedules and this will also help reduce the out of pocket expenses for CTIM.
- Aim to speed up the delivery of technical information to our members and to increase the amount of tax and tax related information to yourselves. Here we need to add more manpower and related resources. So far in 2012 the number of e-CTIMs has already exceeded the whole of 2011 and more will be on the way .
- Promote the relevance of the CTIM qualification to the private sector so that it is recognised by them as a requisite for practicing in the field of taxation or working in the field of taxation within business enterprises. Here there is a need for the Examinations Committee to go on a campaign trail to promote the benefits of the CTIM qualification.
- There is also a need for CTIM through the Education Committee to go out and promote the CTIM examination and qualification to the academia and their students
- Increasing the number of members. Currently it stands at 2,948 and I hope by next June, it will exceed 3,500 through advertising campaigns and other activities.
- To keep on producing a Tax Journal that will carry on being recognised as the best in the country for tax related technical matters and will keep increasing the quality of its technical content.
- Having had extensive dealings with the Ministry of Finance and the Inland Revenue Board over the past year , CTIM needs to carry on building a rapport with other statutory and government bodies and Ministries such as the Ministry of International Trade and Industry and the Ministry of Domestic Trade and Industry, Bank Negara, Securities Commission, Bursa etc..
- Enhancing the activities at the Branches and increasing the number of CTIM members at the Branch level. Branch activities need to be carried out throughout the year so that there is active participation by members outside the Klang Valley in CTIM matters.

These are amongst the many items in my agenda for 2012/2013 and I hope that the help of the Council working closely with one another as a team will help me achieve the wishlist I have set out above.

I hope all of you are aware that the IRB has been carrying out criminal investigations on a limited number of cases and here we understand the whole protocol adopted during such proceedings and thereafter it can be quite different from a normal investigation where statements can subsequently be used in the court proceedings. We need to engage the IRB to come out with a separate framework of the protocol for criminal investigations just as we have for normal investigations and tax audits.

There are many other pressing matters that CTIM needs to address over the next year that affects taxpayers and they include : the ongoing issue of penalties, impending changes to the tax legislation and rules surrounding various FRSs, retrospective implementation of new rules such as the Transfer Pricing rules issued in May 2012 but with an effective date of 1 January 2009. CTIM will endeavour to deal with these other issues as they come up over the year.

Finally the 2012 National Tax Conference will be held from 17 to 18 July and the topic this year is : *Taxation Challenges in a Borderless Economy*. I hope as usual you will give CTIM the full support by registering early for the Conference.

Editor'sNote

DATO' RAYMOND LIEW LEE LEONG

A BUDGET FOR THE NATION

It's that time of the year again and the National Budget month is approaching fast. Effective and efficient taxation is critical to funding the Budget, which will in turn help Malaysia achieve its long-term vision of becoming a developed high-income nation by 2020.

As part of our contribution and services to the nation, the tax community annually makes recommendations for the forthcoming Budget. This year, in tune with a Budget themed "Driving Transformation towards a Developed Nation", we have made a series of proposals in our Memorandum on Budget 2013, which proposes measures specifically related to improvements in the tax system and tax administration, covering indirect tax as well as direct tax.

Measures proposed for improving the indirect tax system include the Goods and Services Tax (GST), which will be implemented in the imminent future. The related and inseparable issues are GST licensing and GST implementation costs, both of which warrant urgent attention and action by the authorities. Meanwhile, in the area of direct taxation, CTIM is making proposals to enhance the efficiency of Income Tax Administration. Our proposals are related to easing the cost of tax compliance, and making the system less onerous and punitive by reviewing penalty provisions and existing tax laws. We are also calling for investment in human capital to build capacity, and investment in innovation to facilitate the nation's migration from a manufacturing-based economy to one oriented towards services and knowledge.

It is CTIM's hope that the desired objectives can be achieved through close collaboration with the government authorities and other stakeholders, via the formulation of policies and strategies that are practical, easily implementable and in the best interests of the Malaysian public. Read all about our proposals in our cover story titled Memorandum on 2013 Budget Proposals and do send us your feedback and recommendations.

Next, delve into the concept and application of tax-efficient supply chain (TESC) planning, an invaluable service that can be provided by tax consultancies to corporate clients wishful to lower their tax rates and improve tax efficiency. Whether you're an internal or external tax consultant, see how you can implement TESC planning to optimise your business.

We also highlight the case study of AQQ, which provides key lessons for Malaysian companies on what not to do if planning to extract value from the franking of credits during these last few years of the transitional period to a single-tier system from an imputation system. It is imperative that every aspect of a transaction's commercial reality can clearly be demonstrated, while downplaying the tax aspect. Each entity in the arrangement should be seen as engaging in the transaction on its own accord/ merits and as actually bearing risks associated with the transaction, and not as a means for tax avoidance.

Corruption never dies and in this issue, we focus on corruption and its permutations, taking a quick look at the treatment of bribery for income tax purposes, the international fight against corruption, and particularly the United Kingdom's Bribery Act of 2010, and the progress made to-date in that fight, including in Malaysia. Do also catch up on competition law in Malaysia which aims to curb anti-competitive practices and promote a competitive market environment and a level playing field for all, including tax practitioners.

The Editorial Committee of CTIM also take this opportunity to congratulate YBhg Tan Sri Dato' Dr. Mohd Shukor Hj. Mahfar on being conferred the Darjah Panglima Setia Mahkota (P.S.M) by DYMM Seri Paduka Baginda Yang Di-Pertuan Agong which carries the title "Tan Sri".

I hope that the topics addressed in this issue will be of use in improving the competency and knowledge of the tax community in Malaysia. Do send us your feedback on how we might improve and I look forward to hearing from you.

All the best.

Editor

THE CHARTERED TAX INSTITUTE OF MALAYSIA (CTIM) COUNCIL MEMBERS 2012/2013

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Phan Wai Kuan

Poon Yew Hoe

Seah Siew Yun

Yeo Eng Hui

Datuk Tan Leh Kiah

CTIM'S 20TH ANNUAL GENERAL MEETING

The Chartered Tax Institute of Malaysia (CTIM) held its 20th Annual General Meeting (AGM) on 16 June 2012 at the Seri Pacific Hotel Kuala Lumpur. A total of 65 members attended the AGM.

Thanneermalai A/L SP SM Somasundaram was re-elected to the Council and the following were elected as new members of the Council:-

1. Jeyapalan A/L Kasipillai
2. Ong Chong Chee
3. Phan Wai Kuan

The first Council meeting for the 2012/2013 term was held on the same day. The Council has elected from amongst the Council Members as listed on the right for the term 2012/2013, the President and the Deputy President.

The Council Members are all committed to the Institute in that by being Council Members means pledging their own time and resources to the objectives of the Institute and in achieving its mission.

PRESIDENT
Thanneermalai Somasundaram
DEPUTY PRESIDENT
Lim Kah Fan
COUNCIL MEMBERS
Khoo Chin Guan
Lew Nee Fook @ Liu Nee Choong
Poon Yew Hoe
Chow Kee Kan @ Chow Tuck Kwan
Dato' Liew Lee Leong
Lai Shin Fah @ David Lai
Lim Thiam Kee
Yeo Eng Hui
Datuk Tan Leh Kiah
Seah Siew Yun
K. Sandra Segaran A/L Karuppiah
Jeyapalan A/L Kasipillai
Ong Chong Chee
Phan Wai Kuan

CHARTERED TAX INSTITUTE OF MALAYSIA'S PRIZE GIVING CEREMONY – 2011 EXAMINATIONS

The Chartered Tax Institute of Malaysia held its Prize Giving Ceremony for graduates and prize winners of the 2011 CTIM Professional Examinations on 16 June 2012 at the Seri Pacific Hotel Kuala Lumpur. Abdul Manap Dim, Deputy Director (Tax Operations) of the Inland Revenue Board Malaysia was the guest of honour at the event. Graduates who have successfully completed the CTIM Professional Examination received their graduation certificates and four prize winners obtained awards of medals for best performance.

In his address, the Chairman of the Examinations Committee of the Chartered Tax Institute of Malaysia, Adrian Yeo, congratulated the 13 new graduates. He congratulated the winners for Best Performance in the taxation subjects and Prize winners for Best Performance in the Foundation and Intermediate level. He reminded them that their knowledge, skills, character and integrity would be tested in the competitive and challenging work environment. He added that graduates should strive to contribute to the tax profession upon their graduation.

Abdul Manap , commended the Institute on the regularly and well updated examination syllabus. In developing and conducting professional examinations in the field of taxation, CTIM has played a vital role in producing competent and knowledgeable tax practitioners to meet the current shortage in the country. He congratulated the graduates for their achievement. He advised them to discharge their duties efficiently to ensure that taxpayers are fully compliant with the law.

Also present at the Prize Giving Ceremony were representatives from various educational institutions, professional bodies, CTIM Council Members, families and friends of the graduates.

BRANCH NEWS

On 24 March 2012, Regina Lau, the Sarawak Branch Chairman conducted a career talk on taxation at the Universiti Teknologi MARA (UiTM) Kuching, Sarawak for the students of the faculty of accounting. The event was officiated by Puan Dayang Nazari Awang Drahman, Accounting Course Coordinator and was attended by over 50 students.

CPD WORKSHOPS

A series of workshops were conducted in the 2nd quarter 2012 as follows:

- Minimising on the Exposure of Withholding Tax & Effectiveness of Double Taxation Agreements in Cross Border Transactions.

- Reinvestment Allowance & Industrial Building Allowance.
- Analysing Tax Cases from the Commonwealth Courts in the Context of Malaysian Tax Practice.
- Tax Audits Findings.
- Submission of 2011 Returns.
- Treatment of Entertainment Expenses and Provisions vs Accruals – Recent Updates.
- Tax Treatment of Income & Expenditure.

The workshop on "Minimising on the Exposure of Withholding Tax & Effectiveness of Double Taxation Agreements in Cross Border Transactions" was conducted by Sivaram Nagappan, who discussed the implications arising on payments subject to withholding tax and how to mitigate them besides being tax compliant.

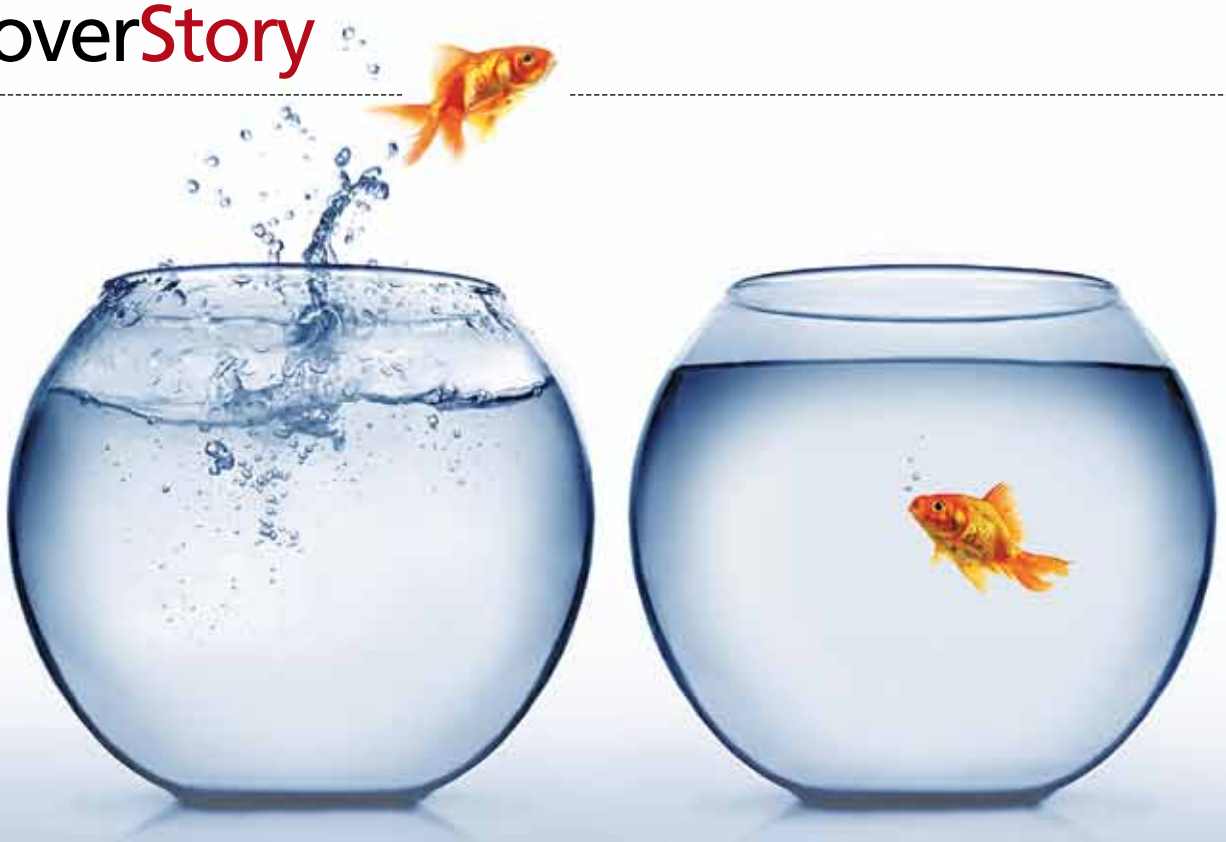
The workshop on "Reinvestment Allowance & Industrial Building Allowance" was conducted twice by Richard Thornton & Thenesh in April 2012 i.e on 17 April and 24 April due to overwhelming response. Many participants from small and medium industries attended this workshop to enhance their knowledge on the deductibility of such capital allowance in the business operations.

A well-known tax lawyer in town, S. Saravana Kumar conducted a series of workshops on "Analysing Tax Cases from the Commonwealth Courts in the Context of Malaysian Tax Practice" across seven major towns in Malaysia. The speaker highlighted a number of Commonwealth cases that are relevant in the context of Malaysian tax practice.

The objective of conducting a workshop on "Tax Audits Findings" was to assist taxpayers or tax agents to have a better understanding of mistakes commonly made and how to resolve them. The speaker, Ong Yoke Yew presented some of the real case studies for participants to identify the weaknesses and how to resolve the issue.

Vincent Josef who is a regular speaker for CTIM guided the participants through all the sections of the various forms such as Form B, C & R, E that tax practitioners may be asked to assist in completing and thereby render better service to their clients in the workshop on "Submission of 2011 Returns" which was held successfully on 17 May 2012.

Farah Rosley, an Executive Director of PricewaterhouseCoopers conducted two workshops for CTIM in this quarter. Both of these workshops namely "Treatment of Entertainment Expenses and Provisions vs Accruals – Recent Updates" and "Tax Treatment of Income & Expenditure" were well received by participants from across various economic sectors who will use this information to apply in the analysis of deductibility of expenses in the accounts of their respective companies.



MEMORANDUM ON 2013 BUDGET PROPOSALS

CTIM

WITH A BUDGET THEMED "DRIVING TRANSFORMATION TOWARDS A DEVELOPED NATION", THE RAKYAT CAN LOOK FORWARD TO DEFINITIVE STEPS TAKEN BY THE GOVERNMENT TO IMPROVE THE MALAYSIAN ECONOMY. THESE STEPS WOULD TIE IN WELL WITH THE BOLD INTRODUCTION OF AN INTEGRATED AND COMPREHENSIVE ECONOMIC AGENDA TO DRIVE NATIONAL TRANSFORMATION BY WAY OF THE GOVERNMENT TRANSFORMATION PROGRAMME (GTP), AND THE ECONOMIC TRANSFORMATION PROGRAMME (ETP), WHICH ARE EXPECTED TO PROPEL MALAYSIA INTO A HIGH-INCOME NATION BY 2020.

This Memorandum proposes measures specifically related to improvements in the tax system and tax administration, covering Indirect Tax as well as Direct Tax. It is hoped that the desired objectives can be achieved through close collaboration with the government authorities and other stakeholders, and the formulation of policies and strategies that are practical and easily implementable.

INDIRECT TAXATION

Measures proposed for improving the Indirect Tax system include the Goods and Services Tax (GST), which will be implemented in the imminent future. The related and inseparable issues are GST licensing and GST implementation costs, both of which warrant urgent attention and action by the authorities.

In this regard, the most pressing needs are the announcement of a firm date for GST, determination of the lead time for implementation (the desirable

period being 18 to 24 months) and training for GST tax agents

CTIM hopes that the Royal Malaysian Customs Department (RMC) would engage the private sector - in particular, the tax practitioners - in prior consultation on the proposed GST orders /regulations /guidelines / rulings on specific arrangements / administrative practices (including lists of items under the zero-rated and exempt categories) in their implementation process. Drafts of the documents should be issued to the relevant stakeholders and published on the GST portal simultaneously to provide clarity and enhance transparency. All finalised documents should be made available to the public within 2 months, upon the announcement of the date of GST implementation. It is hoped that the RMC will continue to educate the public on the new tax regime, and assist in conducting the training programmes for the public and tax agents.

With regard to GST licensing, the proposals are that a) the details (application criteria, professional competency requirements, etc.) on GST licensing should be published as soon as possible; b) the GST tax agent should be members of a professional body, and c) tax agents, licensed under Section 153 of the ITA, should be automatically eligible for the GST tax agent licence.

In addition, GST Implementation Costs, which are expected to have a financial impact on the businessman, should be specifically made tax-deductible by legislation. Further to this, the Ministry of Finance (MoF) / RMC should make application software (with basic GST features) available to the public, by uploading it onto the GST Portal and the RMC website for free download by the public (particularly to assist the small and medium enterprises (SMEs)), and should provide free training and advice to the public. Finally, small grants should be given to SMEs to incentivise the learning of GST.

With regard to Service Tax, the threshold for consultancy and management services should be reviewed. CTIM would like to suggest that MoF raise the threshold of RM500,000 for all professional services so as to promote SMEs and strengthen our services economy,

DIRECT TAXATION

In the area of direct taxation, CTIM is making proposals to enhance the efficiency of Income Tax administration.

One of the proposals is directed at easing the cost of tax compliance. Paragraph 6.4 in the Public Ruling No.6/2006 -Tax Treatment of Legal and Professional Expenses - stipulates that cost of filing tax returns and tax computations as well as cost of appeal (i.e. to the Special Commissioners of Income Tax (SCIT) and the Courts) against an income tax assessment are not allowed a deduction in arriving at a person's adjusted income from a business.

Similarly, it is noted that statutory audit fees are given a deduction under Income Tax (Deduction for Audit Expenditure) Rules 2006 [P.U.(A)129/2006].

CTIM is of the view that taxation fees, expended in respect of a more essential service in ensuring tax compliance, should also be given a deduction to be aligned with the tax treatment of statutory audit fees. The tax authority should take into account the fact that tax agents play a significant role in raising the level and standard of tax compliance, and therefore allow a deduction for professional taxation charges. It must be noted that without a deduction being allowed, taxpayers would easily be tempted to pay the lower fee offered by non-qualified persons, thereby jeopardising the quality of tax compliance.

REVIEW OF PENALTY PROVISIONS

Another proposal is for the review of the penalty provisions under Income Tax Act 1967 (ITA). Currently, the penalty applicable on late filing of tax returns is a cause for grave concern to taxpayers. Section 112(3) (ITA) (Penalty for Failure to Furnish Return or Give Notice of Chargeability) provides that "the Director General may require that person to pay a penalty equal to triple the amount of tax which, before any set-off, repayment or relief under this Act is payable for that year.

Based on the current administrative guidelines, the penalty is imposed at the following rates on tax payable before any set-off:

FILING WITHIN 12 MONTHS AFTER THE DUE DATE	FILING WITHIN 24 MONTHS AFTER THE DUE DATE	FILING WITHIN 36 MONTHS AFTER THE DUE DATE	FILING AFTER 36 MONTHS FROM THE DUE DATE
20%	25%	30%	35%

CTIM is of the view that such a penalty structure should be urgently reviewed, and proposes that Section 112(3) be amended to impose penalty based on the tax liability outstanding (after set-off and deduction of the tax instalment payments paid and the credit balance in the account), instead of tax payable before any set-off. For clarity, guidelines, with examples on how the penalty would be imposed and criteria for discretion to be exercised for extenuating circumstances, should be issued and made available to the public.

In addition, CTIM suggests that the following guiding principles be adopted in reviewing the penalty provisions in the ITA:

- That an independent Penalty Provisions Review Panel, comprising representatives from the Ministry of Finance, the Inland Revenue Board, the Chartered Tax Institute of Malaysia and industry & commercial sectors, be established to look into the revision of the penalty provisions.
- That penalty should be commensurate with the gravity of the offence. Where there is no tax advantage to be gained from the error, penalty should be nominal.
- When imposing a penalty, there is a need to differentiate the occasional oversight or unintentional mistake committed by a taxpayer, from the repetitive offences committed by another taxpayer.
- Discretionary power should be given to the Director General to mitigate the effects of the penalty provision in extenuating circumstances. However, clear guidelines must be given on when and how the discretionary power may be used.

REVIEW OF ONEROUS LAWS AND PROVISIONS

will be aimed at making it easier and less burdensome for taxpayers to fulfil their obligations in respect of taxation.

With regard to Group Relief, CTIM proposes that the definition of related companies be amended to be in line with the definition provided under the Companies Act 1965. Therefore, the restriction of a 70% shareholding should be removed, and the cost of financing should be allowed a deduction in arriving at the adjusted income from a business.

With regard to the recent stand on Interest-Free Loans Among Group of Companies, an administrative concession should be granted to allow companies a transitional period to rearrange their financial structure. CTIM suggests that the new practice be applied to all new loans / advances made or entered into from 1 January 2013.

Although Parliament aims to draft unambiguous legislation that covers all foreseeable circumstances, it does not easily achieve this, as seen by the cases that involve litigation. In this context,

transparency and clarity of laws and regulations becomes imperative. Since no legislation can be complete, case law provides information on the opinions of the Courts on the interpretation of the legislation, relied upon by taxpayers, practitioners and tax officers. In light of this, the tax fraternity welcomes initiatives to improve the dissemination of such information.

In this connection, it is proposed that tax cases decided by the Special Commissioners of Income Tax (SCIT), Customs Appeal Tribunal (CAT) and the Courts be made available to the public, for purposes of improved transparency, through timely dissemination via the IRB's, SCIT's and Customs' websites, or other relevant means. In addition to that, in preparing their tax computations, taxpayers should be allowed to adopt the decisions passed by the Courts (irrespective of the stage of appeal of the case) in respect of the interpretation of the legislation. There should be no penalty imposed on the taxpayer for following such Court decisions.

RE-ENERGISING THE PRIVATE SECTOR

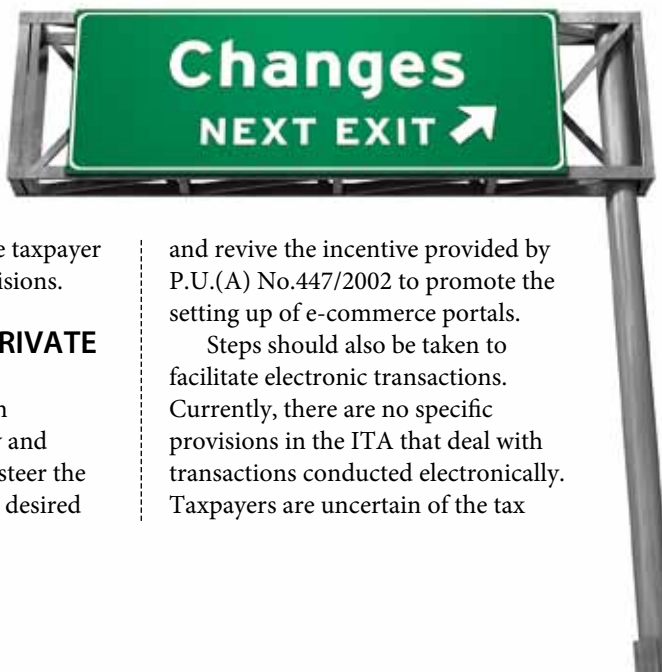
It is acknowledged that an improvement in productivity and productivity-led growth will steer the nation towards achieving the desired goal of a developed nation. Whilst moving towards this same end, it is an opportune time for the creation of an environment that fosters economic growth with the private sector as the main driver.

