Vol.6/No.2/2013/Q2
Official Journal of the Chartered Tax Institute of Malaysia

Tax Guardian

AUTHORITATIVE - RELEVANT - GLOBAL EXCELLENCE

RM28.00

INTRA-GROUP LOANS: IS TRANSFER PRICING RELEVANT?

- Ships and Water Snakes
- Malaysian Personal Tax Simplified
- Of Plants and Car Parks: An Analysis of *Tropiland*'s case

CHARTERED TAX INSTITUTE OF MALAYSIA

ISSN 0128-7583
9 770128 758