Technological advancements have created a borderless world, in which taxation is still relevant. However, to stay relevant, there is a need to promote electronic commerce. Presently, only approved offshore trading companies which buy and sell goods sourced from overseas and consumed overseas through a website in Malaysia are eligible for the preferential treatment under Income Tax (Exemption)(No.5) Order 2003 [P.U.(A) No.152/2003].

CTIM therefore suggests that the government issue guidance on the tax treatment of e-commerce transactions and revive the incentive provided by P.U.(A) No.447/2002 to promote the setting up of e-commerce portals.

Steps should also be taken to facilitate electronic transactions. Currently, there are no specific provisions in the ITA that deal with transactions conducted electronically. Taxpayers are uncertain of the tax treatment resulting from e-commerce transactions – the basis of taxation, impact of double tax treaties, withholding tax implications on payments for internet services, software payments, etc. To address these needs, CTIM proposes that: a) there be improvement in the nation's infrastructure to facilitate e-commerce activities – to facilitate the exchange of ideas and the availability of human resource support, and b) specific provisions/guidelines should be introduced to address the scope of derivation and chargeability to tax, characterisation of receipts and payments, and business presence (when a website may constitute a PE).

IT IS ACKNOWLEDGED THAT AN IMPROVEMENT IN PRODUCTIVITY AND PRODUCTIVITY-LED GROWTH WILL STEER THE NATION TOWARDS ACHIEVING THE DESIRED GOAL OF A DEVELOPED NATION. WHILST MOVING TOWARDS THIS SAME END, IT IS AN OPPORTUNE TIME FOR THE CREATION OF AN ENVIRONMENT THAT FOSTERS ECONOMIC GROWTH WITH THE PRIVATE SECTOR AS THE MAIN DRIVER.



PROMOTION OF SERVICE AND KNOWLEDGE ECONOMY

In line with some of the Strategic Reform Initiatives under the Economic Transformation Programme, changes have to be implemented, one of them in the area of capacity building for the Service Economy.

To transform the Malaysian economy from a manufacturing economy into a service and knowledge economy, efforts have to be taken in building and developing the capacity of our human resources. In the context of an institute serving its members, CTIM has put forward the following proposals:

(i) With regard to widening the scope of professional courses (beyond the provisions under Section 46(1)(f) ITA) – it is important that the government consider allowing a deduction (in the form of a relief) for educational expenses incurred in pursuing courses taken from a local educational/professional institution, unless such a course / professional examination is not available locally. (ii) It is proposed that the costs incurred by individuals in attending Continuing Professional Education (CPE) courses be deductible against their employment/ business income and (iii) Recognition must be given to the contribution of professional bodies. In this context, CTIM suggests that professional bodies be taxed as "mutual" clubs; and the income from conducting (CPE) courses/seminars/workshops etc. be exempt from income tax because the income is mainly from members. The income from non-members is incidental in nature.

FACILITATING INNOVATION

To remain competitive and achieve sustainable growth, Malaysia must move up the value chain and improve productivity through innovation. This can be achieved through the development of Centres of Excellence. For instance, to strengthen our economic foundation, Malaysia should maintain a competitive edge over the other palm oil-producing countries, by the establishment of Centres of Excellence for Palm Oil and Oleo chemicals. This could be a joint effort between the government and the private sector, with the objective of improving the overall quality and production yield and gaining market access for the palm oil and biofuel products.

To encourage the industry players to participate in, and promote the establishment of Centres of Excellence a (tax) double deduction should be given for expenses incurred for the use of the services of the Centres of Excellence; and accelerated building allowance of 20% should be given on the cost incurred on construction or purchase of buildings used as Centres of Excellence.

Innovation also calls for an expansion into research and development (R&D) activities. To encourage research and development, CTIM suggests that incentives for further investment in R&D be given due attention, for example: (i) R&D allowance of 20% be granted on the increase in R&D expenditure incurred during the year, to be set-off against the statutory business income for that year; any unutilised R&D allowance may be carried forward for set-off against future statutory income from the business until it is fully utilised; and (ii) accelerated capital allowance be granted to qualifying expenditure on plant and machinery used for R&D, and accelerated building allowance given on qualifying capital expenditure on buildings used for R&D

PROMOTING THE GROWTH OF SMEs

Since challenges are often faced by businesses when starting, easing start-up barriers is expected to be helpful in promoting the growth of SMEs. Currently, pre-commencement expenses such as interest cost for the business premises / buildings, costs incurred in carrying out feasibility studies, staff and administration costs and all other costs eventually leading to the production of income are not deductible.

CTIM suggests that pre-commencement expenses incurred by an SME for a period of 24 months immediately before the commencement of business be given a deduction in the basis period for the year of assessment in which the business commenced.

Incentives connected with building allowance for all business premises will also encourage the SMEs. Currently, no allowance is accorded to capital expenditure incurred on commercial buildings, office complexes, private medical clinics, private dental clinics, other healthcare facilities, etc. By way of comparison, commercial buildings are recognised as industrial buildings in Hong Kong.

In this context, CTIM proposes that: (i) the scope of Schedule 3, Paragraph 63 of the ITA be extended so that building allowances are given to capital expenditure expended on or after 1 Jan 2013 on all buildings which are used solely for the purposes of a business, and (ii) the eligibility to claim building allowances be extended to the owners or lessors of non-industrial buildings.

SINCE CHALLENGES ARE OFTEN FACED BY BUSINESSES WHEN STARTING, EASING START-UP BARRIERS IS EXPECTED TO BE HELPFUL IN PROMOTING THE GROWTH OF SMEs. CURRENTLY, PRE-COMMENCEMENT EXPENSES SUCH AS INTEREST COST FOR THE BUSINESS PREMISES / BUILDINGS, COSTS INCURRED IN CARRYING OUT FEASIBILITY STUDIES, STAFF AND ADMINISTRATION COSTS AND ALL OTHER COSTS EVENTUALLY LEADING TO THE PRODUCTION OF INCOME ARE NOT DEDUCTIBLE.

FACILITATING ESTABLISHMENT OF LOCAL CONGLOMERATES

Several matters related to local conglomerates have been brought up for consideration by the authorities, for example, the payment in consideration for losses surrendered for Group Relief. Even though the IRB recognises that payments received in consideration of losses surrendered would not be taxable on the surrendering company and similarly payments made would not be allowable on the claimant, CTIM proposes that the above treatment be legislated. It is also suggested that the group relief be extended to unutilised capital allowances so that a company is allowed to transfer its unutilised capital allowances to another company within the same group. In addition, it is suggested that Section 44A(2)(ii) of the ITA be amended to allow a claimant company to claim group relief although its paid-up share capital in respect of ordinary shares is RM2.5 million or less at the beginning of the basis period for that year of assessment.

ADOPTION OF INTERNATIONAL STANDARDS AND PRACTICES

The Malaysian Accounting Standards Board (MASB) has committed to fully converge with the International Financial Reporting Standards (IFRS) by 1 January 2012.

In principle, FRSs are on a fair value-accounting basis while the basis of taxation is still on historical costs, giving rise to divergence between accounting and tax treatment. In view of the above, the Institute, together with the Malaysian Institute of Accountants and the Malaysian Institute of Certified Public Accountants, has set up a Joint Tax Working Group on FRS (JTWG-FRS) to study the tax implications on the implementation of FRS, and has made recommendations on the appropriate tax treatment. Studies have been completed on 12 FRSs and the relevant Discussion Papers have been submitted to the authorities.

CTIM proposes that, as a guiding principle, where the difference between the accounting treatment of an item/ transaction under FRS and the tax treatment is merely a matter of timing, the tax treatment shall converge with the accounting treatment. This will help to reduce the cost of doing business and increase tax administration efficiency. Essentially, with IFRS, it is "all talking the same language".

TAX TREATMENT OF PREMIUM AND PROCEEDS FROM PROFESSIONAL INDEMNITY INSURANCE (PII)

The current stand of the IRB based on the Public Ruling No. 3 of 2009, is that proceeds received from the PII are taxable but the amount paid out to the claimant is not deductible. In view of the firm stand taken by IRB, CTIM suggests that the MoF consider giving justice to the matter by way of a gazette order which would achieve the following objectives: (i) all professional service providers are to be allowed to claim a tax deduction on premium paid on PII to a local insurer; (ii) the income of a professional from the stand-in duties, including that of a locum, should be treated as business income from the carrying out of his profession and the premium on PII is to be allowed as a deduction against such income; and (iii) proceeds from PII are to be taxable and the compensation payment to the claimant to be deductible.

CONCLUSION

It is hoped that with CTIM's input, alongside the innumerable other proposals from other parties – among them organisations, bodies, associations, industry representatives - the next year's Budget will bring more tax reforms that will help keep the nation on a progressive mode, even if it means definitely having to keep pushing the bar, and staying competitive.

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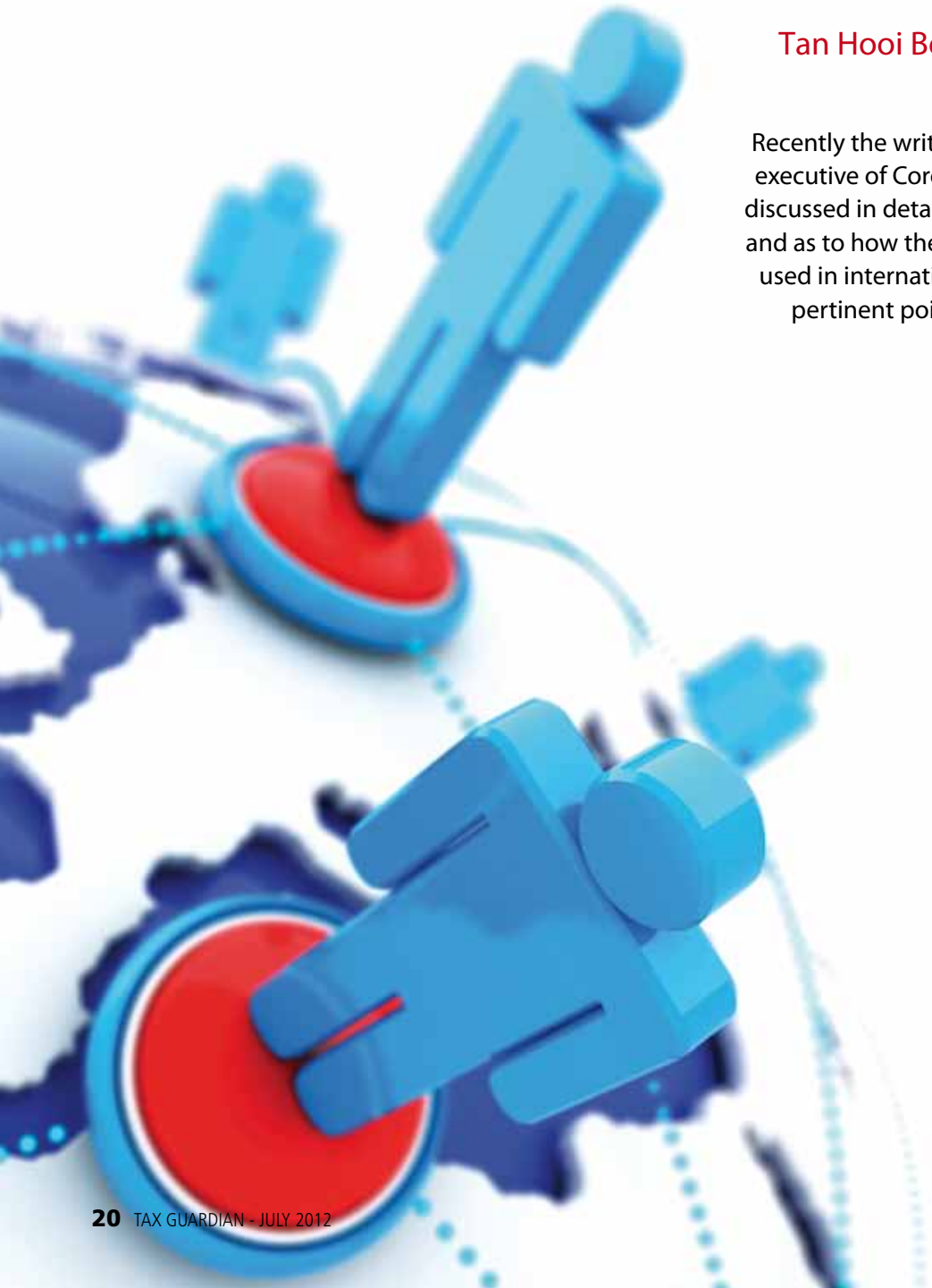
Tax-Efficient Supply Chain
– Making it Happen

Tan Hooi Beng



Recently the writer met **ALYSSA (A)** who is a tax executive of Coro Inc, a US based MNC and they discussed in detail the tax aspects of supply chain and as to how the supply chain concept has been used in international tax planning. Some of the pertinent points discussed are as follows:

t How are you?

a I am doing great. Recently, the Board of Directors of Coro Inc has decided to relook at the group tax efficiency and global effective tax rate. And, it seems that something has to be done to lower the rate.

t What is the main factor that results in a high effective tax rate? Does that apply to all companies within the Coro Group worldwide?

a I would not say all, but in certain countries where the tax holiday enjoyed by our subsidiaries have lapsed and this includes Malaysia. And, the worst is yet to come as more tax breaks will be ending very soon. So, we really need to think of a way to manage this. A tax consulting firm has approached us and introduced the tax-efficient supply chain (TESC) planning. I have heard of this previously but did not bother too much as the group effective tax rate was still manageable then. Do you have experience on this? It will be really helpful if you could provide me

some insight.

t Certainly. To begin with, supply chain is not really a tax concept. Rather, it is purely a business concept. Per *Wikipedia*, supply chain is a system of organisations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer. Supply chain activities transform natural resources, raw materials and components into a finished product that is delivered to the end customer. A well managed supply chain could give rise to the following benefits:

- Centralises many of the strategic global/regional intangibles, functions, activities and risks, and their associated revenue streams, in a Centralised Principal (CP) entity located in a tax-efficient jurisdiction.
- The CP forms the platform for further centralisation of functions, activities, risks and intangibles by virtue of natural business evolution or acquisition.
- The CP is supported by a network of affiliated and unrelated service providers engaged in discrete business processes, such as manufacturing, sourcing, or distribution. Centralised principal can be supported by contract manufacturers, toll manufacturers, limited risk service providers etc.
- Centralised and consistent key operational and strategic business decisions, product development etc.
- Better sharing of services (R & D, payroll, accounting, logistics and quality control), technology and commercialisation of products. Hence, quality and speed can be improved at lower cost.
- Concentration of strategic responsibilities and risks.
- Global tax efficiency.

a Now, I am confused. How does global tax efficiency come into the picture?

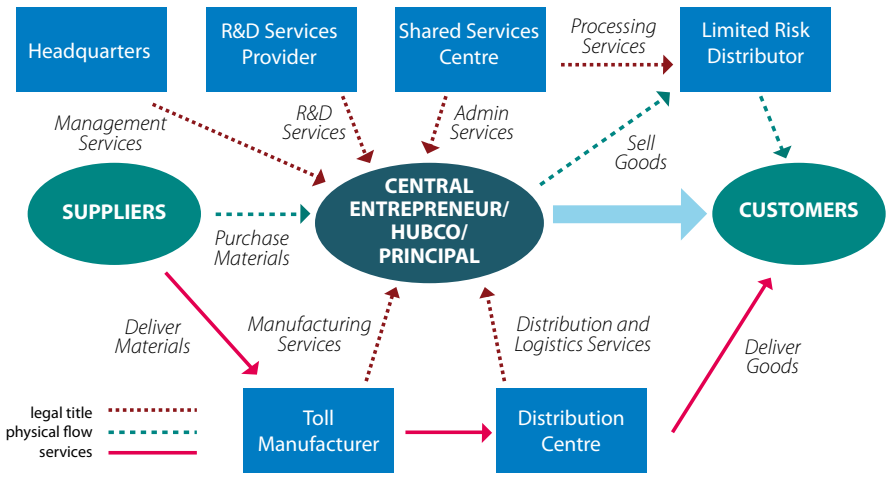


Diagram A

t Let me explain to you the concept of TESC introduced by the consulting firm you mentioned earlier. Basically, a skillful international tax practitioner will always seek to align the supply chain objectives with the tax-efficiency objectives. In other words, he will take the opportunity to structure the supply chain with a view to minimising group effective rate.

a Please elaborate.

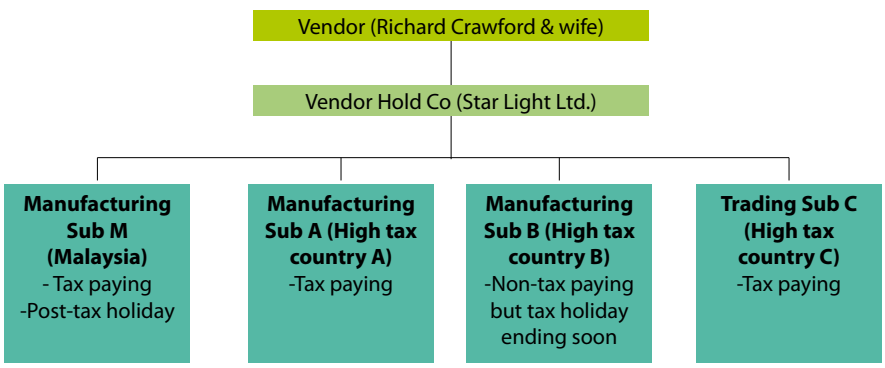
t Sure. Let me use the board. That will facilitate our discussion.

The **Diagram A** depicts a typical TESC business model. As you could see from the diagram, there will be various parties involved. To ensure that the tax efficiency aspects of the supply chain are addressed adequately, the transfer pricing policy of the Group has to be well supported. This is a crucial point as the key profit drivers are placed with the CP which will receive the entrepreneurial return whilst other parties are merely performing routine functions.

a Have you ever implemented a TESC planning for your client previously? If so, can you share your experience on that?

t Yes, indeed. Let me share with you a real case. My tax team was involved in an M & A exercise and we acted on behalf of the acquirer, Nu Horizon Sdn Bhd. The potential sellers were Richard Crawford and his wife. **Diagram B** was the pre-acquisition structure (i.e. the existing holding structure of the vendor).

Diagram B



On behalf of Nu Horizon Sdn Bhd, we have conducted a tax due diligence and the decision was to go ahead with the acquisition. Having said this, you would realise that the effective tax rate for the group will increase soon given that subsidiary B will be paying corporate tax soon. Apart from that, subsidiary M, subsidiary A and subsidiary C were already paying corporate taxes in their respective home countries.

a Noted. But what has the result of your tax due diligence got to do with the TESC?

t As a result of the decision to proceed with the acquisition, this presented a great opportunity to relook at the present business model of the vendor, i.e. are there ways to enhance to global tax efficiency for the group. And, looking at the profile of subsidiaries M, A, B and C, certainly TESC could be the way forward. Where no further tax-efficient consideration is given, the group will continue to pay significant taxes. In short, without TESC planning, the holding/operating structure would be as **Diagram C**.

In essence, nothing changes except for the shareholders. Subsidiaries M, A and B will remain as fully-fledged manufacturers whilst Subsidiary C continues to act as a fully-fledged distributor.

a So, what was your suggestion?

t We have suggested that from the commercial and business perspective, the group should consider relooking at its supply chain model. Where possible, the efficiency of the model should be enhanced. Where TESC is implemented, the holding/operating structure of the group would be as **Diagram D**.

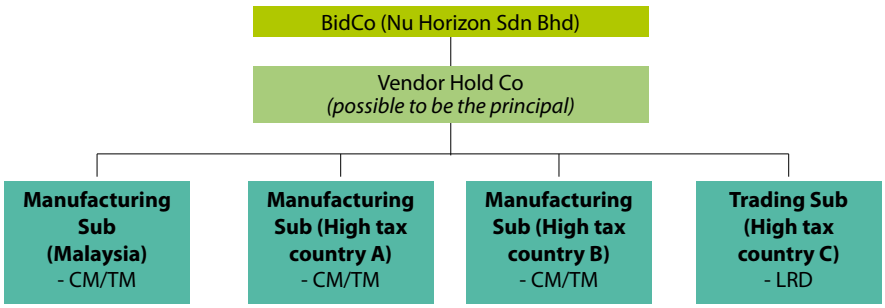


Diagram D

You would note that all the fully fledged manufacturers (FFM) would be converted into either toll manufacturer (TM) or contract manufacturer (CM). Also, the full fledged distributor (FFC) in country C would be turned into a limited risk distributor (LRD).

a As a result of the conversion, would there be a reduction in the group effective tax rate?

t Absolutely – on the basis that TESC is properly implemented and this includes the choosing of the right jurisdiction to house the CP. Under a well-implemented TESC model, CM/TM and LRD in the high tax-paying countries would have minimal profits given the new transfer pricing position. In essence, CM/TM and LRD undertake and assume minimal functions and risks respectively. As such, they are only entitled for minimal profits. On the other hand, the CP would be the entity that assumes most functions and risks respectively – hence has the right to most of the profits. Given this, naturally a CP should be based in a tax-neutral/low tax jurisdiction. Alternatively, CPs can also be housed in countries that provide tax holiday for CP's, notably Singapore.

a Does Malaysia grant tax holiday to CP's?

t This is an interesting question. Based on the merit of each case, it is possible to write to the Minister of Finance for a special tax incentive. Indeed, there are precedents to this!

a Is this a challenging task?

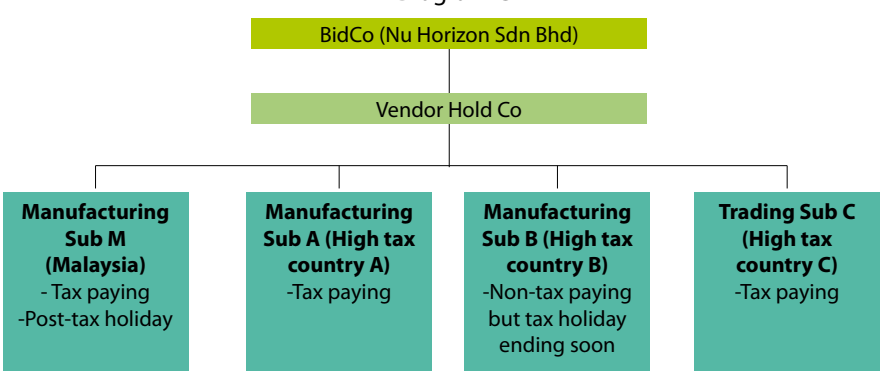
t As always for the case of special tax incentive, the applicant must demonstrate that various economic benefits will accrue to Malaysia if the new business model is implemented.

a After having heard what you said, I believe that it is not easy at all to implement a TESC business model. What are the technical aspects from the tax perspective that one must consider?

t There are many issues and challenges. Some of the pertinent aspects are:

- The defensibility of the TP position taken by the group that deals with the returns of a CP, TM/CM and LRD

Diagram C



- The TP position of the intangibles as this is a complex area
- Whether the activities of a CM/TM would trigger a permanent establishment (PE) or taxable presence for the principal in the country where TM/CM is operating in
- Whether the activities of LRD would trigger a PE or taxable presence for the principal in the country where LRD is operating in
- Indirect tax issues (VAT, customers) for the TM/CM and LRD
- The appropriate jurisdiction for the CP to be based in and the level of economic and business substance for the CP
- Conversion issues (e.g. exit charge) that could arise when FFM is converted into CM/TM or when FFD is converted into a LRD
- Same country issue – for e.g. when the CM/TM and final customers are in the same country.

a Looks like there are a host of technical issues to be considered.

t In all honesty, based on my experience, technical issues can be sorted out. The major stumbling block to a TESC is the people issue!

a What do you mean?

t Let me explain and start by saying this – gone were the days where "paper" companies based in popular tax havens could be used in international tax planning. The revenue authorities around the globe have caught up and the structure without economic substance will not stand their challenges. Therefore, the only way to implement a proper TESC structure is to ensure that the CP is a real company with real people! Hence, key management would need to be relocated to the CP – and this does not necessarily augur well with everyone as leaving the comfort zone could be the hardest thing to do.

a I see what you mean. I have one last question for you – can a TESC planning be challenged by the tax authorities, including your Malaysian authorities?

t As you know, no matter how well a tax planning structure is implemented, it is not immune from the tax office's challenge. This is a fact as there is a thin line between tax avoidance and tax mitigation. Hence, it is very crucial for all tax mitigation schemes to be integrated with commercial reasoning so as to mitigate the risk of being challenged.

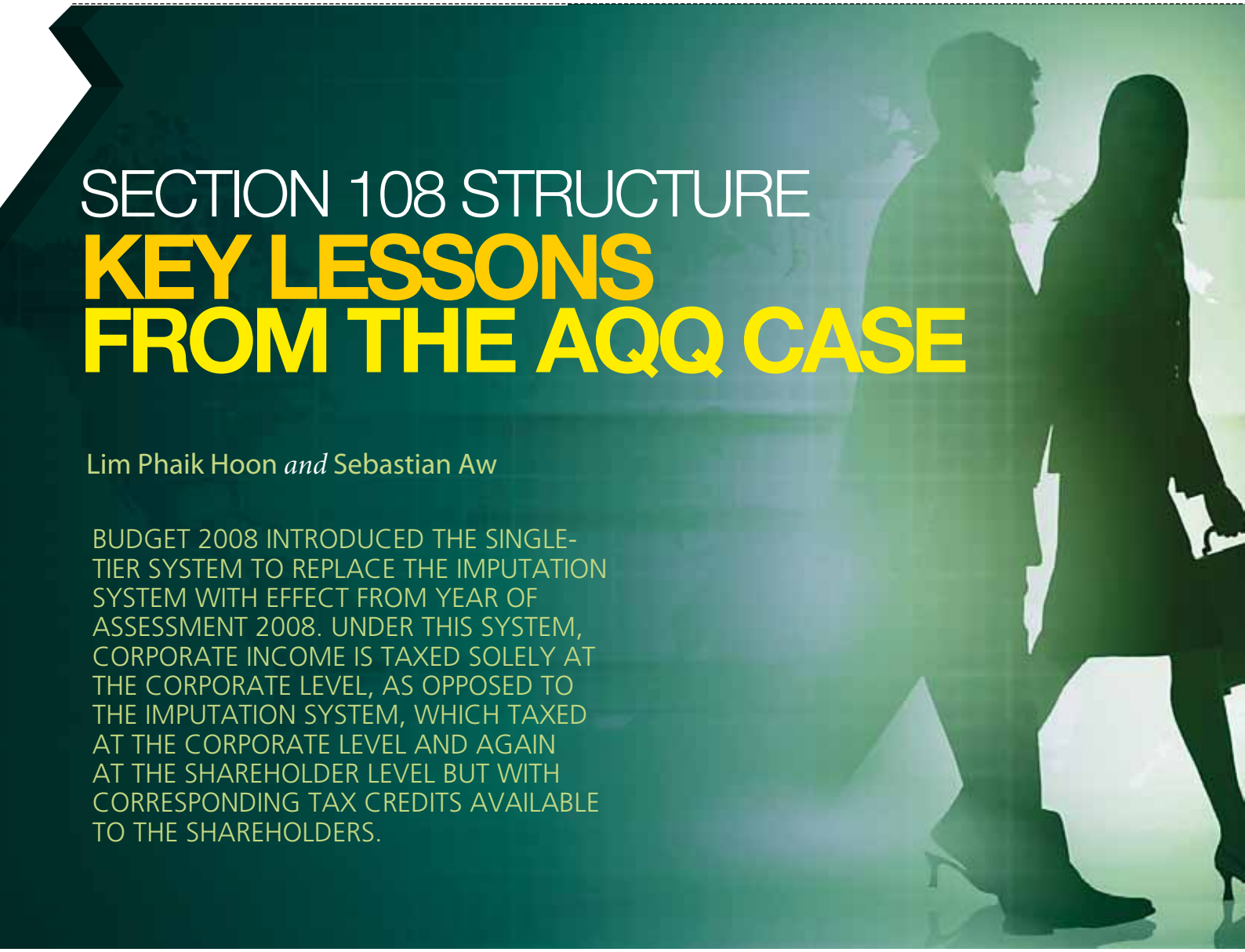
a Is it so even though there is a tax treaty between the country where the CP is with the country where the CM/TM/LRD is?

t The tax authorities will and should respect the tax treaty. But, please do not forget that certain countries have local anti-avoidance rules that can override the treaty in the case of tax avoidance. Even though there is no treaty override position in the domestic tax law (for e.g. the Malaysian Income Tax Act 1967), one should always go back to the original intention of a tax treaty, i.e. to avoid double taxation and prevent fiscal evasion. There is always a possibility for the tax authorities to contend that a tax treaty is not meant to promote a tax avoidance scheme.

a Thank you very much. I have a better understanding of the tax aspects of supply chain now.

t My pleasure.

Tan Hooi Beng *is an executive director of tax at BDO Malaysia. He has many years of experience in international tax and was previously the international tax leader at Deloitte Malaysia. The above views are his own. He can be contacted at hbtan@bdo.my*



SECTION 108 STRUCTURE
KEY LESSONS FROM THE AQQ CASE

Lim Phaik Hoon *and* Sebastian Aw

BUDGET 2008 INTRODUCED THE SINGLE-TIER SYSTEM TO REPLACE THE IMPUTATION SYSTEM WITH EFFECT FROM YEAR OF ASSESSMENT 2008. UNDER THIS SYSTEM, CORPORATE INCOME IS TAXED SOLELY AT THE CORPORATE LEVEL, AS OPPOSED TO THE IMPUTATION SYSTEM, WHICH TAXED AT THE CORPORATE LEVEL AND AGAIN AT THE SHAREHOLDER LEVEL BUT WITH CORRESPONDING TAX CREDITS AVAILABLE TO THE SHAREHOLDERS.

Despite the single-tier system coming into effect in 2008, the government has allowed a six-year transitional period (1 January 2008 to 31 December 2013) to enable companies with unutilised balances to continue to pay franked dividends during the period.

With the death knell of the imputation system, some corporate taxpayers may feel tempted to utilise these last few years of the transitional period to minimise their tax liability through creative application of their franking credits. However, the Singaporean case of *AQQ v The Comptroller of Income Tax*[1] weaves a cautionary tale for any business so tempted.

THE FACTS

AQQ, a Singapore incorporated company, was a wholly-owned subsidiary of B Berhad, a public company listed on the Kuala Lumpur Stock Exchange. As part of the Group's reorganisation, AQQ was incorporated in May 2003 to be the proposed holding company to hold the various Singapore subsidiaries of the Malaysian parent company.

In order to facilitate the reorganisation, a financing structure was put in place to fund the acquisition of the Singapore subsidiaries. This involved AQQ issuing fixed rate convertible notes (Notes) to a third party bank in Singapore (Bank) on 18 August 2003. With the proceeds

[1] *[2011] SGITBR 1*

from the Notes, AQQ acquired all the issued shares in the existing Singapore subsidiaries of the Malaysian parent company.

On the same day, the Bank sold the principle component of the Notes at par (while the interest component of the Notes was structured as a forward sale agreement) to its Mauritius Branch which then on-sold the same Notes to one of the group's subsidiaries, C. The transactions were structured in such a manner that C was able to pay the Mauritius Branch for the Notes by way of its own funds and intercompany borrowings, both arising from the proceeds from the sale of the subsidiaries to the Appellant. The Mauritius Branch then in turn paid the Bank for the purchase of the Notes.

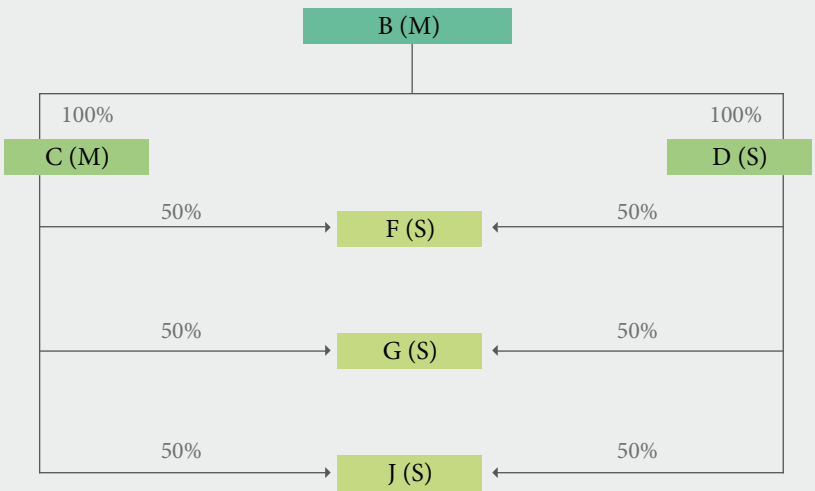
Following the completion of the reorganisation, the Singapore subsidiaries paid dividends to AQQ for years of assessment (YA) 2004 to 2007. These dividends are franked dividend under the imputation system which carries tax credits.

In its tax returns for YAs 2004 to 2007, the Appellant deducted the interest paid on the Notes against the franked dividend income from its subsidiaries. As a result, a refund of the tax credit was made to AQQ.

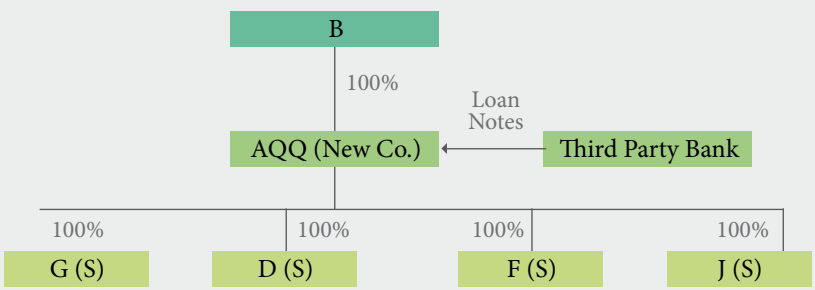
However, following further queries, the Comptroller of Income Tax invoked Section 33 of the Singapore Income Tax Act (equivalent of Section 140 of the Malaysian Income Tax Act1967). The Comptroller disregarded the dividend income as well as the interest expenses incurred, as he was not satisfied that "there were commercial justifications for the financing arrangement". Consequently, AQQ had to repay the tax refund. AQQ then appealed to the Income Tax Board of Review (the Board), contending the Comptroller had wrongly applied Section 33.

The group structure ***before and after*** the reorganisation together with the transaction flows are reproduced as follows:-

Group Structure Before Reorganisation

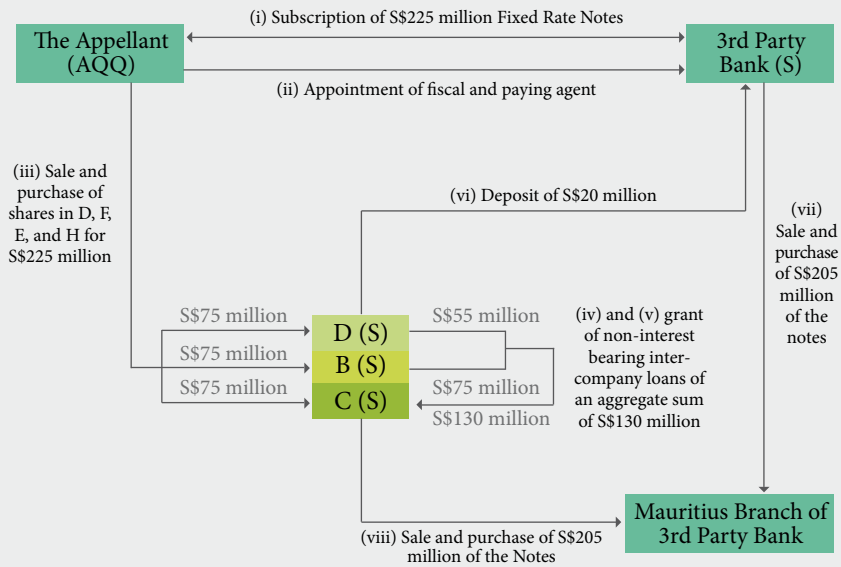


Group Structure After Reorganisation

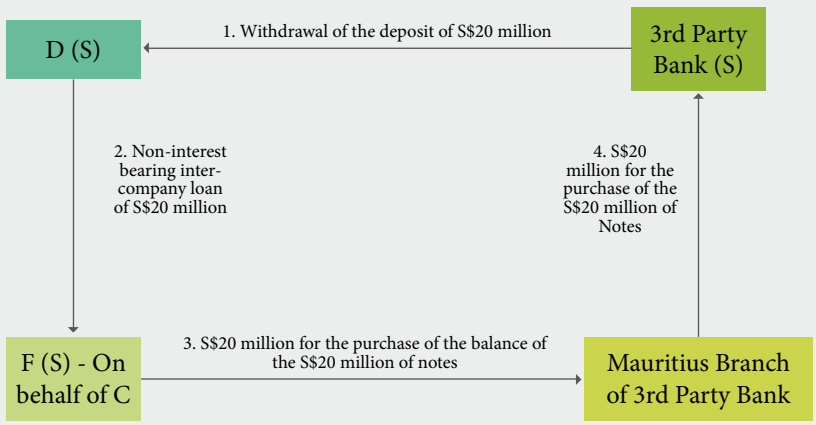


IT WAS FOUND TO BE CONTRIVED AND ARTIFICIALLY STRUCTURED TO OBTAIN A TAX REFUND THROUGH UTILISATION OF TAX CREDITS AND WAS NOT MADE AT ARM'S LENGTH.

Transactions which took place on 18 August 2003



Flow of funds on or around 18 November 2003



THE DECISION

The Board dismissed the appeal. To summarise, it found that the anti-avoidance provisions had been satisfied and that the actions of AQQ had amounted to the purpose and effect of tax avoidance. It was found to be contrived and artificially structured to obtain a tax refund through utilisation of tax credits and was not made at arm's length.

Material to the decision of the Board was the lack of documentary and contemporaneous evidence of the group's intention for restructuring. The Board noted the following:

> We are not persuaded that there was any real commercial justification for the loan, other than as part of an arrangement entered into in order to obtain or extract tax benefits. For a loan of this magnitude, we would have expected the Appellant to adduce minutes of meetings or other records of discussions by the directors of the Appellant... regarding...the commercial considerations or a business case justifying the taking of the loan. [2]

Another factor in the Board's decision was that it did not perceive

[2] *Ibid, 105.*

the transaction to be at arm's length. Relevant to this perception was that all the entities involved in the financing arrangement (except the Bank) were related parties. They were thus held to be in the same enterprise and under the same control and direction. Further solidifying the Board's finding was the fact that all the transactions were carried out in the same day and that the role of the Bank had been merely facilitative and not that of a lender.

THE LESSON

Singapore's anti-avoidance section[3] is very similar to Malaysia's own anti-avoidance law[4], and in absence of any relevant Malaysian precedent, *AQQ v CIT* will likely prove to be persuasive should similar facts ever be brought before Malaysian Courts.

The reasoning behind the Board's decision, which was elaborated on prior, can be summarised as follows:

- There was no real commercial justification for the loan, nor was there any documentary or contemporaneous evidence of the group's intention for restructuring; and
- The arrangement was found to be a contrived and artificial way to enable the Appellant to utilise the tax credits and obtain a tax refund; and
- The arrangement was not carried out for bona fide commercial reasons; and
- All the relevant transactions took place in a single day.

Malaysian companies can thus learn several key lessons from AQQ.

Firstly, the case has illustrated the vital importance in maintaining documentary evidence of the commercial reasoning behind the transaction. In addition to the prior quotation, the Board further opined:

> In the discussion paper, it is stated that the main objective of the proposed restructuring of [B Berhad]'s operations in Singapore was to enable [B Berhad] to streamline its operations in Singapore... however, the paper does not go on to explain how this objective could be achieved by the proposals set out in the paper...there was also no documentary evidence adduced during the appeal to provide the explanation. [5]

The importance of documentary evidence cannot be understated in the AQQ decision, and will likely play a similar role in Malaysian Courts. As can be garnered by the reasoning of the Board, documents will have to provide sufficient commercial justification, objectives and explanations on how those objectives will be met by the transaction.

[3] Income Tax Act 1988 S33 (1) Where the Comptroller is satisfied that the purpose or effect of any arrangement is directly or indirectly – (a) to alter the incidence of any tax which is payable by or which would otherwise have been payable by any person; (b) to relieve any person from liability to pay tax or to make a return under this Act; or (c) to reduce or avoid any liability imposed or which would otherwise have been imposed on any person by this Act, the Comptroller may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the arrangement and make such adjustments as he considers appropriate, including the computation or recomputation of gains or profits, or the imposition of liability to tax, so as to counteract any tax advantage obtained or obtainable by that person from or under that arrangement.

[4] Income Tax Act 1967 S140 (1) The Director General, where he has reason to believe that any transaction has the direct or indirect effect of- (a) altering the incidence of tax which is payable or suffered by or which would otherwise have been payable or suffered by any person; (b) relieving any person from any liability which has arisen or which would otherwise have arisen to pay tax or to make a return; (c) evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by this Act; or (d) hindering or preventing the operation of this Act in any respect, may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustments as he thinks fit with a view to counteracting the whole or any part of any such direct or indirect effect of the transaction.

[5] Above n1, 106-7.

Further, transactions of significant magnitude must be justified with similarly detailed documentation.

The second matter for consideration is that businesses must ensure that there is a reasonable commercial basis for the transaction. In addition to the importance of documentary evidence, the said documents must also sufficiently illustrate a commercial justification for the transaction in order to ward off accusations of non-bona fide dealings. On the facts of AQQ, the Board found no such justification:

> Stripped of details, the Appellant in effect borrowed money from another company within the group (namely, C) to acquire the Notes and C in turn borrowed money from D and B to acquire the Notes. In our view, the Comptroller was right to point out that if the Appellant had wanted to borrow money, it could simply have borrowed from C without involving the Notes as an intermediary and that the Appellant was merely involved in a round-robin flow of funds...that the financing arrangement was artificial and contrived is also supported by fact, which we find, that the role of the Notes in the arrangement was merely facilitative and not really that of a lender. [6]

Finally, businesses must also be attuned to the context in which the transactions take place. Contextual elements such as the timing of the transaction and the parties involved can prove influential in whether the transaction is perceived to be bona fide and at arm's length.

For instance, the Board expressed concern that all relevant transactions occurred on the same day, seemingly without valid reason:

> No commercial justification was provided as to why the transactions must occur on the same day...we find that the transactions, which were all carried out on the same day, bear the trace of artificiality or contrivance, which the Appellant did not manage to erase. [7]

Continuing on the subject of timing, whilst the Board did not explicitly state such, it seems likely that the timing of a transaction relative to the commencement dates of relevant tax changes may also influence the view of the Court. Therefore, should a transaction appear at first glance to have been planned specifically in relation to the commencement date of a change in tax law, the parties to it must ensure that they also have a bona fide commercial reason for the date of the transaction.

Also relevant are the parties to the transaction. In AQQ, the Board took exception to the fact that nearly all parties to the transaction were interconnected:

The incontrovertible fact is that all the entities involved in the Financing Arrangement (except the Bank) were related parties and ultimately owned by B. [8]

Malaysian companies should therefore take due care to ensure that when involved in such transactions, parties should be independent of each other and that the dealings should be at arm's length.

FURTHER NOTES

AQQ has appealed to the High Court. While the case could well be overturned in future and one may claim that these judicial pronouncements are not binding on the Malaysian Courts, the principles established cannot be disregarded as they will generally serve as persuasive guidance as to whether one transaction can fall within anti-avoidance provisions.

While companies are planning to extract value from the franking credits during these last few years of the transitional period, it is important to keep the AQQ case in mind. It is imperative that every aspect of a transaction's commercial reality can clearly be demonstrated so that its tax aspect does not become dominant. It is important to have documentation which explains the commercial thinking that went behind the transaction. Such documentation could include financial analysis models, investment/ financing proposals and approvals, board minutes, etc. Each entity in the arrangement should be seen as engaging in the transaction on its own accord/ merits and is actually bearing risks associated with the transaction.

Not forgetting, potential penalties may arise where there is tax adjustments being made by the Malaysian tax authorities during an audit.

[6] *Ibid, 112-3.*
[7] *Ibid, 111.*
[8] *Ibid, 108.*

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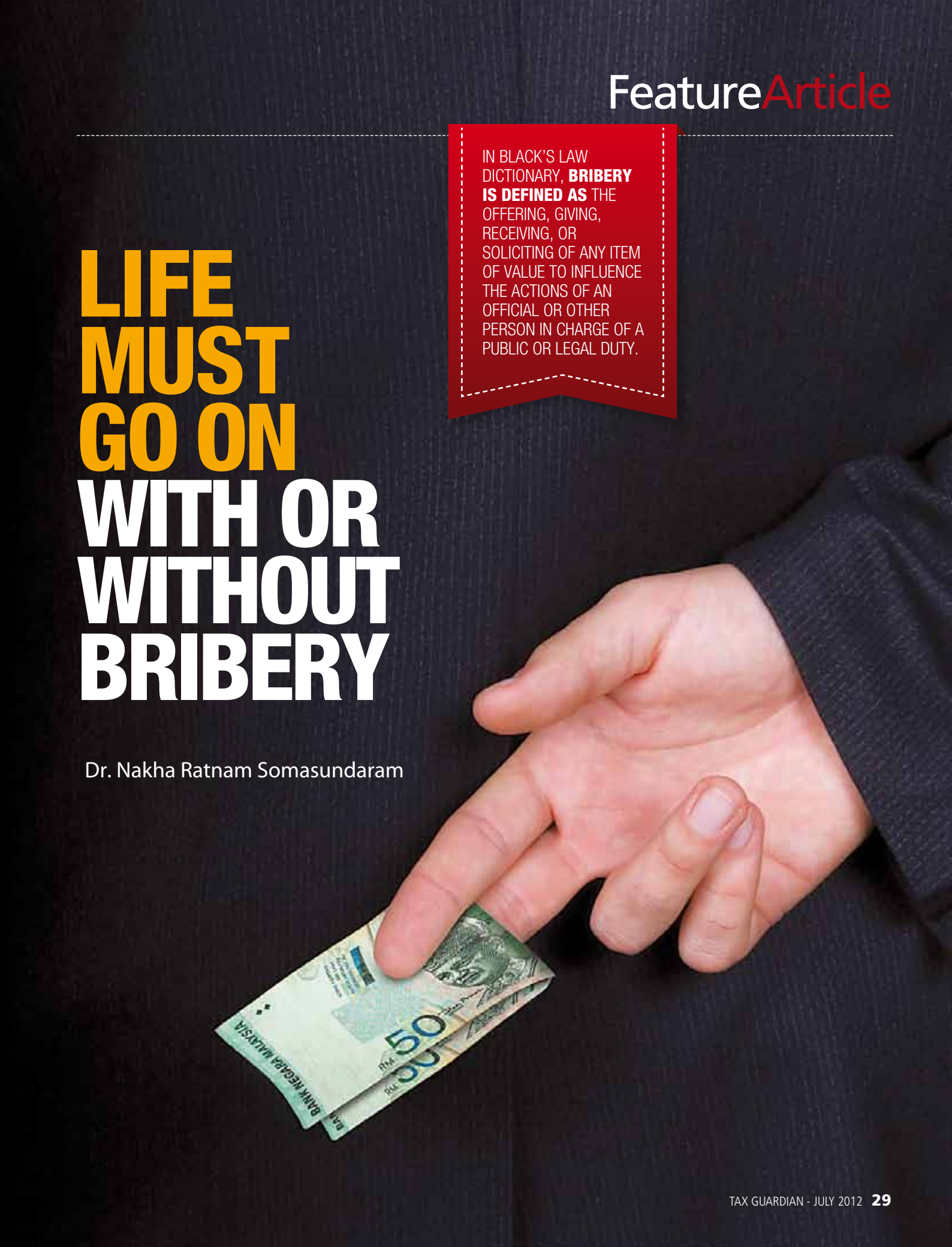
IN BLACK'S LAW DICTIONARY, **BRIBERY IS DEFINED AS** THE OFFERING, GIVING, RECEIVING, OR SOLICITING OF ANY ITEM OF VALUE TO INFLUENCE THE ACTIONS OF AN OFFICIAL OR OTHER PERSON IN CHARGE OF A PUBLIC OR LEGAL DUTY.

LIFE MUST GO ON WITH OR WITHOUT BRIBERY

Dr. Nakha Ratnam Somasundaram



THIS ARTICLE takes a brief look at corruption and its permutations, with a particular focus on bribery. The effect of corruption on a country, economy, its political institutions, as well as on society and on the average person is profound, and is examined here in an overview manner. The article also takes a quick look at the treatment of bribery for income tax purposes, the international fight against corruption, and particularly the United Kingdom's Bribery Act of 2010, and the progress made todate in that fight, including in Malaysia.

THE CORRUPTION PERCEPTION INDEX

Something as evasive and pervasive as corruption is difficult to grasp, and therefore poses great difficulty when it has to be quantified for measurement purposes. But Transparency International (TI)[1] had come up with an annual ranking of more than 180 countries in the world on a scale of 0-10 with '0' being highly corrupt and '10' being very clean.[2]

TI defines corruption as 'the misuse of public power for private benefit'. Absolute levels of corruption are difficult to measure and therefore a Corruption Perception Index (CPI) is used which draws on 13 different surveys and assessments from 10 independent institutions around the world (for example, the Asian Development Bank and the World Bank). The studies are then co-related to other proxies like black market activities, rules and regulations (large number of rules and regulations being an indicator of underlying chaos), gross domestic product and per capita earnings.

The study while being a useful indicator of corruption, is admittedly not an accurate comparison of corruption over a period of time nor between countries. It is also criticised for its lack of actionable insights, use of proxies to measure levels of corruption, and simple construct ranking (example: Is corruption a big problem in your country?).[3]

Methodology used also keeps changing, resulting in some countries showing an 'improvement' while others obtaining a 'worse off' score – an issue quickly capitalised by the media and governments to make conclusions without really understanding what the numbers mean.[4]

Nevertheless, on the basis that some numbers are better than no numbers, the TI figures are accepted for international comparisons, albeit with a tablespoonful of salt.

BRIBERY - DEFINITION

In Black's Law Dictionary[5], bribery is defined as the offering, giving, receiving, or soliciting of any item of value to influence the actions of an official or other person in charge of a public or legal duty. In any instance, it is a gift bestowed on the recipient to influence his conduct – the gift taking the form of money, goods, a promise, or a right of action,

[1] This is a non-governmental organisation founded in 1993 with its headquarters in Berlin, Germany. It publishes corporate and political corruption information, including an annual Corruption Perception Index, a ranked list of countries obtained from surveys of business people as regards the prevalence of corruption within each country. While not a 'perfect list', it nevertheless is accepted as a general indicator of the state of affairs as regards corruption by the international community.

[2] For example, for the year 2011, the TI ranked New Zealand at 9.5 (the cleanest score) (number 1 out of 182 countries), the Netherlands at 8.9 (number 7), Uruguay at 7.0 (number 25), Poland at 5.5 (number 41) and South Africa at 4.1(number 64). Malaysia scored 4.3 and comes out ranked at 60 out of the 182 countries surveyed in 2011. Somalia is rated a score of 1.0 and comes out last on account of the civil war raging in that country since 1991, making it one of the most violent and dangerous states in the world.

[3] 'CPI Methodology FAQ', Transparency International, 1 Dec 2011

[4] Sik, Endre (2002). "The Bad, the Worse and the Worst: Guesstimating the Level of Corruption," in Political Corruption in Transition: A Skeptic's Handbook, Stephen Kotkin and Andras Sajo, Eds. (Budapest: Central European University Press'): 91-113.

[5] Black's Law Dictionary, first published in 1891, is a widely used law dictionary in the United States and is the reference of choice for definition in legal brief and court opinions.

privileges, and other advantages in cash or kind.

Economists consider bribes as a form of 'rent' while the businessman considers it as another reason for higher cost of production of goods and services.[6]

FORMS OF BRIBERY

Bribery exists in the form of tips, gifts, perks, discounts, fee waivers, free trips or tickets, kickbacks and paybacks, sponsorships, even stock options and commission.

The form bribery takes can be an issue in the context of culture and social norms – for example, tipping is considered an accepted form of appreciation in Western countries but is not acceptable in some other societies. In the United States, political campaign contributions in the form of cash is acceptable, provided some rules are adhered to, while it is blatant corruption in some other countries.

On account of these variations in perception, the term bribery takes on its own localised meaning in the various countries of occurrence. For example, in Spain it is known as 'morbida' (to bite), in France it is 'desssous-de-table' (under the table), and in Germany, 'Schmiergeld' (smoothing money). In Malaysia it is known as 'duit kopi' (coffee money).

ACTIVE AND PASSIVE BRIBERY

Bribery is divided into two classes: one where a person with authority or power is induced to use (or not to use) that power or authority in a particular manner or in a particular situation; and the other being the purchase of that action by those who can impart it to the payer. A simple example is a motorist bribing a police officer not to issue a summons (inducing the officer not to use his power or authority) or an individual bribing a municipal functionary to obtain a speedier approval for a utility connection (purchase of a speedy service that would have been provided free of charge otherwise). From a legal point of view, bribery is now classified as active bribery and passive bribery[7]. The distinction makes it easier to prosecute bribery offences, since proving that two parties i.e. the giver and the receiver, have agreed on a corrupt deal is relatively difficult and cumbersome.

Where payments are made to ensure a smooth, speedy transaction, and are considered necessary by the party making the payment, the corruption perception enters a grey stage, particularly where two standards are used. For example, in the United States, there is a strict limitation on the ability of business to pay for the awarding of contracts[8], but an exception is made for 'grease' or 'facilitating payments' for overseas contracts. Thus, some confusion

[6] Chowdhury, Faizul Latif (2006). Corrupt Bureaucracy and Privatization of Tax Enforcement. Pathak Shamabesh, Dhaka. ISBN 984-8120629. http://en.wikipedia.org/wiki/Rent_seeking. Retrieved 7 May 2012.

[7] Article 2 and Article 3 of the Criminal Law Convention on Corruption (ETS 173 of the Council of Europe).

[8] The Foreign Corrupt Practices Act, 1977. The Act deals with accounting transparency requirements under the Securities Exchange Act of 1934 and that of bribery and facilitating payments of foreign officials.

is introduced and corporations seeking to seal contracts, obtain construction permits or licenses to expand businesses in a foreign territory and paying large sums of money to secure those benefits could be exposed to these risks, both at the individual and corporate level.[9]

MEDICINE

In the medical and pharmaceutical field, corporations involved often reward doctors and medical personnel with gifts and perks for advancing their products in their prescriptions. These gifts and perks would include grants for travelling, attending medical conventions, usually organised by the particular pharmaceutical company, and attendance at seminars that also double as a tour trips.

In some East European countries, where social services like medical care are government funded, patients may have to pay if they want that special medication and the extra care.[10]

BUSINESS

In business, managers and sales executives may have to offer money and gifts to clients or potential clients to secure business or expand the business. In addition, where the system of law or its implementation is lax, payments may have to be made to continue the business without disruption. For example, a government enforcement official may decide to check on a firm or a production facility for irregularities (either real or imagined) causing disruption to the production process resulting in losses to the firm. The bribe to the officers may be far less than the cost of the disruption. And in a system where no credible avenue exists to report such 'checking' to the authorities, bribing the officers, in due course, becomes a common way to deal with such 'checking'. In established cases, a third party may be involved to act as a clean middleman, known as the 'White Glove'.

SPORTS

Even in sports, corruption creeps in – where judges and referees may be offered money, gifts, or a promise to produce or guarantee a particular outcome in a competition[11]. The athletes and sportspersons, too, may be bribed to perform or underperform in a competition or

[9] Wal-Mart in Mexico, for example, was alleged to have paid US24m in bribes to Mexican authorities to obtain construction permits for its outlets, and both the company and its directors were charged for corruption. Miguel Bustillo (23 April 2012). "Wal-Mart Faces Risk in Mexican Bribe Probe". The Wall Street Journal. http://online.wsj.com/article/SB10001424052702303978104577360283629622556.html. Retrieved 6 May 2012

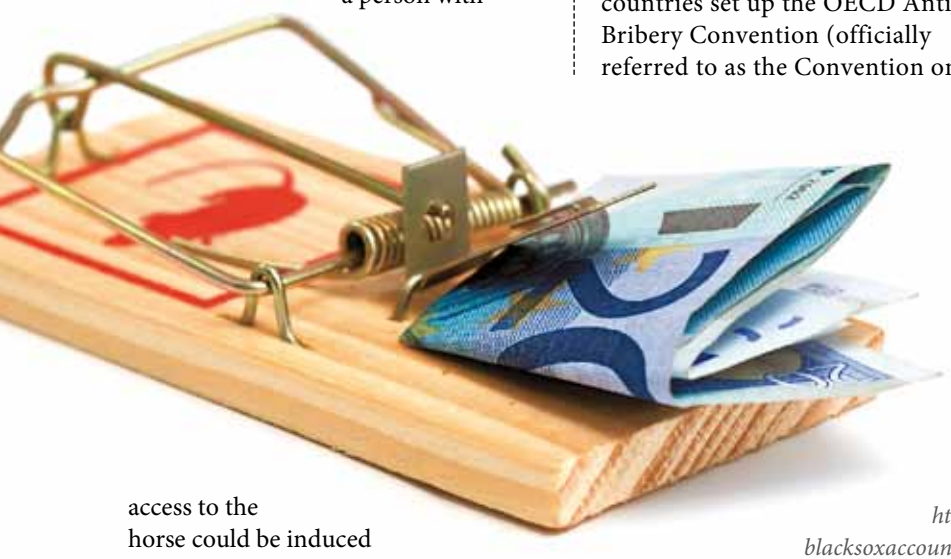
[10] Lewis, Mauree. (2000). Who is paying for healthcare in Eastern Europe and Central Asia? World Bank Publications.

[11] In the 2002 Olympic Winter Games figure skating scandal for example, the French judge in the pairs competition voted for the Russian skaters in order to secure an advantage for the French skaters in the ice dancing competition. http://en.wikipedia.org/wiki/2002_Olympic_Winter_Games_figure_skating_scandal. Retrieved 7 May 2012.

game.[12]

Participating athletes could be paid substantial sums to perform or underperform in a game so that a gambler or gambling syndicate can secure a winning bet. This is an old game (pardon the pun) and goes back as far as the 1919 World Series, better known as the Black Sox Scandal.[13] The most recent match fixing scandal involves two football teams in Turkey.[14]

Elements of the sports, too, may be tampered with, to produce the desired results – for example in horse racing, a person with access to the horse could be induced to dope the animal to run faster or slower in a particular race thus increasing or decreasing the chance of a win.



Even cities may be caught in the bribery frenzy. Cities may offer bribes to secure athletic franchise or the hosting of a competition, sports or championship events, golf tournaments and even Olympic Games. [15]

POLITICAL CORRUPTION

Political corruption involves cronyism, electoral fraud, nepotism, conflict of interest - and bribery is a major element, for which slush funds are maintained to facilitate payments.

FIGHT AGAINST CORRUPTION AND BRIBERY

Bribery together with corruption and fraud hits the headlines frequently in a range of sectors that include finance, pharmaceuticals, mining industries[16], construction and the lucrative arms, defense and security industries. Companies as well as directors are now held responsible and personally accountable for corrupt practices as in the case of Alstom. [17]

To contain and prevent activities involving bribery, the OECD countries set up the OECD Anti-Bribery Convention (officially referred to as the Convention on Combating Bribery of Foreign and Public Officials in International Business Transactions) to create a bribery free environment for the conduct of international business.[18]

THE BRIBERY ACT 2010

In the United Kingdom, the Bribery Act (the Act) came into effect on 1 July 2011 and in October 2011 a clerk at a Magistrates Court was convicted under the Bribery Act for misconduct in public office – a right place indeed to send off a serious message.

The Act replaces some antiquated English laws on corruption and corrupt practices and is designed to be 'the toughest anti-corruption

[12] In a Pakistan cricket spot-fixing controversy, three Pakistani cricketers were found guilty in 2010 of accepting bribes to bowl no balls against England at certain times. "Salman Butt and Pakistan bowlers jailed for betting scam". BBC News (British Broadcasting Corporation). 3 November 2011. http://www.bbc.co.uk/news/uk-15573463. Retrieved 6 May 2012.

[13] Linder, Douglas. "Famous American Trials". The Black Sox Trial: An Account. http://law2.umkc.edu/faculty/projects/ftrials/blacksox/blacksoxaccount.html. Retrieved 6 May 2012.

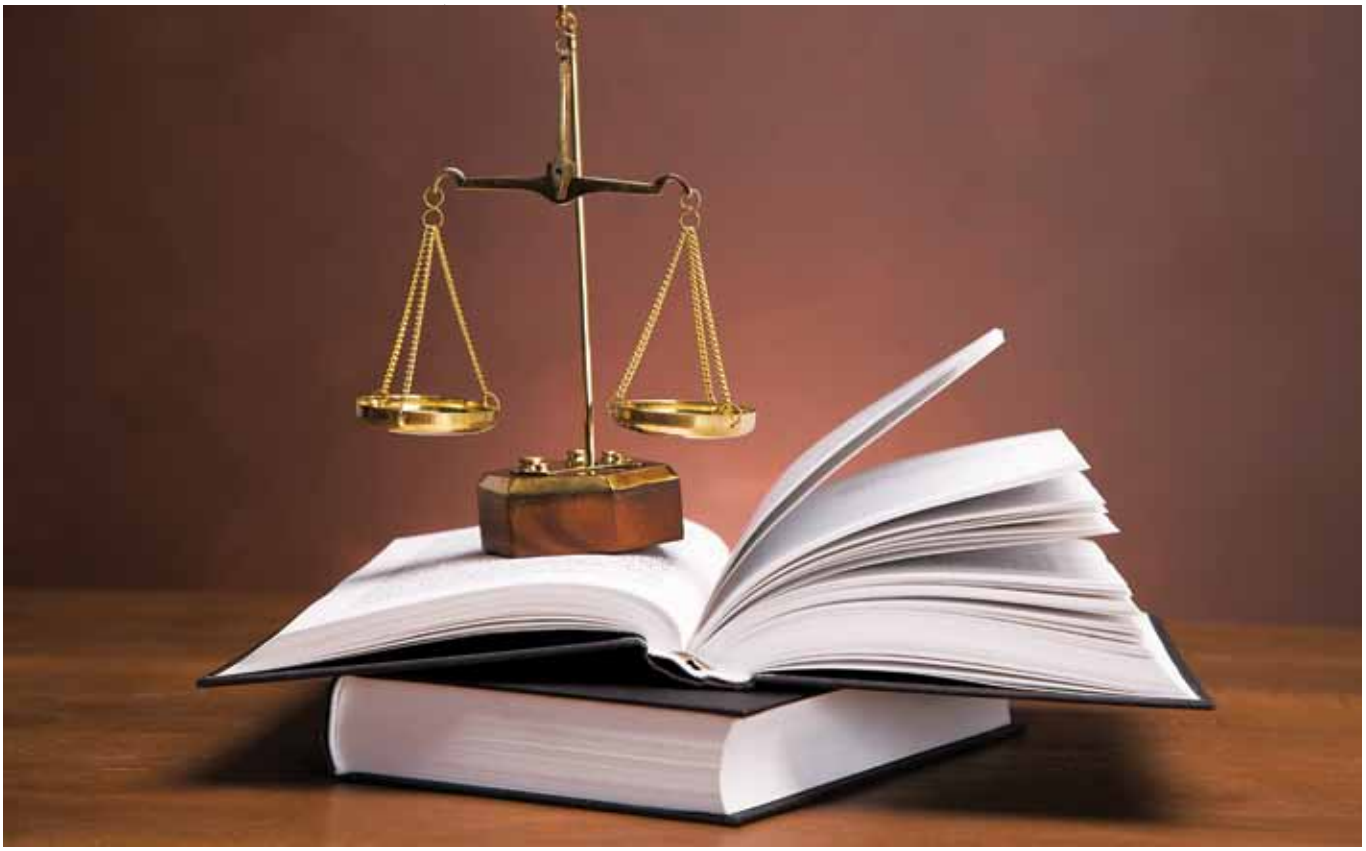
[14] "Fenerbahce withdrawn from Europe because of Match-fix probe". BBC. 25 August 2011. http://news.bbc.co.uk/sport1/hi/football/14656932.stm. Retrieved 6 May 2012

[15] Salt Lake City in the United States, for example, made four unsuccessful bids for the right to host the 2002 Winter Olympics, finally succeeding in 1995. It led to a scandal with allegation of bribery (millions in cash, free ski trips, scholarships, and even plastic surgery) in the bidding process resulting in the expulsion of several International Olympic Committee (IOC) members and later the adoption of new IOC rules. Their competitor for the hosting of the 1998 Games, Nagano in Japan, was found to have provided the IOC members millions of dollars in 'illegitimate and excessive level of hospitality'. http://en.wikipedia.org/wiki/2002_Winter_Olympic_bid_scandal. Retrieved 7 May 2012.

[16] Between 2010 and 2011, there were about 1,800 cases reported in the British press about well-known corporations involved in various corrupt payoffs. Sabrian Baran, Institute of Business Ethics. http://www.trust.org/trustlaw/blogs/anti-corruption-views/ Retrieved 6 May 2012

[17] Alstom is a British engineering firm whose three directors in the United Kingdom were arrested over allegations of substantial payments to secure contracts abroad.

[18] The OECD took steps in 1989 to review national legislations in regards to bribery, particularly bribing of public and foreign officials. Forty countries signed the convention on 17 December 1997 that came into force in February 1999. Malaysia participated in the convention's working group as an observer.



legislation in the world'.[19]

The Act defines the two separate acts of giving and receiving - the separation making it easier to prosecute offenders. Under the Act, bribery occurs when a person offers, gives or promises to give a financial or other advantage to another individual in exchange for improperly performing a relevant function or activity. It also covers offences of being bribed including requesting, accepting, or agreeing to accept such advantages in exchange for improperly performing such functions or activity.

While the Act does not define what is a 'financial or other advantage', there is a comprehensive coverage of 'relevant function or activity' as being "any function of a public nature; any activity connected with a business, trade, or profession; any activity performed in the course of a person's employment; or any activity performed by or on behalf of a body of persons whether corporate or unincorporated".[20] This applies to both private and public industries, and encompasses activities performed outside the UK, and even activities with no link to the country. The conditions attached are that the person performing the function could be expected to be performing it in good faith or with impartiality, or that an element of trust attaches to that person's role.[21]

A breach occurs when a function is improperly performed i.e. when the expectation of good faith or impartiality is breached – and the standard for deciding such breach is viewed from a reasonable person's perspective in the United Kingdom (UK). Where such breach occurs outside the UK, then local practices or customs should be disregarded when deciding this, unless they form part of the "written law" of the jurisdiction.[22]

Bribing a foreign public official is a separate and distinct crime under Section 6 of the Act and is in line with the OECD Anti-Bribery Convention. A person will be guilty of bribing if they promise, offer, or give a financial

[19] The Bribery Act 2010 replaces the Public Bodies Corrupt Practices Act 1889, the Prevention of Corruption Act of 1906, and the Prevention of Corruption Act 1916 whose provisions on corruption were described as 'inconsistent, anachronistic, and inadequate'. Brigid, Doron Ezickson, John Kocoras (2010). "The Bribery Act 2010: Raising the Bar Above the US Foreign Corrupt Practices Act". Company Lawyer (Sweet & Maxwell) 31 (11). Retrieved 6 May 2012.
[20] Anwar (2010) p.125-126. http://en.wikipedia.org/wiki/Bribery_Act_2010#cite_note-anw126-13. Retrieved 6 May 2012.
[21] Ibid
[22] ibid

or other advantage to a foreign public official, either directly or through a third party, where such an advantage is not legitimately due.

A foreign public official is "an individual holding legislative, administrative, or judicial posts or anyone carrying out a public function for a foreign country or the country's public agencies or an official or agent of a public international organisation" [Section 6(4)]. The inclusion of "through a third party" is intended to prevent the use of go-betweens to avoid committing a crime, although if the written law of the country of the foreign public official allows or requires the official to accept the advantage offered, no crime will be committed.

A major difference in respect of the foreign public official involvement is that, unlike with general bribery offences, there is no requirement to show that the public official acted improperly as a result; this is a departure from the Anti-Bribery Convention.

Furthermore, the offence under Section 6 only applies to the briber, and not to the official who receives or agrees to receive such a bribe. This has far reaching consequences for the UK companies. For example, a Dutch company having a retail business outlet in the UK and paying a bribe to a French company to expedite the supply of goods would be liable to prosecution for bribery in the UK.

The Act also introduces some very broad and new offences under which failure by commercial organisations to prevent bribery on their behalf is now an offence. The offence will cover the organisation and the individual employees of the organisation – the offence under the Act now being one of both strict liability[23] and vicarious liability. However, it is sufficient defense, on the balance of probabilities, if the organisation can show that it had in place adequate procedures designed to prevent persons associated with the organisation from undertaking such conduct.

Individuals found guilty of any offence under the Act could be tried as a summary offence[24] with lighter penalties – upto 12 months imprisonment and fines of upto £5,000. On the other hand, persons found guilty on indictment face up to 10 years' imprisonment and an unlimited fine. The crime of a commercial organisation failing to prevent bribery is punishable by an unlimited fine. In addition, a convicted individual or organisation may be subject to a confiscation order under the Proceeds of Crime Act 2002, while a company director who is convicted may be disqualified under the Company Directors Disqualification Act 1986.

The scope of the Act's provisions is set out in Section 12. For someone to be caught under the provisions of the Act, they must have either committed a crime inside the United Kingdom, or acted outside of the United Kingdom in a way which would have constituted a crime had it occurred in the UK and where the person is proved to have a "close connection" to the UK - which includes being a British citizen, resident or protected person, a company incorporated in the UK, or a Scottish partnership.

However, gaps come into the picture when defense is provided for a general bribery in the case of conduct necessary for the proper functioning of the intelligence service or the armed forces. This provision introduces a grey area quite similar to the 'grease payment' permitted by the United States for dealings outside the United States.

While the Act is hailed as the 'toughest anti-corruption legislation in the world' and an improvement on earlier corruption legislations, there is concern that British industry competitiveness may be eroded or even harmed, particularly when applied to situations where such actions are ethically problematic but seen as legally permissible.[25]

INCOME TAX DEDUCTION FOR BRIBERY

The OECD Convention prohibits companies from claiming tax deductions for bribes to foreign public

[23] In a strict liability, the prosecution need not prove any intention – in this case to bribe; vicarious liability arises when a third party for example an employee, agent or a subsidiary of the company commits the offence. [Section 7 and 8 of the Bribery Act 2010].

[24] A summary offence is a crime in some common law jurisdictions that can be proceeded against summarily, and without the right to a jury trial and/or indictment.

[25] Aaronberg (2010) p.9 http://en.wikipedia.org/wiki/Bribery_Act_2010#cite_note-28. Retrieved 6 May 2012

officials. Apparently, it is not permitted for local officials since bribery in the local context is already an offence. The Convention has also issued a handbook to help tax examiners identify suspicious payments with a view to disallowing deductions as well as to report to law enforcement authorities.[26] Internal audit guidance on bribery awareness and detection is also provided.

GERMANY

In Germany, bribery can be claimed as a tax deduction.[27] In a country where bribery does not deserve a second look, the fuzzy lines separating entertainment, bribes, and corruption are routinely crossed several times in doing business. Journalists, for example, think nothing of accepting air tickets and hotel rooms from the companies they are covering.

Siemens, Europe's largest engineering firm which adopted the slogan 'Be Inspired" for its business operations, funneled some USD67m across the globe including the Middle East and the United States to 'inspire' officials and politicians in those countries to award it telecommunications contracts. The payment came to light when it claimed a large tax deduction under the 'useful expenditure' category. In December 2008, it pleaded guilty to charges of bribery and was fined USD800m in the United States and €395m (USD555m) in Germany.

With bribes and cartel-like pricing adding 20% to 30% to public contracts in Germany, the outcry against corruption is striking a chord now more than ever as Germany struggles to define its future economy. To help its companies and banks compete, it is trying to make its business practices more transparent.

UK

The UK Serious Fraud Office (SFO) requires companies to disclose portions of their tax calculations as part of its enforcement of the country's Bribery Act. The SFO, which prosecutes white-collar crime, will look at the tax data to see if companies are claiming deductions for bribes.[28]

AUSTRALIA

The Income Tax Assessment Act 1997 denies taxpayers a deduction for bribes paid to foreign or domestic public officials where such payment takes the form of a benefit to another person.

But it has a potentially conflicting provision quite similar to that in the United States and the UK when it allows 'facilitation payments' and benefits to third parties that may be customary or is perceived to be customary in the particular situation.[29]

CORRUPTION, BRIBERY AND TAX DEDUCTION IN MALAYSIA

In Malaysia, corruption or graft was under the purview of the Anti-Corruption Agency (ACA) until 2008. After the 12th General Elections, there was some political change and demands began to be made for a more accountable anti-corruption agency. In 2009, an independent body - the Malaysian Anti-Corruption Commission (MACC) - was formed with greater powers to fight corruption and with a new organisational structure to provide greater check and balance to ensure an independent operation.

The MACC's activities are overseen by five different bodies to whom it must present its annual report, in addition to a report to be submitted to a special committee comprising of government and opposition members of parliament to scrutinise its activities and provide explanation where required.

MACC was to focus on all corruption cases and investigate it swiftly and professionally to bring it to an end ensuring in the process that it has a high impact on the public. Towards this end investigations are to be made both actively (based on

[26] 1996 Recommendation of the OECD Council on the Tax Deductibility of Bribes for Foreign Public Officials and the Bribery Awareness Handbook for Tax Examiners.

[27] While bribery is not legal, for income tax purposes, it is permissible to deduct private business bribes in Germany. It is available to German business persons who disclose both his or her identity and the recipient of the bribe, and can be claimed as a deduction against business income as a 'useful expenditure'. However, reportedly, few persons use this 'facility'.

[28] http://www.businessweek.com/news/2011-09-05/u-k-sfo-will-look-for-tax-deductions-for-bribes-alderman.html. Retrieved 6 May 2012.

[29] Section 26.53 Income Tax Assessment Act 1997.

information and complaints) as well as proactively (based on intelligence).

However, a series of recent events, including two mysterious and unexplained deaths (of persons being investigated) at its office premises shook the public confidence in the agency's integrity and ability. In order to restore confidence and credibility, substantial damage control activities were undertaken '…to create a new landscape in the fight against corruption'. [30]

BRIBERY AND TAX DEDUCTION

For income tax purposes, deductions for expense (whether bribery or otherwise) are governed by Section 33 and 39 of the Income Tax Act 1967 (as amended) [ITA]. Payments that are claimed as a deduction against business income must satisfy the 'wholly and exclusively incurred in the production of gross income' test. And as in Germany, the Malaysian revenue officers may consider allowing a deduction for the expenditure if it could be shown that the payment made was so incurred i.e. it falls within the meaning of Section 33.

However, the taxpayer claiming the deduction for any bribery payment must also disclose the full details of the payee to enable the revenue officers to follow up with the recipient. Given the clandestine and covert nature of corruption and bribery, there are very few takers on the proposition.

CONCLUSION

The list of companies that are pulled up the world over for oversight, corruption, fraud and bribery or sheer negligence read like a 'Who Is Who' in the list of global corporations.

Apparently, money has a powerful way of bending rules and ethics till it breaks, and sadly, nobody notices the damage. Acceptance of the way business is done with free flow of cash and wine combined with a real and perceived pressure to meet sales targets have an effect of placing ethical issues of corruption and bribery on the sidelines. In a global scenario where ethics itself varies from culture to culture and country to country, this line between ethics and corruption is blurred beyond recognition – just like the million shades of grey between black and white.

Eventually, as the writer sees it, life must go on – with or without ethics - and so does sales - with or without bribery. [31]

[30] Muhammad Salim Sundar, Head of Corporate Communication MACC – article based on the recent presentation by the Chief Commissioner to Division and State Directors on "MACC transformation and expectations" at MACC, Putrajaya, on 18 August 2011.

[31] The views expressed in this article are those of the writer.

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AN INTRODUCTION TO COMPETITION LAW IN MALAYSIA

Adlin Abdul Majid

THE COMPETITION ACT 2010 (CA) CAME INTO FORCE ON 1 JANUARY 2010. THE CA AIMS AT PROVIDING A COMPREHENSIVE LEGAL FRAMEWORK TO CURB AND RESTRICT ANTI-COMPETITIVE PRACTICES IN MALAYSIA, AND PROMOTE A COMPETITIVE MARKET ENVIRONMENT BY PROVIDING A LEVEL PLAYING FIELD FOR ALL PLAYERS IN THE MARKET.

Prior to the implementation of the CA (which applies across the majority of economic sectors), Malaysia did not have a comprehensive competition law regime except in the multimedia and communications sector and energy sector via the Communications and Multimedia Act 1998 and the Energy Commission Act 2001 respectively, which have specific provisions regulating anti-competitive behaviour. It should, however be noted that the provisions on competition in these Acts are less extensive than those contained in the CA.

The Malaysia Competition Commissions (MyCC) was formed to regulate competition matters in Malaysia and are actively involved in the process of implementing a competition regime. To date, MyCC has issued three guidelines, on anti-competitive agreements, on the definition of a relevant market in competition law terms, and on the procedure for complaints to be made.

MyCC has also recently released draft guidelines on abuse of dominance, which are presently open to public comments.

WHAT ARE THE KEY PROVISIONS UNDER THE CA?

The CA regulates 1) anti-competitive agreements and 2) abuse of dominance. The CA does not currently have a merger and acquisition control regime though this may change in the future.

The CA applies to any commercial activity, both within Malaysia and transacted outside Malaysia that has an effect on competition in any market in Malaysia. As mentioned, the multimedia and communications and energy sectors already have their own competition regime. As such, the CA will not apply to any commercial activity regulated under the Communications and Multimedia Act 1998 and the Energy Commission Act 2001.

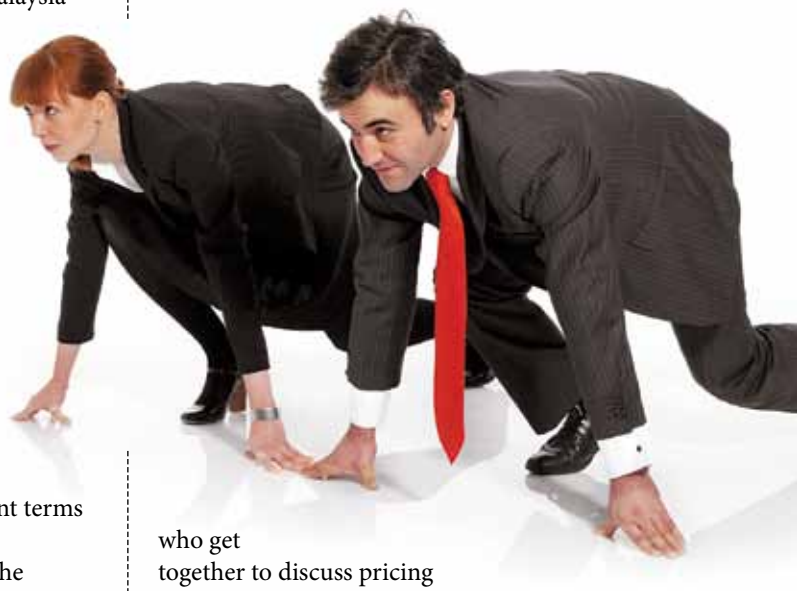
The CA also excludes the following:

- an agreement or conduct engaged in, in order to comply with a legislative requirement;
- collective conduct relating to negotiating and concluding employment terms and conditions; and
- conduct of enterprises entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly.

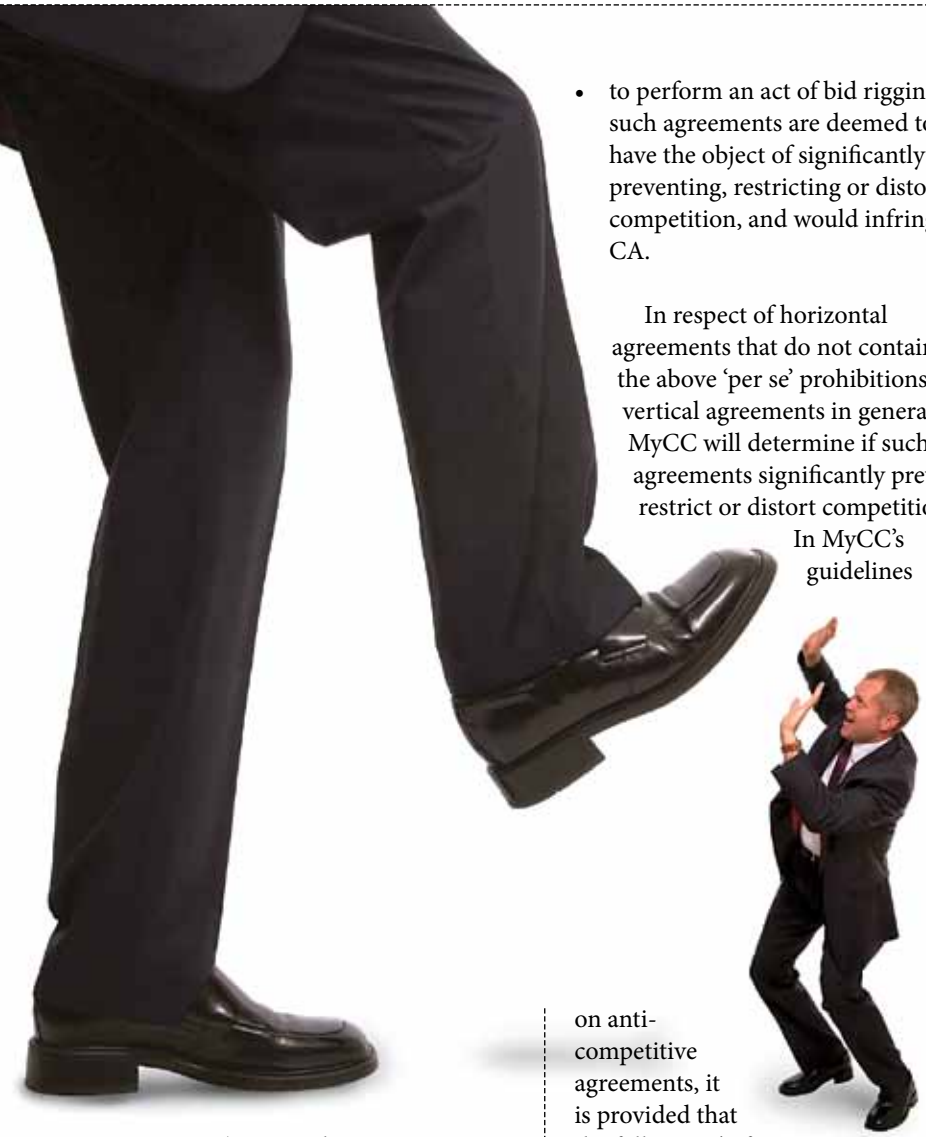
ANTI-COMPETITIVE AGREEMENTS

The CA prohibits horizontal and vertical agreements between enterprises that have the object or effect of significantly preventing, restricting or distorting competition in any market for goods or services.

It is important to note that the CA does not only apply to formal agreements or written contracts. Any form of contract, arrangement or understanding, whether or not legally enforceable, between enterprises, including a decision by an association or concerted practices, will fall under the scope of the CA. Therefore, two competitors who get together to discuss pricing strategies over a game of golf will be caught under the same way a formal agreement would. More often than not, verbal agreements are harder to uncover.



Horizontal agreements are agreements between enterprises each of which operate at the same level in the production or distribution chain (e.g. agreement manufacturer and manufacturer – these agreements are typically entered into between



competitors). Vertical agreements are agreements between enterprises each of which operate at a different level in the production or distribution chain (eg. agreement between manufacturer and distributor or supplier and retailer).

For horizontal agreements that have the following objects:

- to fix, directly or indirectly, a purchase or selling price or any other trading conditions;
- to share market or sources of supply;
- to limit or control production, market outlets, market access, technical or technological development or investment; or
- to perform an act of bid rigging, such agreements are deemed to have the object of significantly preventing, restricting or distorting competition, and would infringe the CA.

In respect of horizontal agreements that do not contain the above 'per se' prohibitions, or vertical agreements in general, MyCC will determine if such agreements significantly prevent, restrict or distort competition. In MyCC's guidelines on anti-competitive agreements, it is provided that the following 'safe harbour' approach will be taken:

"... anti-competitive agreements will not be considered 'significant' if:

- the parties to the agreement are competitors who are in the same market and their combined market share of the relevant market does not exceed 20%;
- the parties to the agreement are not competitors and all the parties individually has less than 25% in any relevant market..."

Enterprises that find themselves involved in agreements that are prohibited under the CA may apply for either an individual exemption for a particular agreement, or a block exemption for a particular category of agreements, provided that they are able to establish and satisfy all of the following:

- there are significant and identifiable technological, efficiency and social benefits arising from the agreement;
- the benefits could not reasonably be achieved without the agreement having the effect of preventing, restricting or distorting competition;
- the detrimental effect of the agreement on competition is proportionate to the benefits; and
- the agreement does not completely eliminate competition in respect of a substantial part of goods or services.

Exemptions may be granted subject to conditions or obligations and on payment of prescribed fees, as MyCC considers appropriate.

ABUSE OF DOMINANT POSITION

MyCC has indicated in its draft guidelines on abuse of dominance that it will take a 2-stage approach in examining whether or not there is an abuse of dominant position:

- MyCC will ask whether the enterprise is dominant in a relevant market in Malaysia; and
- If the enterprise is dominant, MyCC will assess whether the enterprise is abusing that dominant position.

In establishing if an enterprise has a dominant market position, market share is a relevant factor but not conclusive under the CA. In order to assess whether an enterprise is dominant, it would be necessary to consider the market conditions within which a business competes including determining its existing competitors and their market share and barriers to entry into the market.

Dominance in itself would not be

an infringement of the CA. It is the abuse of an enterprise's dominant position that is prohibited, and conducts amounting to abuse would include:

- imposing an unfair purchase or selling price or other unfair trading conditions on a supplier or customer;
- limiting or controlling production, market outlets / access, technical or technological development or investment to the prejudice of consumers;
- refusing to supply; or
- engaging in predatory behaviour towards competitors.

Other abusive behaviour may include applying discriminatory conditions, forcing conditions or buying up scarce supply. These listed types of behaviour are not exhaustive in determining whether certain conduct amounts to an abuse of dominance.

However, the conduct is not prohibited if the dominant enterprise has a reasonable commercial justification for the conduct or the conduct is a reasonable commercial response to market entry or competitive conduct.

POWERS OF MYCC

Investigation

Under the CA, MyCC has wide powers, including the power to conduct investigations. The Act grants MyCC and its officers the same investigatory powers as those of a police officer in relation to corresponding police investigations, including the power to require the provision of information from any person, or to retain documents and have access to records, books, accounts.

Anyone who fails to cooperate with an investigation (eg. does not respond/ provide requested information or documents), obstructs MyCC officials or hides, destroys or falsifies relevant documents may be guilty of a criminal offence punishable by a fine and/or imprisonment.

In the course of an investigation, MyCC may also impose 'interim measures' if it reasonably believes that there is an infringement and the measures are necessary as a matter of urgency to prevent serious and irreparable damage or to protect public interest. Such interim measures may involve requiring or causing any person to:

- suspend the effect of and desist from acting in accordance with an agreement which may be an infringement of the CA;
- desist from any conduct which may be an infringement of the CA; or
- do or refrain from doing any act (but excluding the payment of money).

In addition, MyCC may require that the infringement be ceased immediately and may specify steps to be taken by the infringing enterprise to bring the infringement to an end.

Market Review

MyCC can also conduct market reviews to determine whether any feature or combination of features of a market prevents, restricts or distorts competition in the market. On completion of a market review, MyCC must publish a report of its findings and recommendations, which must be made available to the public.

WHAT ARE THE CONSEQUENCES OF INFRINGING THE CA?

An infringement of the CA would attract financial penalty of up to 10% of the worldwide turnover of the enterprise over the period during which the infringement occurred.

In keeping with a proven method in other jurisdictions, a leniency regime is established under the CA. A maximum reduction of 100% of the penalty may be granted if an enterprise has admitted its involvement in any of the *per se* prohibitions under Section 4(2) of the CA, and provides significant information or other form of cooperation to MyCC.

The requirement to be the first creates a powerful incentive among parties to a cartel to inform the regulator about the cartel. One example of the effectiveness of a leniency regime was when the Royal Bank of Scotland was fined £28.6million in 2010 for breaching competition laws after sharing confidential information about the pricing of its commercial loans with rival staff at Barclays Bank. Barclays voluntarily notified the UK Office of Fair Trading, and co-operated with them throughout the entire investigation. In this case, Barclays avoided the fine by being a whistleblower.

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CONCLUSION

As the consequences of an infringement of the CA are severe, precautions must be taken. Companies should implement an effective compliance programme in order to ensure that all their business practices, whether within the country or beyond Malaysia's shores, are in line with the CA. An effective compliance programme would include a review of its dealings, business strategies and arrangements, to ensure that such activities comply with the CA. In addition, training and awareness programmes should also be conducted so that employees, particularly those who meet competitors, understand the do's and don'ts involved in dealing with and communicating with competitors. Finally, employees at all levels of a business, from the top down, need to demonstrate a commitment to complying with the law.

The technical updates published here are summarised from the selected government gazette notifications published between 1 February 2012 and 30 April 2012 including Public Rulings and guidelines issued by the Inland Revenue Board (IRB), the Royal Customs Department and other regulatory authorities.

INCOME TAX

Public Ruling No. 1/2012: Compensation for loss of employment

Public Ruling No.1/2012 issued on 27 January 2012 by the IRB explains the tax treatment of compensation payments received by employees upon the termination of their employment, and is effective from the year of assessment (YA) 2012.

Income Tax (Deduction for expenditure on franchise fee) Rules 2012

The Income Tax (Deduction for expenditure on franchise fee) Rules 2012 [P.U.(A) 76] was gazetted on 23 February 2012. The deduction was announced as a 2012 Budget proposal and takes effect from YA 2012.

Income Tax (Deduction for expenditure to obtain the 1-InnoCERT Certification) Rules 2012

The Income Tax (Deduction for expenditure to obtain the 1-InnoCERT Certification) Rules 2012 [P.U.(A)109] was gazetted on 25 April 2012. The Rules came into operation in YA 2010 and provide a tax deduction on expenditure incurred directly for the application of the 1-InnoCERT Certification, and for on-site audit fees, logistics and accommodation costs for the 1-InnoCert auditors.

Income Tax (Deduction for promotion of international or private school) Rules 2012

The Income Tax (Deduction for promotion of international or private school) Rules 2012 [P.U.(A)110] was gazetted on 26 April 2012 and take effect from YA 2012. The Rules provide for a double deduction to be given for outgoings and expenses incurred in promoting Malaysian schools (international and private).

List of updated certification bodies

An updated list of approved certification bodies was issued by the IRB on 9 April 2012 and is available on its website. Section 34(6)(ma) of the Income Tax Act 1967(ITA) permits companies to claim a double deduction on expenses incurred on quality systems and standards or *halal* certification.

Prescribed form to report incentive payments made to agents, dealers and distributors

The new Section 83A of the ITA requires companies to furnish the particulars of incentive payments (whether monetary or not) to agents, dealers and distributors, and the IRB has introduced a prescribed form (Form CP58) for this purpose. Further clarification on how to complete Form CP58 was issued on 10 April 2012 and is available on the IRB website

Incomplete income tax return forms to be returned

The IRB announced on 29 March 2012 that income tax return forms (ITRFs) will be returned to the taxpayers if they are deemed as incomplete. Guidance on what would constitute an incomplete ITRF is provided on the IRB website.

M-filing introduced for employees

The government has introduced M-filing to enable resident individuals with no business income to file Form BE using their mobile devices. In this regard, the following mobile devices have the requisite operational systems for this purpose:

- iPhone and iPad with iOS version 4

and above.
- Android version 2.2 (Froyo) and above.
- Blackberry (version 6 and above) and Playbook.
- Windows Phone version 7.0 and above, and 7.5 (Mango).

Promotion of investment incentives - Revised list of promoted activities and products

Five new Orders which provide lists of promoted activities and products that qualify for tax incentives under the Promotion of Investment Act 1986, were introduced recently. They are:

1. Promotion of Investments (Promoted Activities and Promoted Products for High Technology Companies) Order 2012 [P.U.(A) 59];
2. Promotion of Investments (Promoted Activities and Promoted Products for Selected Industries) Order 2012 [P.U.(A) 60];
3. Promotion of Investments (Promoted Activities and Promoted Products for Reinvestment) Order 2012 [P.U.(A) 61];
4. Promotion of Investments (Promoted Activities and Promoted Products) Order 2012 [P.U.(A) 62]; and
5. Promotion of Investments (Promoted Activities and Promoted Products for Small Scale Companies) Order 2012 [P.U.(A) 63].

The new Orders take effect from 2 March 2012 and revoke previous Orders.

Regulating private retirement schemes

The Securities Commission of Malaysia issued the Capital Markets and Services (Private Retirement Scheme Industry) Regulations 2012 [P.U.(A) 77] on 16 March 2012. The Regulations take effect from 19 March 2012. It was proposed in the 2012 Budget that a tax relief of up to RM3,000 would be available for contributions by individuals to private retirement schemes approved by the Securities Commission.

STAMP DUTY

Stamp duty exemption on loan/financing agreements

The Stamp Duty (Exemption) Order 2012 [P.U.(A)108] was gazetted on 25 April 2012.

Pursuant to this Order, any loan agreement or financing under *Syariah* principles is exempted from stamp duty. The instrument must, however, be executed between 15 June 2011 and 31 December 2014 and be executed between a Small and Medium Enterprise (SME) approved under the Green Lane Policy and

(a) Bank Perusahaan Kecil & Sederhana Malaysia Berhad,
(b) Bank Pembangunan Malaysia Berhad or
(c) Export-Import Bank of Malaysia Berhad.

CUSTOMS DUTIES

Customs Duties (Goods Under The Free Trade Agreement Malaysia-Chile) Order 2012, Customs Act 1967 [P.U. (A) 51/2012]

The Customs Duties (Goods Under The Free Trade Agreement Malaysia-Chile) Order 2012 came into operation on 25 February 2012. Under this Order, the importation of goods [as specified in Column (4) of the Second Schedule] originating from Chile will be subject to preferential import duty rates, subject to compliance to the Rules of Origin and Operational Procedures/Rules.

Please see P.U. (A) 51/2012 for details.

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

S. Saravana Kumar and Siti Fatimah Mohd Shahrom

CASE 1

Gra Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax
Tax Appeal No. PKCP(R) 40/2008
(2012) MSTC 10-038

Counsel for the Appellant:
Datuk D. P. Naban, S. Saravana Kumar and Siti Fatimah Mohd Shahrom
Counsel for the Inland Revenue Board:
Ahmad Isyak Mohd Hassan and Azrul Safinas Rosli

FACTS

The Appellant was incorporated on 11 July 1988. Under the Memorandum and Articles of Association dated 11 July 1988, the principal activity of the Appellant, amongst others, was an investment holding company. On 23 October 1989, the Appellant purchased 2 parcels of land registered as H.S.(D) 86910 (No. PT 97) and H.S.(D) 86911 (No. PT 98) from S Resort (M) Bhd. The 2 parcels of land were part of Master Title G 28578, Lot 13567, Mukim Damansara, Selangor. On 15 December 1995, the Appellant had sold the land held under No. PT 97 to H Dinamis Sdn. Bhd. and the land held under No. PT 98 to S Sdn. Bhd. On 11 April 2000, the Inland Revenue Board raised a notice of additional assessment for income tax (Borang JA) for the year of assessment 1997 for the sum of RM8,540,810.70 against the Appellant for the gains made from the disposal of the two parcels of land. On 21 September 2007, the Appellant's tax consultants, Messrs KPMG Tax Services Sdn. Bhd. filed a notice of appeal to the Special Commissioners of Income Tax (Form Q) against the notice of additional assessment for income tax dated 11 April 2000 on behalf of the Appellant.

The first witness (AW1) said in evidence that he had retired from S Consolidated Berhad as its Director of Business Development in 2010. He said the Appellant was part of P (Malaysia) Sdn Bhd which was the ultimate holding company of S Consolidated Berhad. Between 1997 and 2003, AW1 was a Director of the Appellant. Between 1989 and 1999, AW1 was also the Senior Finance Manager in charge of OPD Sdn Bhd, one of the Master Title owners. By virtue of this, he was involved directly in the application for sub-division and development of the Master Title. The relevant testimony of AW1 pertaining to this case are as follows:

i. The Appellant did not purchase any other parcels of land except for the two parcels of land (namely H.S.(D) 86910 (No. PT 97) and H.S.(D) 86911 (No. PT 98)) (the Two Parcels), which the Appellant purchased as an investment.

ii. • The Appellant had consistently held the Two Parcels as "property development expenditure" items, i.e. non-current assets, in its audited accounts from the time the Two Parcels were purchased and sold. Other than holding the Two Parcels and some shares for the purposes of investment, the Appellant did not have any other business. The Appellant was then a dormant company.

iii. • Although the audited accounts state that one of the Appellant's principal activities was property development, the Appellant never undertook any such activity. In fact, even after the Two Parcels had been disposed of, the principal activity was continued to be stated to be of property development although the Appellant owned no land.

(iv) From AW1's experience having been involved at the time the Appellant purchased the Two Parcels and managing the various applications for OPD and AW1's interaction with the Appellant's directors then, it was apparent and clear to AW1 that the Appellant purchased the Two Parcels for investment. It must be noted that at the time the Appellant purchased the Two Parcels:

(a) The value of the Two Parcels was projected to increase substantially in the future due to the up and coming infrastructure improvements in the surrounding areas;
(b) The S Golf and C Club, which was located in the same area, was the brainchild of the then Prime Minister, Tun Dr. Mahathir Mohamad, who had initiated the creation of a government task force to set up a golf club in Kuala Lumpur to attract investors and industrialists. Given that this was a government initiative with huge potential for success, the Appellant was of the view that the Two Parcels were lucrative investments; and
(c) The Two Parcels were strategically located near the then international airport, Lapangan Terbang Subang.

For the reasons above, the Appellant purchased the Two Parcels for the purposes of investment.

(v) The Appellant took no steps to develop the Two Parcels. In fact, nothing was done by the Appellant to exhibit such intention. The Appellant was only interested in capital appreciation. This was evident from the fact that the Appellant had consistently held the Two Parcels as "property development expenditure" items, i.e. non-current assets, in its audited accounts from the time the Two Parcels were purchased and until it was sold. If the Appellant had intended to develop the Two

Parcels, it would have held the Two Parcels as current assets.

(vi) AW1 was clear about the Appellant's intention and purpose, which was to hold the Two Parcels as investment, as besides being the Appellant's director between 1997 and 2003, AW1 was also the officer in charge of the Appellant's financial affairs for the years 1994 and 1995. Further, AW1 was also employed by the vendor's then ultimate holding company at the time the Appellant purchased the Two Parcels. The Appellant's intention to hold the Two Parcels as an investment was present from the time it was purchased up until the time the Two Parcels were sold off. There was no change of intention and the Appellant took no steps to develop the Two Parcels.

(vii) The Appellant did not hold a developer's licence. Undertaking such development activities without a developer's license amounts to an offence and one would be subjected to various civil and criminal sanction. The Appellant had no experience in property development. From corporate and financial perspectives, it would have been much easier and efficient to use an existing subsidiary that was in property development to purchase the Two Parcels if the intention was to develop the Two Parcels. This was because the existing subsidiary would have the necessary licenses and permits from the local authorities and professional bodies to undertake the development on the Two Parcels. Prior to the disposal of the Two Parcels, the Appellant was a loss-making company and with a record like this, the Appellant could not undertake property development. The Appellant also had no income whatsoever. With such financial record, it was impossible for the Appellant to obtain the necessary approvals from the authorities and gain public confidence to undertake property development. No one would take the Appellant seriously.

(viii) At the time of purchase, the Two Parcels were classified as agriculture land and it remained so until the Two Parcels were sold. The Appellant did not make any application to convert the status of the Two Parcels or to subdivide the Two Parcels. The Appellant did not engage a surveyor to survey the Two Parcels. Further, the Appellant did not make any plan for irrigation and draining on the Two Parcels. The Appellant did not take any effort to level or clear the Two Parcels and did not employ any engineer, architect or contractor. The Appellant was not a property developer as the Appellant did not do anything to the Two Parcels and did not even submit any plan to the authorities or engage consultants to exhibit intention to develop the land.

(ix) The Appellant sold the Two Parcels on 15 December 1995. At the time the Two Parcels were sold, the Appellant was owned by D Sdn Bhd, which was owned by P (Malaysia) Sdn Bhd. Sometime in 1995, P conducted a group restructuring exercise in view of strengthening S Consolidated Berhad's position for public listing purposes. In giving effect to this exercise, the Appellant was required to sell the Two Parcels to S Sdn Bhd's subsidiaries, namely H Dinamis Sdn Bhd and S Sdn Bhd. Further, since the Two Parcels had appreciated in value, the Appellant thought it would be a good time to realise the investment. The Two Parcels remained agriculture land in terms of status and remained untouched since it was first purchased by the Appellant. The nature and character of the Two Parcels at the time of the sale remained the same as how it was at the time the Appellant purchased it. The Appellant did not pay the premium as it never intended to change the nature of the land. If not for the group restructuring activity, the Appellant would not have sold the Two Parcels.

(x) The Appellant did not appoint any broker or agent to sell the Two Parcels as the Appellant was not trading in land. The Appellant kept the Two Parcels for six years. The Two Parcels were meant as an investment and thus, the Appellant did not do anything to mature the Two Parcels. The Appellant wanted the Two Parcels to be an investment only. The Appellant took no steps at all to develop the Two Parcels or commence the business of property development.

The Appellant contended that the Two Parcels were held as investment and thus, the gains arising from the disposal of the Two Parcels were not subject to income tax. Meanwhile, the Inland Revenue Board argued that the Appellant was a property development company, which therefore meant that the gains from the disposal of the two parcels were business income. According to the Inland Revenue Board, there was profit seeking motive by the Appellant at the time of the acquisition of the said land since it was foreseeable that various development steps would be undertaken by the government to develop the area.

ISSUE

The issue for determination by the Special Commissioners of Income Tax was whether the gains from the disposal of the 2 parcels of land were trading receipts and taxable under Section 4(a) of the Income Tax Act 1967 as business income or capital receipts and taxable under the Real Property Gains Tax Act 1976.

DECISION

In order to resolve this issue, it is necessary to determine the intention with which the Appellant acquired the subject lands. The intention of the Appellant must be judged against the background of its acts and conduct and the circumstances of the case. The question whether a profit realised on the sale of real estate is a realisation or change of investment or an act done in the carrying on of a business is to be determined in the light of the facts in each case. The intention must be shown to have existed at the time of the acquisition of the asset. It is also of critical importance to note that the intention must amount to an intention in law. Based on this and the facts highlighted above, the Special Commissioners found that when the Appellant acquired the subject lands, its intention was for investment.

The Special Commissioners allowed the Appellant's appeal and ordered the notice of additional assessment for income tax to be discharged.

CASE 2

S (Malaysia) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax
Tax Appeal No. PKCP(R) 13/2011
(2012) MSTC 10-039

Counsel for the Appellant:
Datuk D. P. Naban, S. Saravana Kumar and Siti Fatimah Mohd Shahrom
Counsel for the Inland Revenue Board:
Ahmad Isyak Mohd Hassan and Azrul Safinas Rosli

FACTS

At a hearing held in Putrajaya on 25 July 2011, the Special Commissioners of Income Tax heard the submission by both parties on the preliminary issue for determination in respect of the assessment made by the Director General of Inland Revenue. The preliminary issue framed by the Special Commissioners was whether the provision of Section 102 (1) of the Income Tax Act 1967 is directory or mandatory. The chronology of events are as follows:

28.9.2007	The Inland Revenue Board raised notices of additional assessment for the years of assessment 2001, 2002 and 2003.
25.10.2007	The Appellant filed notices of appeal (Form Q) with the Inland Revenue Board.
8.3.2011	The Inland Revenue Board forwarded the three Form Qs to the Special Commissioners of Income Tax.

The Appellant argued that the wordings of Section 102(1) of the Income Tax Act 1967 (Act) are clearly mandatory. It prescribes a statutory duty on the Inland Revenue Board to forward the Form Q within 12 months from the date of receipt of the notice of appeal. In the present case, the three Form Qs should have been forwarded to the Special Commissioners on or before 24 October 2008. However, the Inland Revenue Board only forwarded the said Form Qs on 8 March 2011, nearly 42 months after the Form Qs were filed. No valid reasons were provided for the delay. It was further contended that ongoing negotiations with the Appellant, which were initiated by the Inland Revenue Board cannot be used as a reason to justify the delay. Even if the Inland Revenue Board had initiated the negotiations in good faith, their decision to delay the Form Qs beyond the stipulated time frame would still result in their decision to be null and void as the Inland Revenue Board had misconstrued Section 102(1) of the Act. It was submitted that neither the Inland Revenue Board nor the Special Commissioners has the jurisdiction to confer on extension of the prescribed time frame of 12 months. Section 102(1) is mandatory in nature because Section 101(1A) of the Act clearly prescribes that if the Inland Revenue Board requires more time to review the Form Qs, it is incumbent on the Inland Revenue Board to apply to, and obtain an extension of time of up to 6 months, from the Minister of Finance. The Inland Revenue Board's delay in forwarding the notices of appeal within the prescribed time frame had caused unnecessary

injustice and prejudice to the Appellant. It was especially contended that although Section 102(1) is silent as to the effect of its non-compliance by the Inland Revenue Board, the Special Commissioners could be aided to grant relief to the Appellant on the authority of *Sunthararaju Pachayappan v Jabatan Kastam Di Raja Malaysia [2010] 3CLJ 865* where the High Court held that the failure of the Director General of Customs to comply with the procedural provision of the Customs Act 1967 rendered his decision null and void. The Appellant humbly prayed that the Special Commissioners set aside the impugned notices of additional assessments as being null and void.

The Inland Revenue Board responded stating that there was no failure on its part to comply with Section 102 (1) of the Act because it is not mandatory for the Defendant to forward the Form Qs to the Special Commissioners within the 12 month period. This is so because there is nowhere mentioned in the said provision that the Inland Revenue Board was legally obliged to forward the Form Qs within the prescribed 12 month period. The provision merely provides that the Inland Revenue Board may send an appeal to the Special Commissioners at any time within the 12 month period from the date of receipt of appeal if it is of the opinion that there is no reasonable prospect of coming to an agreement with the appellant in accordance with Subsection 101(3) and 101(4) of the Act. It was further contended that there is no need for the Inland Revenue Board to apply for an extension of time to the Minister of Finance under Section 101(1A) because the said Subsection merely provides for the Director General to apply for extension of time to review an assessment, if the need arises but not for the Director General to apply extension of time to forward the appeal (Form Q) to the Special Commissioners. The Inland Revenue Board further submitted that the "Doctrine of Crown Immunity" provides that only in a situation where there is clear provision in a statute which states that any provision in the impugned statute is applicable to the government, only then is the government bound to comply with the provision, and not otherwise. According to the Inland Revenue Board, the delay in forwarding the Form Qs to the Special Commissioners was due to the negotiations between both parties in resolving the issues in dispute between them, hence the delay was reasonable and justified.

ISSUE

Whether the provision of Section 102 (1) of the Income Tax Act 1967 is directory or mandatory.

DECISION

The Special Commissioners observed that the Form Qs all dated 25 October 2007 from the Appellant had been filed within time in compliance with Section 99(1) of the Income Tax Act 1967 (Act). However the said Form Qs had only been submitted by the Inland Revenue Board to the Special Commissioners vide the Inland Revenue Board's covering letter dated 8 March 2011 and received by the Special Commissioners' office on 11 March 2011. The Special Commissioners took cognizance that the Form Qs were forwarded nearly 42 months after they had been filed. Section 102(1) provides:

"Subject to Subsection (3), the Director General may send an appeal forward to the Special Commissioners at any time within the 12 month period from the date of receipt of the notice of appeal or, if an extension under Section

101(1B) has been granted, within the extended period if he is of the opinion that there is no reasonable prospect of coming to an agreement with the Appellant in accordance with Section 102(2) in respect of the appeal ……"

The Special Commissioners held that it is statutorily mandatory for the Inland Revenue Board to have submitted the impugned Form Qs within the 12 month period from the date of receipt for the following reasons:

(a) The existence and provisions of Section 101(1A), 101(1B), 101(1C) of the Act and the words "…… or, if an extension under Section 101(1B) has been granted, within the extended……" in Section 102(1) of the Act, clearly show by necessary implication that Section 102(1) is mandatory in nature in terms of the Director General's time frame for reviewing the disputed taxes under appeal which is limited to 12 months, and he has to forward the Form Q at anytime within that period if he is of the opinion that there is no prospect of settlement. If it is purely directory, then by implication the provisions and words of those sections mentioned above are rendered redundant, and surely that cannot be the intention of the legislature. As a matter of fact, Subsection (1A), (1B), (1C) in Section 101 and the impugned words in Section 102(1) were held to mean to be a Ministerial check and balance to curb delays in the past .

(b) In the Hansard, Tuan Hashim Ismail, Parliamentary Secretary, Ministry of Finance was reported to have said that the time frame for the DGIR to conduct the review of the disputed tax is a period of 12 months, with a further extension of 6 months thereafter upon application to and approval by the Minister of Finance. Hence, by necessary implication, the Inland Revenue Board must forward the Form Q to the Special Commissioners at any time within the 12 month period if there is no prospect of settlement.

(c) In the Explanatory Statement to the Finance Bill 2000, the legislative intent was clearly disclosed, which is reproduced verbatim for its full impact:
"Clause 10 of the Bill seeks to amend Section 102 of Act 53 to require the Director General to send an appeal forward to the Special Commissioners within 12 months from the date of receipt of the notice of appeal or within such extended period as may be granted by the Minister if the Director General is of the opinion that there is no reasonable prospect of settling the matter in accordance with Section 101 of Act 53. This amendment is effective upon the coming into operation of the proposed Act".

(d) By virtue of not filing any affidavit in rebuttal to contradict the Appellant's two affidavits, the Inland Revenue Board is deemed to have admitted the Appellant's material averments on the injustice and prejudice suffered by the latter, including the Appellant's twice repeated assertions therein that the Inland Revenue Board had failed to comply with the mandatory duty imposed under Section 102(1) of the Act and its failure to do so renders the impugned notices of additional assessment null and void.

The Special Commissioners found that the Appellant's description of every instance of injustice and prejudice suffered by him as inherently probable, reasonable and therefore acceptable.

Administrative law is replete with cases where procedural non-compliance with the provisions of law, including non-compliance with time provision, have been adjudged to be fatal for the defaulting litigants. The case cited by learned counsel for the Appellant i.e. *Sunthararaju Pachayappan v Jabatan Kastam [2010] 3 CLJ 865* can be considered such an example. In that case, a declaration was sought by the plaintiff to declare a Customs Department's Forfeiture Notice dated 6 November 2008 null and void because the Customs Department's decision to refer the matter to the Magistrate approximately 12 months later after receipt of a Notice of Claim from the plaintiff was held to be in breach of the impugned Section 128(3) of the Customs Act 1967.

As the Inland Revenue Board had breached the statutorily mandatory provision of Section 102(1) of the Act, the Special Commissioners held that the disputed notices of additional assessment become unenforceable and the additional assessment cannot be recovered anymore. The additional tax paid by the Appellant was ordered to be returned within 30 days.

The Special Commissioners allowed the Appellant's appeal.

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InternationalNews

The column only covers selected developments from countries identified by the CTIM and relates to the period 16 February 2012 to 15 May 2012.

CHINA (PEOPLE'S REP.)

The Ministry of Finance (MoF) and the State Administration of Taxation (SAT) jointly issued the following rulings:

i. Deductibility of bad-debt provision for financial institutions clarified - On 29 January 2012 (Cai Shui [2012] No.5) clarifying the deductibility of bad-debt provision for financial institutions. The Notice applies in the period from 1 January 2011 to 31 December 2013.

ii. Deductibility of provisions for securities industry clarified - On 16 February 2012 (Cai Shui [2012] No.11), to clarify the deductibility of provisions for the securities industry. The Notice applies to the period from 1 January 2011 to 31 December 2015, and its content includes provision for securities and provision for futures.

Implementation rules for VAT pilot programme in Shanghai published

Following the announcement of the pilot programme of the value added tax (VAT) and business tax (BT) reform by Notice Cai Shui [2011] No. 110, the MoF and SAT jointly issued the implementation rules of the pilot programme on 16 November 2011 (Cai Shui [2011] No. 111) which became effective on 1 January 2012. Together with the Notices Cai Shui [2011] No. 131, Cai Shui [2011] No. 133 and Announcement No. 65, the Notice 111 intends to address and clarify the complicated implementation issues. The main points of these rules include: (i) Applicable scope of the Notice; (ii) Taxpayers; (iii) Taxable services; (iv) Providing service in China; (v) Tax rate; (vi) VAT calculation methods; (vii) Input tax; (viii) Currency; (ix) Mixed sales and exempt sales; (x) Sales adjustment by the tax authority; (xi) Timing of tax liability; (xii) Collection issues; (xiii) Exemptions and zero-rated export of services; (xiv) Implications; (xvi) Transitional measures; and (xvii) Future developments.

Income tax incentives for software and integrated circuits (IC) enterprises renewed and extended

The MoF and SAT issued a Notice on 20 April 2012 (Cai Shui [2012] No. 27) to renew the enterprise income tax (EIT) incentives for software and IC enterprises. The Notice applies from 1 January 2011 to 31 December 2017 and is generally in line with a prior Notice (Guo Fa [2011] No.4) regarding the encouragement of development of software and IC industries. The main renewed and extended incentives are summarised as follows. (a) In the period from 1 January 2011 to 31 December 2017 the exemption from EIT for the first 2 years (starting from the first profit-making year) and the reduction of the EIT rate from 25% to 12.5% for the 3 following years apply to: (i) The certified enterprises (CE) engaged in manufacturing IC with a line width of less than 0.8 microns (inclusive 0.8 microns); (ii) The CE which are engaged in manufacturing IC with a line width of less than 0.25 microns (inclusive 0.25 microns) or have invested more than CNY8 billion in IC industry if the operation of such an enterprise lasts more than 10 years. The CE operating less than 10 years are subject to EIT at a reduced rate of 15%; (iii) The software and IC enterprises which are newly established in China and certified by the relevant government bodies.(b) The 10% EIT rate is available to the certified key software enterprises (i.e. those being recognised within the state's plan). (c) A CE engaged in software or IC industries may, based on the Notice Cai Shui [2011] No. 100, claim a refund of the part of VAT which exceeds 3% of the total VAT paid (the normal rate of VAT paid is 17%). The refunded VAT is not subject to EIT if the refund is reinvested in R & D activities or expansion of the enterprise. (d) Employee training expenses incurred by the IC design enterprise or certified software enterprise are not

subject to restriction of deduction and fully deductible for EIT purposes. (e) Accelerated amortisation or depreciation is introduced for purchased software which is considered as fixed asset or intangible and for machines used for IC production. The purchased software is allowed to be amortised or depreciated within 2 years and IC machine may be depreciated within 3 years. (f) To be eligible for the incentives, a software or IC enterprise must meet various requirements in respect of sale revenue, the education level of the personnel, the number of personnel engaged in R & D activities, the possession of the core

technology or intellectual properties, quality management system and the premises and machineries suitable for the development of software and the production of IC products.

Several issues on enterprise income tax clarified

The SAT issued a Bulletin on 24 April 2012 (Gong Gao [2012] No.15) clarifying several issues in respect of the determination of taxable income for the purposes of EIT. The provisions contained in the Bulletin apply from 1 January 2011 and onwards. The main issues clarified are summarised below. *(i) Retroactive adjustment of deductions of the preceding years* - Allowable costs and expenses which were actually incurred in the preceding tax years, but were unclaimed as deductions, may be adjusted within 5 years provided that the enterprise submits a special filing and statement to the competent tax authority. The overpaid EIT resulting from the unclaimed deductions may be offset against the income tax liability of the year in which the omission is discovered. In the case of insufficient tax liability, any amount which cannot be offset may be carried over to the 5 following years or reclaimed as a tax refund. The enterprises suffering losses or ended up in a loss situation because of the adjustments may first make the adjustments, and subsequently recalculate the losses which can be carried forward for 5 years in the normal manner. Under the Chinese tax collection and administration law, a taxpayer may reclaim the overpaid tax within 3 years of the tax payment and this Bulletin seems to have extended the adjustment period to 5 years. *(ii) Salaries/ wages of casual workers* - Expenses incurred by employment of casual or part-time workers, trainees and reemployed retirees should be divided into salaries/ wages and social insurance contributions for employees, and are deductible for the purposes of EIT. However, only the part of the expenses related to salaries and wages may be included in the total salaries/wages amount on which some deductions are contingent under the EIT law (for example, the deduction of educational contributions paid for employees is restricted to 2.5% of the total salaries/wages amount). *(iii) Deductibility of financing expenses* - Expenses, incurred on corporate bonds and other debenture of an enterprise, are fully deductible provided that such bonds or debentures are not of an equity nature.

(iv) Deductibility of expenses in the business incubation period - 60% of entertainment expenses in the incubation period may be added up to entertainment expenses which are deductible up to 0.5% of the sale revenue of the enterprise. The expenses on advertisement in the incubation period are fully deductible once the enterprise starts up. *(v) Deductibility of fees and commissions for agencies* - Fees and commissions paid by the enterprises engaged in the agency business (e.g. securities, future and insurance) to the intermediaries are fully deductible.

HONG KONG

Proposed legislative amendments for Islamic bonds (sukuk) – Consultation launched

On 29 March 2012, the Hong Kong Financial Services and the Treasury Bureau launched a two-month consultation exercise on proposed amendments to the Inland Revenue Ordinance (IRO) (Cap.112) and the Stamp Duty Ordinance (Cap.117), to promote the development of an Islamic bond (sukuk) market in Hong Kong. The proposed legislative amendments are intended to level the playing field for common types of *sukuk vis-à-vis* their conventional counterparts in terms of profits tax, property tax and stamp duty liabilities.

Budget for 2012-13: Inland Revenue (Amendment) Bill 2012 gazetted

Further to the Budget 2012-13 announcement on 1 February 2012, the Inland Revenue (Amendment) Bill 2012 was gazetted on 27 April 2012. The Bill amends the IRO to implement the measures in respect of salaries tax and tax under personal assessment. The Bill does not cover proposed changes to profits tax or indirect taxes. The Bill is still subject to approval by the Legislative Council.

APA programme guidelines – details

Further to the announcement of the advance pricing agreement (APA) programme on 3 January 2012, the HKIRD released DIPN No. 48 setting out the guidelines for taxpayers seeking an APA. It explains the APA process and the terms and conditions

prescribed by the Commissioner. The salient points of the DIPN are summarised below. DIPN No. 48 makes it clear that an APA is to reach an agreement on the methodology used to determine the transfer pricing in controlled transactions, but not to establish the actual profit to be taxed in Hong Kong in future. The arm's length principle is followed and the DIPN refers to the article on associated enterprises in Hong Kong's tax treaties for the definition of associated enterprises (which generally follow the *"http://online.ibfd.org/linkresolver/static/tt_o2_02_eng_2010_mo" \o "OECD (income and capital model convention), 2008"* OECD Model Convention (2010)). For the purposes of this DIPN, the scope of an APA is extended to cover transactions between a permanent establishment and its head office or between two permanent establishments of the same enterprise. Generally, an APA will apply for 3 to 5 years, and can be renewed with the consent of all parties. No fee is charged by the HKIRD.

Type of APA applications - At least at the initial stage of the programme, only bilateral APA or multilateral APA applications will be considered. This indicates the HKIRD's intention to focus on international tax issues that can be solved via the mutual agreement procedures under article 25 of the OECD Model. For the time being, APA applications will only be accepted for cross border related-party transactions involving countries that are treaty partners. However, a unilateral APA application can be considered if:(i) the treaty partner in a bilateral APA application process does not wish to participate in or continue the process; (ii) the HKIRD is unable to reach an agreement with the treaty partner; or (iii) a state with which Hong Kong does not have a tax treaty is prepared to give a unilateral APA regarding transactions that are integrally linked to the controlled transactions covered by the bilateral or multilateral APA.

Time frame and threshold - DIPN No. 48 indicates a tentative time frame of 18 months from the acceptance of the formal application, with a possible additional 6 months depending on the progress of negotiation with the competent authority of the treaty partner(s). The threshold for an APA application is as follows:(i) HKD80 million per annum for transactions involving the sale and purchase of goods; (ii) HKD40 million per annum for transactions involving services; and (iii) HKD20 million per annum for transactions involving intangible property. The threshold can be relaxed on a case-by-case basis, depending on the number and relative size of the transactions, the transfer pricing risk, and likely acceptance of the treaty partner(s).

The APA process - The APA process has five stages as commonly seen in other APA programmes around the world:(i) pre-filing; (ii) formal application; (iii) analysis and evaluation; (iv) negotiation and agreement; and (v) drafting, execution and monitoring. A preparation is required before the pre-filing stage, which involves a detailed APA proposal and case plan, including specific information about the scope of the APA, the transactions to be covered, collateral issues, and proposed methods. The HKIRD is willing to conduct a pre-filing meeting on an anonymous or a named basis.

Audit and rollbacks - The DIPN states that factual information disclosed in an APA application may be used by the HKIRD, e.g. in reviewing the tax positions of prior years, even where an APA is not concluded or the applicant withdraws from the process. The approach of the HKIRD to the rollback of the transfer pricing methodology to years prior to the start of the APA will depend on the specific circumstances of the case and whether previous years' assessments can be reopened under Hong Kong's domestic tax laws and the relevant tax treaty. As a rule of practice, the HKIRD will not consider requests for rollbacks in the case of unilateral APAs. DIPN No.

48 sets out the following principles which will be incorporated into the practice for rollbacks:(i) the HKIRD will not undertake the years prior to an APA that will not be audited;(ii) an APA does not have retrospective application; (iii) there may be situations where principles developed in concluding an APA might provide a basis for resolving issues for prior years; (iv) prior year adjustment resulting from an APA request will be treated as though the taxpayer has made a voluntary disclosure provided compliance activity has not commenced or been notified; (v) where an audit has not commenced or been notified, any additional tax will be computed as if a voluntary disclosure had been made; (vi) when as audit has commenced, the normal

penalty provisions will apply to any adjustments made to prior years under audit. Rollback is likely to be sought for cases where previous year transfer pricing issues are considered high risk. The HKIRD is more likely to seek a rollback for a lesser number of years for cases involving voluntary APA requests than for cases resulting from an audit or HKIRD request.

Collateral issues - Collateral issues will be processed in parallel with the APA application wherever possible, and it may be that they have to be resolved through an advance ruling from the HKIRD. Examples of collateral issues include whether the covered controlled transactions involve a permanent establishment, whether the income constitutes a royalty or business profit, and any legal issues on which the HKIRD has not yet taken a position.

INDIA

The Indian Income Tax Appellate Tribunal (ITAT) delivered the following rulings:

i. Ruling on use of controlled transactions for benchmarking

The ITAT delivered a ruling dated 23 December 2011 in the case of *Bayers Material Science Pvt. Ltd. v. ACIT [ITA No. 7977/Mum/2010]* wherein it provided guidance on the use of the controlled transaction for benchmarking purposes among other issues. The ITAT applied the principle of purposive interpretation (i.e. law has to be interpreted keeping in mind the purpose of its enactment) and held that where there are no comparable uncontrolled transactions, due to the nature of the transaction being such that it is ordinarily between AEs, then a controlled transaction would assume the character of an uncontrolled transaction and can be used for the purpose of benchmarking. Thus the ITAT ruled in favour of the Tax Authorities.

ii. Ruling on benchmarking of interest on loans

The ITAT delivered a ruling dated 12 January 2011 in the case of *Aithent Technologies Pvt. Ltd. v. ITO (2010-TII-134-ITAT-DEL-TP)* wherein it was held that the Comparable Uncontrolled Price (CUP) is the most appropriate method to benchmark an interest-free loan provided by the Taxpayer to its US subsidiary.

iii. Ruling on transfer pricing for logistics industry

The ITAT delivered a ruling dated 25 January 2012 in the case of *Agility Logistics Pvt. Ltd. (ITA No. 2000/Mum/2010, ITA No. 6004/Mum/2010 and ITA No. 8146/Mum/2010)* wherein it was held that sharing of net revenues in the ratio of 50:50 in between origin and destination companies for both controlled and uncontrolled transactions constitutes a valid arm's length price.

iv. Ruling on transfer pricing for distributors

The ITAT delivered a ruling dated 22 February 2011 in the case of *Mastek Ltd. v. ACIT (ITA No. 3120/Ahd/2010)* which upheld the nature of the activities undertaken by the Taxpayer's subsidiary and hence the benchmarking used for transfer pricing purposes.

Direct Taxes Code Bill, 2009 – Parliamentary Standing Committee submits its recommendations

The Parliamentary Standing Committee, which was constituted to review and comment on the provisions of the Direct Taxes Code, 2009 (DTC), submitted its comments/recommendations to the Parliament on 9 March 2012. The major recommendations that are suggested by the Committee are: (i) provision of tax consolidation of group entities; (ii) modernisation and computerisation of tax department's operations; (iii) increase in the threshold limit and tax brackets for individual income tax and wealth tax; (iv) availability of tax credit to non-resident shareholders on the additional dividend distribution tax paid by Indian domestic companies; (v) greater clarity before implementation on international tax rules like GAAR, CFC, etc. The DTC was supposed to be implemented from 1 April 2012 but it seems likely that it would be postponed to a later date in view of the above recommendations.

Budget for 2012/13 presented

The Budget for 2012/13, which was presented by the government on 16 March 2012, includes various amendments to the direct and indirect tax regimes. Generally, the direct tax proposals, when passed, are to take effect when ratified by the Parliament, whilst the indirect tax proposals are to have immediate effect. The main proposals are highlighted below. *(a) Direct taxes* – (i) The CIT rates remain unchanged; (ii) The income tax brackets for individuals are modified, first and last annual taxable income bracket increased from INR180,000 to INR200,000 and INR800,000 to INR1,000,000 respectively; (iii) Individuals are allowed a deduction of up to INR10,000 for interest from savings bank accounts and INR5,000 for preventive health checkups; (iv) The rate of withholding tax

on interest payment on External Commercial Borrowings reduced from 20% to 5% for 3 years for certain sectors;(v) The restriction on Venture Capital Funds to invest only in 9 specified sectors is removed; (vi) The investment link deduction of capital expenditure for certain businesses is enhanced to 150% and new sectors are added for the purposes of investment linked deduction; (vii) The weighted deduction of 200% for R&D expenditure in an in-house facility is extended for a further period of 5 years beyond 31 March 2012; (viii) The turnover limit for compulsory tax audit of accounts and presumptive taxation of Small and Medium Enterprises is raised from INR6 million to INR10 million; (ix) An exemption from capital gains tax on sale of residential property is provided to individuals, if sale consideration is used for subscription in equity of a new start-up manufacturing small and medium enterprise which is used by the company for purchase of new plant and machinery; (x) The securities transaction tax is reduced by 20% on cash delivery transactions; (xi) A General Anti-Avoidance Rule has been introduced to counter aggressive tax avoidance schemes; (xii) A Tax Residency Certificate containing prescribed particulars, is made mandatory for a non-resident to claim benefits under India's tax treaties; (xiii) New provisions are introduced to provide a framework for APA; and (xiv) TP provisions are extended to domestic transactions between related parties.
(b) Indirect taxes – (i) Service tax has been levied on all the services except negative list comprising 17 specified services; (ii) The rate of service tax has been enhanced from 10% to 12%; and (iii) The standard rate of excise duty has been raised from 10% to 12%. The government of India has announced that the General Anti-Avoidance Rule (GAAR), which was announced as part of Budget 2012/13, has been postponed to 1 April 2013.

INDONESIA

Tax data and information – Government Regulation issued

The government issued Government Regulation No 31 of 2012, regarding the submission and collection of tax-related data and information, dated 27 February 2012 which is effective since the issuance date. Article 1 of the Regulation stipulates that the data and information collected includes letter, document, book or written record, which could provide guidance about income or wealth of any company or individual, including business activities and professional services from the company or individual. Additionally, according to article 2 of the Regulation, the data and information collected consists of wealth or assets, debt, income, expenses, economic activities and financial transaction from the company or individual. governmental institutions, governmental ministries, non-governmental institutions and private associations are obliged to submit the data and information to the Directorate General of Taxation (DGT). "Private association", as noted in article 3, comprises (i) Indonesian Industry and Trade Chamber; (ii) Indonesian Banks Association; (iii) Indonesian Public Accountant Association; (iv) Indonesian Entrepreneur Association; (v) Association of Indonesian Automotive Industry; (vi) Association of Young Indonesian Entrepreneur; (vii) Indonesian Tax Consultants Association; (viii) Association of Indonesian Reporter, and (ix) Association of Indonesian Retailers. Based on article 4 of the Regulation, it is compulsory to submit the tax data and information periodically at least once every year. The Regulation will be subsequently supplemented by Regulation from the Ministry of Finance, which is expected to provide further details regarding the institutions or associations obliged to provide the data and information, and how detailed the data and information should be. The Regulation itself is based on the of General Provision and Procedure on Taxes Law No 28 / 2007; specifically – (i) article 35A regarding the obligation to submit tax-related data and information to DGT; and (ii) article 41C regarding the criminal penalty for the failure to submit the data and information to DGT.

MIDDLE-EAST

Egypt - Reductions introduced for early payment of tax debts

On 16 January 2012, the Military Council issued a Decree Law according to which reductions are granted with regard to early payments of tax debts and connected penalties

as follows: (i) 25% on amounts paid between 17 January and 31 March 2012; (ii) 15% on amounts paid between 1 April and 30 June 2012; and (iii) 10% on amounts paid between 1 July and 31 December 2012.

On 23 January 2012, the MoF issued a decision to clarify the scope of the Decree Law. Accordingly, the above mentioned reductions do not apply to the following: (i) corporate tax liabilities with respect to the tax year 2011; (ii) withholding taxes whether on payments to resident or non-resident persons; (iii) advance payments on account of corporate income tax and individual income tax; (iv) taxes collected by the taxpayer in order to be remitted to the tax authority; and (v) taxes due by companies operating in oil and gas exploration and production activities.

Iran - Social security contribution ceiling increased

The Social Security Administration published recently the new ceiling for social security contributions purposes with respect to the Iranian year 1391 (i.e. 20 March 2012 to 30 March 2013). The ceiling per day is increased from IRR770,700 to IRR909,300.

Standard VAT rate increased

The Tax Office has recently issued a press release stating that the standard VAT rate is increased from 4% to 5%. The new rate is effective as of 20 March 2012.

Iraq - Budget 2012 adopted by parliament

On 23 February 2012, the parliament adopted the Budget for 2012.

Jordan - Finance Law 2012 approved by parliament

On 23 February 2012, the Parliament approved the Finance Law 2012.

Lebanon - Draft 2012 Budget – Changes to VAT measures announced

The MoF recently announced that the standard VAT rate will be increased to 11% instead of 12% as initially provided in the draft 2012 Budget (see Lebanon-1, News 6 December 2011). The current standard rate is 10%. Additionally, the right to claim refund of input VAT charged on fixed assets and operational expenses related to the supply of certain zero-rated goods and services will not be abolished.

Palestinian Autonomous Areas - Income tax rates increased

On 14 February 2012, the Ministerial Council amended the new Income Tax Law 8/2011 by decision number 04/123/13 for 2012. As of 1 January 2012, income tax rates are as follows: *(a) corporate tax* – (i) 15% for income up to NIS125,000; and (ii) 20% for income over NIS125,000; *(b) individual income tax* – (i) 5% for income up to NIS40,000; (ii) 10% for income between NIS40,001 and NIS80,000; (iii) 15% for income between NIS80,001 and NIS125,000; and (iv) 20% over NIS125,000. Income earned in 2011 is taxable according to the previously applicable rates as follows:- (i) 15% flat corporate tax rate; and (ii) 15% as a top marginal rate for individual income tax purposes

Saudi Arabia - Proposal to tax expatriates rejected by the Shura Council

On 1 April 2012, the Saudi Shura (Consultative) Council has rejected a proposal to impose tax on the income of expatriate workers in the public and private sectors. Supporters of the proposal argued that the tax will reduce the gap between the wages of Saudi and non-Saudi employees and encourage the latter to work in the private sector, as the cost of employment of aliens will be higher. The majority of the Council Members rejected the proposal because it was inappropriate, considering the development activities in which Saudi Arabia is currently engaged. Several members also noted that imposing tax on expatriates will not only be discriminatory against alien residents in the Kingdom but also inefficient because, ultimately, the cost of the tax will be borne in one way or another by Saudi nationals. It should also be noted that in 2003 the Council rejected a similar proposal to tax non-Saudis. The Shura Council is an advisory body

composed of 150 members appointed by the King. The Council may propose draft laws to the King, who has the power to enact them.

Syria - Income tax return deadlines extended

On 20 March 2012, the MoF extended the income tax return deadlines by 30 days. The new deadlines are as follows: (i) 30 June 2012, for joint stock companies and limited liability companies; and (ii) 30 April 2012, for other taxpayers.

Yemen - 2012 budget presented

On 6 March 2012, the Council of Ministers presented to the Parliament the 2012 budget.

SINGAPORE

Budget for 2012 – details

The Budget for 2012 was presented to the Parliament by the Finance Minister on 17 February 2012. Details of the Budget, which unless otherwise indicated will apply from the year of assessment (YA) 2013, are summarised below.

Direct taxation *(A) Corporate taxation* – (i) a one-off cash grant will be provided for small and medium sized companies, pegged at 5% of the company's revenue for YA 2012 and capped at SGD5,000. To enjoy the cash grant, the company must have made CPF contributions for at least 1 employee during the relevant accounting period for YA 2012; (ii) the expenditure cap for the renovation and refurbishment scheme will be doubled to SGD300,000 for each 3-year period; (iii) the full cost of an asset that may be written down in 1 year for capital allowance purposes is increased to SGD5,000; (iv) the 200% deduction for internationalisation expenditure will be enhanced for qualifying expenditure incurred on or after 1 April 2012 on: (a) overseas business development trips; (b) overseas investment study trips; (c) participation in overseas trade fairs; and (d) participation in local trade fairs; (v) gains derived from the disposal of equity investments on or after 1 June 2012 will not be taxed, if: (a) the divesting company holds a minimum shareholding of 20% in the company whose shares are being disposed; and (b) the divesting company maintains the minimum 20% shareholding for a minimum period of 24 months just prior to the disposal.

(B) Personal taxation - The earned income relief (EIR) and Handicapped EIR will change as follows for the respective age group: (i) Below 55 – EIR SGD1,000 and Handicapped EIR SGD4,000; (ii) 55 to 59 – EIR SGD6,000 and Handicapped EIR SGD10,000; and (iii) 60 and above – EIR SGD8,000 and Handicapped EIR SGD12,000.

(C) Tax incentives – (i) the Special Employment Credit (SEC) is enhanced, such that employers will receive an SEC of 8% of wages for each Singaporean worker above 50 years old, earning up to SGD3,000 per month, and who is on the payroll between January 2012 and December 2016. A lower SEC will also be provided for workers with a monthly wage of between SGD3,000 and SGD4,000; (ii) various enhancements were made to the Productivity and Innovation Credit (PIC) scheme effective YA 2012, including the increase in the cash payout rate to 60% and extension of the cash payout to YA 2015; (iii) the M&A scheme is enhanced, such that a 200% tax allowance will be granted on the transaction costs incurred on qualifying M&As completed from 17 February 2012 to 31 March 2015, subject to an expenditure cap of SGD100,000 per YA; (iv) an Integrated Investment Allowance (IIA) scheme will be introduced, providing an additional allowance on fixed capital expenditure incurred on or after 17 February 2012 for productive equipment placed overseas on approved projects; (v) with retroactive effect to 1 June 2011, qualifying ship operators and ship lessors under the Maritime Sector Incentive (MSI) awards are granted tax exemption automatically on: (a) gains from the disposal of vessels; and (b) gains from the disposal of vessels under construction and new building contracts. For ship lessors under the MSI-ML (Ship) award, the exemption applies to gains from the disposal of foreign vessels; (vi) bareboat, voyage and time charter payments made on or after 17 February 2012 to non-residents (excluding permanent establishments in Singapore) for the use of ships will be exempted from withholding tax; (vii) the Aircraft Leasing Scheme (ALS) will be extended to 31 March 2017 and withholding tax exemption will be granted automatically, subject to conditions, on interest and qualifying payments made on or after 1 May 2012 by existing and new ALS recipients in respect of qualifying foreign loans entered into on or before 31 March 2017; (viii) the liberalised withholding tax exemption regime for banks is enhanced such that the specified entities do not need to withhold tax on interest and other payments made to permanent establishments in Singapore. This change will take effect for: (a) payments to be made from 17 February 2012 to 31 March 2021 (for contracts already in force before 17 February 2012); and (b) all payments arising from contracts effective on or after 17 February 2012 to 31 March 2021; (ix) the withholding tax exemption for Over-The-Counter financial derivatives payments is extended to 31 March 2021; (x) the tax deduction concession for collective

impairment provisions of banks is extended for a further 3 years until YA 2016 or YA 2017, depending on the financial year-end of the taxpayer; (xi) a real estate investment trust that makes distributions to unit holders in the form of units on or after 1 April 2012 can continue to enjoy tax transparency, subject to conditions; and (xii) various enhancements will be made to the MSI-Maritime Leasing (Container) award and the Financial Sector Incentive schemes.

Indirect taxation (a) *GST* – (i) beginning 1 October 2012, the import and supply of investment-grade gold and precious metals will be treated as exempt supplies; (ii) beginning 1 January 2013, the GST Tourist Refund System will be extended to international cruise passengers; and (iii) effective 1 April 2012, the GST import relief for new articles brought in by inbound travellers will be simplified such that a relief of SGD150 is provided where the time spent abroad is less than 48 hours, or SGD600 otherwise.

(b) *Excise duties* - Effective 17 February 2012, excise duties on tobacco products will be increased by 10% to 20%.

(c) *Other taxes* – (i) with effect from 18 February 2012, the transfer fee for vehicles is revised to SGD11 and the additional transfer fee is abolished; (ii) the Green Vehicle Rebate (GVR) scheme for commercial vehicles, buses and motorcycles is extended to 2014; and (iii) the GVR scheme for passenger cars and taxis is replaced by a Carbon Emissions-based Vehicle Scheme (CEVS) with effect from 1 January 2013.

Other measures – (i) effective 1 January 2013, the CPF contribution rates of self-employed persons aged 50 and above will be raised from 9% to 9.5%; and (ii) effective 1 September 2012, the CPF contribution rate for employed persons will be changed as follows for the respective age group: (a) above 50-55 – Employer 14% and Employee 18.5%; (b) Above 55 to 60 – Employer 10.5% and Employee 13%; and (iii) Above 60 to 65 – Employer 7% and Employee 7.5%.

Property tax treatment of common property

The IRAS issued an e-Tax Guide on 9 May 2012, detailing the tax treatment of the property tax of common property, including common areas and facilities, atrium space, as well as the maintenance office in both residential and non-residential buildings.

VIETNAM

VAT on credit services

Pursuant to Official Letter 608/VPCP-KTTH (OL 608), issued on 4 February 2012, VAT is applicable on loan interest from credit services provided by entities which are not credit or financial organisations (i.e. licensed institutions), includes foreign entities (which are not licensed credit or financial institutions) lend money to their Vietnamese entities, VAT would be applicable on the interest.

MALAYSIA – TREATY DEVELOPMENT

The following tax treaty partners signed the tax treaties with Malaysia: (i) Hong Kong and (ii) India.

Bosnia and Herzegovina has ratified the tax treaty with Malaysia as published in the Official Gazette of 6 April 2012.

The amending protocol, signed on 5 April 2011, to the Malaysia - South Africa Income Tax Treaty (2005), entered into force on 6 March 2012. The protocol generally applies from 6 March 2012.

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BENEFITS OF APAs OUTWEIGH THE COSTS

IN THE CURRENT GLOBAL ECONOMIC ENVIRONMENT TAX AUTHORITIES ARE INCREASING THEIR TRANSFER PRICING AUDIT ACTIVITIES TO ENSURE THAT THEY ARE STAKING THEIR CLAIM TO TAXABLE PROFITS—AND THE AMOUNTS OF TAX AT STAKE CAN BE MATERIAL. TO MITIGATE THIS RISK, MANY COMPANIES ARE OPTING TO ENTER FORMAL ADVANCE PRICING AGREEMENT (APAs) WITH ONE OR MORE TAX AUTHORITIES.

SOME RESPONDENTS SAW VALUE IN THE OPPORTUNITY TO IMPROVE THEIR RELATIONSHIPS WITH THE TAX AUTHORITIES AND TO HELP THEM UNDERSTAND THEIR BUSINESS MODEL OVER THE COURSE OF THE NEGOTIATIONS.

A new survey released by **KPMG International**, titled Navigating APAs, shows that respondents believe the benefits of an APA outweigh the costs. The stability and security of knowing how their transfer pricing will be treated clearly offsets the concerns about the time and expense involved in pursuing an APA. Through an APA respondents also indicated they are better able to manage internal resources and save time and costs by preventing future audits.

"APAs offer security that the tax authorities will accept your transfer pricing methodology over the term of the agreement," says Sean Foley, KPMG's Head of Global Transfer Pricing Services. "To ensure APA programmes keep attracting companies that want the security of an APA at a reasonable cost and speed, the introduction of a simplified, expedited and risk-based process will be critical."

To explore the current perceptions and experiences with APA programmes globally, in-depth interviews were conducted with tax directors (or their equivalents) from 25 multinational companies in seven countries. The findings were reviewed and analysed by a panel of Transfer Pricing Leaders from KPMG member firms. This survey is the result of their considerable collective experience in dealing with APA programmes and shares insights on how policymakers can improve the efficiency and effectiveness of transfer pricing compliance and dispute prevention systems.

According to the survey, with more control over the timing of the APA process compared to an audit, respondents were better able to manage their workflows and internal resources.

Some respondents saw value in the opportunity to improve their relationships with the tax authorities

"OVER THE PAST 20 YEARS, APAs HAVE BECOME WELL-ESTABLISHED TOOLS FOR RISK MANAGEMENT AND ADVANCE COMPLIANCE," SAYS FRANÇOIS VINCENT, KPMG'S LEADER, GLOBAL TRANSFER PRICING DISPUTE RESOLUTION. "EXPERIENCE SHOWS THAT ONCE A COMPANY GOES THROUGH THE PROCESS AND SEES THE BENEFITS, MANY WILL DO IT AGAIN – ALBEIT IN THE RIGHT SITUATION."

and to help them understand their business model over the course of the negotiations. Successful APAs can also serve as precedents to support the company's transfer pricing in other jurisdictions.

"Over the past 20 years, APAs have become well-established tools for risk management and advance compliance," says François Vincent, KPMG's Leader, Global Transfer Pricing Dispute Resolution. "Experience shows that once a company goes through the process and sees the benefits, many will do it again – albeit in the right situation."

Negotiating an APA may consume a lot of time and resources. While completion times vary by country, the average time to process and complete APAs typically runs from 10 to 20 months.

With more countries adopting APA programmes, most respondents expect that taxpayer demand for APAs will increase in the near term, but they worry that tax authorities will not have the resources to keep up with the increased demand. Some predict increase in demand for APAs will slow down the process even more and cause a drop in the number of files accepted into the programme. Others suggest that the rising caseload will prompt tax authorities to introduce a streamlined, expedited APA process. In the survey, KPMG's transfer pricing professionals make a case for an expedited, fast-track APA process that could be a win-win for tax authorities and taxpayers alike by reducing risks and increasing the efficiency of administration.

For example, the Australian Taxation Office (ATO) has introduced separate APA products for taxpayers based on three levels of risk and complexity: simplified, standard, and complex. This allows the ATO to focus its resources on areas of higher risk and complexity while simplifying requirements for straightforward, lower-risk transactions.

In addition, the Organisation for Economic Co-operation and Development (OECD) is reviewing transfer pricing administration with an eye to simplifying it.

"KPMG's Global Transfer Pricing Services practice has submitted comments calling on the OECD to consider the benefits of incorporating a process for expedited APAs into the OECD's transfer pricing guidelines," says Foley. "The results of this survey support the view that tax authorities should adopt expedited APA processes to supplement existing programmes. Doing so could boost participation and increase the efficiency of transfer pricing administrations, for the benefit of all concerned."

OTHER BUSINESS DEDUCTIONS

continuation from vol.5/no.2

Siva Subramaniam Nair

In the last article we looked at deductions for research and development expenditure under S34(7) and S34A. We shall now continue the discussion by deliberating on double deductions under S34B, relief for capital expenditure and incentives available for research and development activities.

SECTION 34B - SPECIAL DEDUCTION FOR CONTRIBUTION TO AN APPROVED RESEARCH INSTITUTE OR PAYMENT FOR USE OF SERVICES OF AN APPROVED RESEARCH INSTITUTE OR COMPANY

The first Subsection reads:

Subject to this section, in ascertaining the adjusted income of a person from a business for the basis period for a year of assessment, a deduction shall be made, as specified in Subsection (2), from the gross income from the business for that period in respect of expenditure, not being capital expenditure, incurred by that person during that period in respect of—

a. contribution in cash to an approved research institute;
b. payment for the use of the services of an approved research institute or an approved research company; or
c. payment for the use of the services of a research and development company or a contract research and development company.

The availability of a double deduction for the above expenditure is enshrined in Subsection (2) which clearly indicates that "the amount of deduction to be made under Subsection (1) shall be twice the amount of expenditure, not being

capital expenditure, referred to in that Subsection:"

However, the proviso to this Subsection states that "no deduction in respect of that expenditure shall be made under this section to a person being a related company of a research and development company which has been given approval under Section 27D(1) of the Promotion of Investments Act 1986 [this means enjoying Investment Tax Allowance] and whose period as prescribed under Section 29E(2)(b) of that Act has not ended."

A precautionary clause to ensure that no further claims are made on the same expenditure is placed in Subsection (3) which clearly stipulates that "where any deduction in respect of expenditure referred to in Subsection (1) is made under this Section, no deduction in respect of that expenditure shall be made under Sections 33, 34 or 34A."

A clear distinction is made in the fourth Subsection between the different entities mentioned in Sub-section (1), and these are detailed below:

a. an "approved research institute" means an institute, including a company licensed under Section 24 of the Companies Act 1965, approved by the Minister to mainly carry on research in an industry specified in the approval and to commercially exploit the benefit of such research thereof;
b. an "approved research company" means a company, other than a company licensed under Section 24 of the Companies Act 1965, approved by the Minister to mainly carry on research in an industry specified in the approval and to commercially exploit the benefit of such research thereof;
c. a "contract research and development company" and a "research and development company" have the same meaning assigned thereto in Section 2 of the Promotion of Investments Act 1986 and fulfills the conditions specified by the relevant Ministry;

On checking out Section 2 of the Promotion of Investments Act 1986 we find the following:

- "contract research and development company" means a company which provides research and development services in Malaysia only to a company other than its related company;
- "research and development company" means a company which provides research and development services in Malaysia to its related company or to any other company.

Students should be careful when dealing with the terms "related" and "associated" in relation to companies because they come with different definitions under the various topics in taxation; (example: for stamp duty exemption under S15A, associated means 90%, for group relief purposes qualifying companies must be related directly or indirectly to the tune of 70%, control in control sales means holding in excess of 50% etc.) So the question now is what is a related company in this context? The definition provided there is as follows:-

"related company" ,in relation to a company, means a company

a. the operations of which are or can be controlled, either directly or indirectly, by the first-mentioned company;
b. which controls or can control, either directly or indirectly, the operations of the first-mentioned company; or
c. the operations of which are or can be controlled, either directly or indirectly, by a person or persons who control or can control, either directly or indirectly, the operations of the first-mentioned company:

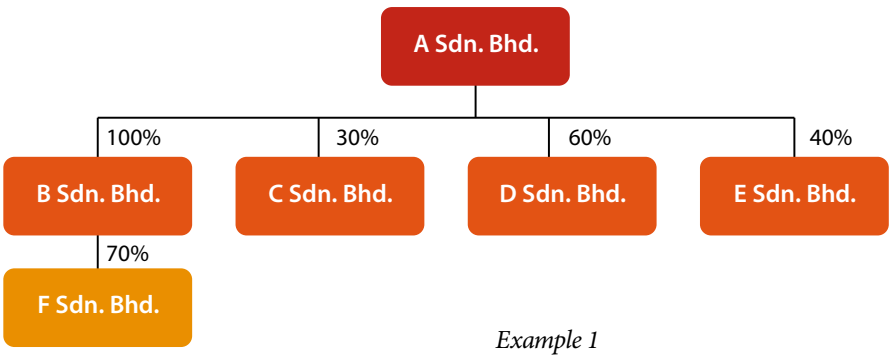
In addition,

"… a company shall be deemed to be a related company of another company if

- at least 20 per cent of its issued share capital is beneficially owned, either directly or indirectly, by that other company; or

- at least 20 per cent of the issued share capital of that other company is beneficially owned, either directly or indirectly, by the first-mentioned company;

In simple English, it basically encompasses any holding company, subsidiaries, fellow subsidiaries, and associated companies. However, candidates should note that "fellow associates" are NOT covered by this definition as illustrated in ***Example 1***.



Example 1

In the above corporate hierarchy, A Sdn. Bhd is related to all the other companies. B Sdn. Bhd, D Sdn. Bhd and F Sdn. Bhd are related to each other. However, C Sdn. Bhd and E Sdn. Bhd are ONLY RELATED TO A Sdn. Bhd and none of the other companies.

Therefore, both research and development companies and contract research and development companies provide research and development services in Malaysia BUT a contract research and development company cannot provide the services to its holding company, subsidiaries, fellow subsidiaries, nor any associated companies.

RELIEF FOR QUALIFYING CAPITAL EXPENDITURE

Paragraph 37B of Schedule 3 of the Income Tax Act 1967 provides that industrial building allowance can be claimed in respect of a building used in approved research, by a contract R&D company or by a R&D company. In addition to capital expenditure incurred on the construction of a building or part thereof, capital expenditure incurred on the alteration or renovation of rented premises for research purposes also ranks as qualifying capital expenditure. Similarly, paragraph 37D provides for capital allowances in respect of capital expenditure for plant and machinery used for the purpose of approved research, even where the research is not related to the business activity.

In both cases note that the building or plant and machinery shall be deemed to be in use for the purposes of the business even though such research is not related to that business.

TAX INCENTIVES FOR RESEARCH AND DEVELOPMENT ACTIVITIES

Under the Promotion of Investments Act 1986, investment tax allowance can be claimed by research and development companies and contract research and development companies and companies undertaking inhouse research and development activities. Details of the claim are summarised in **Table 1**.

Alternatively, contract research and development companies can enjoy pioneer status with an exemption of 100% of statutory income for 5 years.

ELECTION BY A PIONEER COMPANY

This is provided for under s34(4) of Income Tax Act 1967 and clarified in the Addendum to Public Ruling No. 5/2004

A pioneer company which has incurred qualifying research expenditure for an approved project during its tax relief period may elect that the amount of that expenditure be deducted in the first basis period of its post-pioneer business. The election has to be done on a yearly basis for each relevant year of assessment.

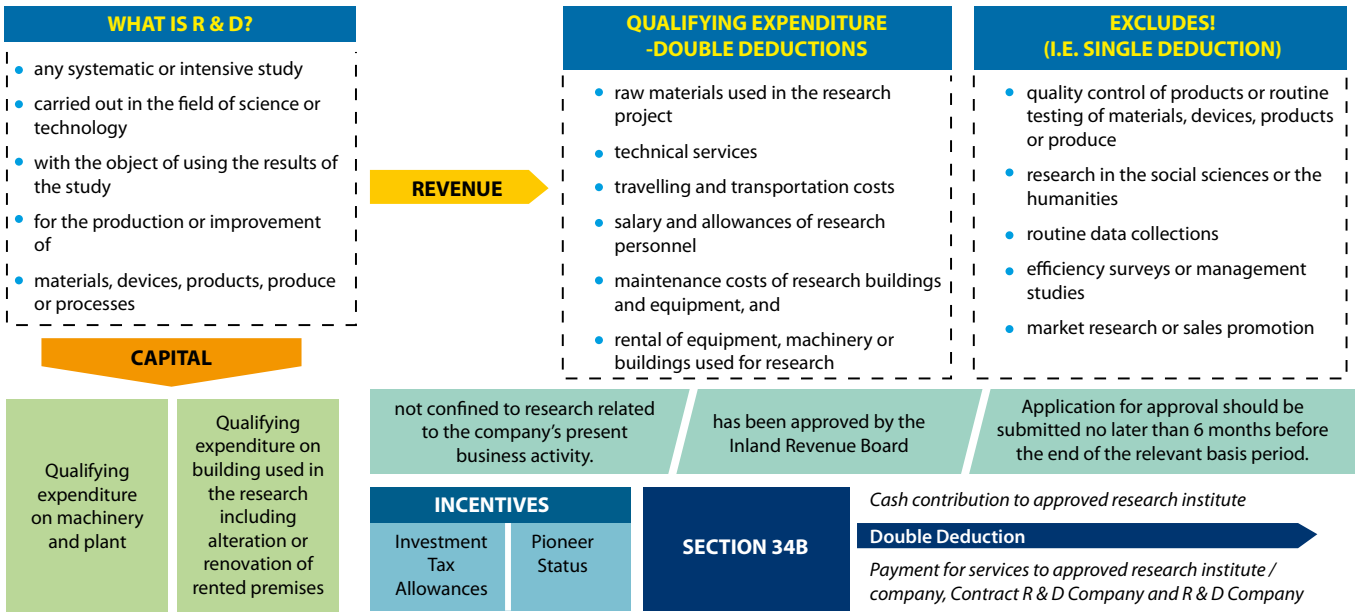
With this election, the amount of qualifying research expenditure for each particular year of assessment will be accumulated and carried forward to be deducted in the first basis period of the post-pioneer business instead of being given a double deduction for each relevant year of assessment.

To summarise, candidates should keep in mind the following factors **(Example 2)** when attempting questions on research and development activities.

Investment Tax Allowance	% of Qualifying Capital Expenditure	% of Statutory Income Offset	Qualifying Period
Reaserch and Development Companies	100	70	10
Contract Research and Development Companies	100	70	10
Companies with Inhouse Research and Development	100	70	10

Table 1

Example 2



Let us look at a recent past year question on research and development companies.

CTIM TAX V - DECEMBER 2011 QUESTION 5

Cekap Group, through its Cekap Resources Sdn Bhd (CRSB) is involved in the manufacturing of mobile phones. CRSB is owned by Cekap Holdings Berhad (CHB). Cekap Group closes its accounts on 31 December every year.

It has recently managed to develop a new smartphone technology and has commenced the manufacturing of smartphones under a newly established subsidiary of CHB, Cekapmaju Manufacturing Sdn Bhd (CMSB).

CMSB has made an application to the Malaysian Industrial Development Authority (MIDA) and successfully secured an approval for 100% pioneer incentive (high technology category) for a period of 5 years under the Promotion of Investments Act 1986 (PIA) for the manufacturing of smartphones. The commencement date of the tax exempt period has been determined by the Ministry of International Trade and Industry (MITI) on 1 January 2011.

The Group will continue investing in research and development (R&D) expenditure with the view to enhance its 2G and smartphones products and is expected to spend at least RM9 million on an annual basis. The R&D project would be undertaken inhouse. The capital expenditure to be incurred for the R&D activities is expected to be minimal.

For the financial year ended 31 December 2011, the R&D expenditure to be incurred by the company is as follows:

	CRSB (2G mobile phone) RM '000	CMSB (Smartphone) RM '000
Engineers' remuneration - Basic Salary - Bonus	 500 200	 4,000 1,500
Cost of raw materials used directly for R&D	300	1,800
Rental of R&D assets	100	300
Depreciation of R&D assets	100	200
Total	1,200	7,800

Cekap Group's CEO, Ravi has recently attended a tax seminar where he learned that the Malaysian government has offered various tax incentives for companies undertaking R&D activities. Ravi is excited that Cekap Group will be entitled to avail for the R&D tax incentives. He has consulted you, as his tax advisor as to how he can maximise the tax incentive claims for the company's R&D expenditure.

Required

1. You have advised Ravi that the R&D expenditure incurred by CRSB and CMSB are eligible for double deduction benefit. Explain to Ravi as to the amount of double deduction which will be available to

CRSB and CMSB for YA 2011 (on the assumption that the R&D expenditure has been incurred on an approved research project). You are also required to advise him as to the timing in which the double deduction benefit will be given.

2. Ravi heard that there are tax incentives given to an approved R&D company. In this regard, Ravi is considering whether CHB Group should set up a new company to undertake R&D activities for the group.

Required

Explain to Ravi on the tax incentives given to an approved R&D company. Specifically, you are required to cover the following:

- Definition of approved R&D company;
- Type of incentives given to an approved R&D company; and
- Discuss whether it is tax efficient for Cekap Group to establish an approved R&D company, considering the tax incentives enjoyed by CMSB.

The salient points that the candidate should have addressed in answering this question is detailed below.

a. In order to qualify for double deduction incentive, the research project undertaken by the company:
   - would need to be approved by the Inland Revenue Board
   - application for approval would need to be submitted no later than 6 months before the end of the relevant basis period i.e. by 30 June 2011 in respect of the double deduction claim for YA 2011.

On the basis that the research project has been approved by the IRB, the amount eligible for double deduction claim would be as in **Table 2**:

- For CRSB the company is eligible to claim approved R&D expenditure of RM0.9 million in YA 2011.
- however, since CMSB, is enjoying pioneer status it may elect on a yearly basis for each relevant YA
- that the amount of that expenditure be deducted in the first basis period in respect of its post-pioneer business
- i.e. the amount of qualifying research expenditure for each particular YA will be accumulated and carried forward to be deducted in the first basis period of the post-pioneer business
- The amount of deduction to be made in the post-pioneer period is equivalent to the amount of qualifying research expenditure incurred for each YA.

	CRSB (2G mobile phone) RM '000	CMSB (Smartphone) RM '000	Remarks
Engineers' remuneration **- Basic Salary** **- Bonus**	**500** **-**	**4,000** **-**	*Only basic salary is eligible for claim*
Cost of raw materials used directly for R&D	**300**	**1,800**	
Rental of R&D assets	**100**	**300**	
Depreciation of R&D assets	-	-	*Capital expenditure is not given as double deduction*
Total	**900**	**6,100**	

Table 2

b. Definition of approved R&D company:
- a company which provides R&D services
- in Malaysia
- to its related company or to any other company.

Type of incentives to be granted to an approved R&D company:
- can apply to MIDA for investment tax allowance (ITA)
- of 100% on the capital expenditure incurred
- within 10 years.
- The allowance can be offset against 70% of the statutory income for each YA.
- Any unutilised allowances can be carried forward to subsequent YAs until fully utilised.

The capital expenditure in relation to manufacture based research, means capital expenditure incurred on:
- a factory or on
- any plant and machinery used in Malaysia
- in connection with and for the purposes of an activity relating to research and development.

Alternatively, if the approved R&D company opts not to avail for the ITA incentive, the payment of the R&D service fees by the service recipient companies to the approved R&D company can avail for double deduction benefits in accordance with Section 34B of the Act.

Tax efficiency of setting up of an approved R&D company
- it can either choose to avail for ITA incentive or to allow the R&D service fees payable by the group companies to the R&D company to avail double deduction benefit.
- Since the capital expenditure to be incurred for the R&D activities are not significant, the R&D company should elect for its R&D service recipient to claim double deduction.
- e.g. fees payable by CRSB for the 2G mobile phones, the amount should avail for double deduction against the 2G mobile phone business source.
- since CMSB is enjoying

100% pioneer exemption on its promoted activity of manufacturing smartphones, and
- there is no specific provision in Section 34B to allow the double deduction for the payment of R&D services to be deferred to post-pioneer period.
- therefore, the R&D activities should continue to be undertaken inhouse by CMSB, in respect of the R&D expenditure for smartphones.
- the double deduction benefit can be claimed in the post pioneer period.

Conclusion
- it may not be appropriate at this stage to spin-off the R&D activities into a separate company.
- however, upon expiry of the pioneer period, Cekap Group may want to consider setting up an approved R&D company to facilitate the double deduction claims.
- once the approved R&D company status is obtained from MIDA, the full amount of the payment of R&D services can avail for double deduction without any restriction (as in the case of double deduction claim on inhouse R&D activities under Section 34A of the Act).

With this we have concluded our discussion on all the deductions available under S34 of the Income Tax Act 1967

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FURTHER READING

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CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: July 2012 – September 2012

Month /Event	Details				Registration Fee (RM)			CPD Points/ Event Code
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
JULY 2012								
Workshop: Maximising on Tax Incentives	2 July	9a.m. - 5p.m.	Kuala Lumpur	Sivaram Nagappan	350	400	460	8 WS/ 048
Workshop: Maximising on Tax Incentives	4 July	9a.m. - 5p.m.	Penang	Sivaram Nagappan	335	385	435	8 WS/ 049
NATIONAL TAX CONFERENCE 2012	**17 & 18 JULY**	**9a.m. - 5p.m.**	**KUALA LUMPUR CONVENTION CENTRE**	**LOCAL & FOREIGN SPEAKERS**	**Early Bird 1100 Normal 1300**	**Early Bird 1200 Normal 1400**	**Early Bird 1300 Normal 1500**	**25**
Workshop: New Public Rulings 2011/12	20 July	9a.m. - 5p.m.	Ipoh	Chow Chee Yen	335	385	435	8 WS/ 055
Workshop: New Public Rulings 2011/12	24 July	9a.m. - 5p.m.	Johor Bahru	Chow Chee Yen	335	385	435	8 WS/ 056
Workshop: New Public Rulings 2011/12	25 July	9a.m. - 5p.m.	Penang	Chow Chee Yen	335	385	435	8 WS/ 057
Workshop: New Public Rulings 2011/12	26 July	9a.m. - 5p.m.	Kuala Lumpur	Chow Chee Yen	350	400	460	8 WS/ 058
AUGUST 2012								
Workshop: New Public Rulings 2011/12	1 Aug	9a.m. - 5p.m.	Melaka	Chow Chee Yen	335	385	435	8 WS/ 059
Workshop: Maximising on Tax Incentives	2 Aug	9a.m. - 5p.m.	Ipoh	Sivaram Nagappan	335	385	435	8 WS/ 050
Workshop: Maximising on Tax Incentives	6 Aug	9a.m. - 5p.m.	Johor Bahru	Sivaram Nagappan	335	385	435	8 WS/ 051
Workshop: New Public Rulings 2011/12	8 Aug	9a.m. - 5p.m.	Kota Kinabalu	Chow Chee Yen	335	385	435	8 WS/ 060
Workshop: New Public Rulings 2011/12	9 Aug	9a.m. - 5p.m.	Kuching	Chow Chee Yen	335	385	430	8 WS/ 061
Workshop: Maximising on Tax Incentives	13 Aug	9a.m. - 5p.m.	Melaka	Sivaram Nagappan	335	385	435	8 WS/ 052
Workshop: Tax Audits Findings	16 Aug	9a.m. - 5p.m.	Johor Bahru	Ong Yoke Yew	335	385	435	8 WS/ 065
Workshop: Maximising on Tax Incentives	28 Aug	9a.m. - 5p.m.	Kota Kinabalu	Sivaram Nagappan	335	385	435	8 WS/ 053
Workshop: Maximising on Tax Incentives	29 Aug	9a.m. - 5p.m.	Kuching	Sivaram Nagappan	335	385	435	8 WS/ 054
Workshop: Tax Audits Findings	29 Aug	9a.m. - 5p.m.	Penang	Ong Yoke Yew	335	385	435	8 WS/ 062
Public Holidays ***(20 – 21 Aug: Hari Raya Aidilfitri, 31 Aug: National Day)***								
SEPTEMBER 2012								
Seminar: The Law, The Practice & You	4 Sep	9a.m. - 5p.m.	Kuala Lumpur	Various Speakers	Early Bird 375 Normal 425	Early Bird 425 Normal 475	Early Bird 475 Normal 525	8 SE/001
Workshop: Tax Audits Findings	5 Sep	9a.m. - 5p.m.	Sibu	Ong Yoke Yew	335	385	435	8 WS/ 064
Workshop: Tax Responsibilities for Directors, Managers and Employers	6 Sep	9a.m. - 5p.m.	Ipoh	Vincent Josef	335	385	435	8 WS/ 069
Workshop: Tax Audits Findings	7 Sep	9a.m. - 5p.m.	Kuching	Ong Yoke Yew	335	385	435	8 WS/ 063
Workshop: Tax Responsibilities for Directors, Managers and Employers	10 Sep	9a.m. - 5p.m.	Kuala Lumpur	Vincent Josef	350	400	460	8 WS/ 067
Workshop: Tax Audits Findings	20 Sep	9a.m. - 5p.m.	Kota Kinabalu	Ong Yoke Yew	335	385	435	8 WS/ 066
Workshop: Tax Responsibilities for Directors, Managers and Employers	24 Sep	9a.m. - 5p.m.	Penang	Vincent Josef	335	385	435	8 WS/ 068
Workshop: Tax Responsibilities for Directors, Managers and Employers	26 Sep	9a.m. - 5p.m.	Melaka	Vincent Josef	335	385	435	8 WS/ 070
Public Holidays ***(16 Sep: Malaysia Day)***								

DISCLAIMER : CTIM reserves the right to change the speaker (s)/date (s), venue and/or cancel the events if there is insufficient number of participants. A minimum of 3 days notice will be given.

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

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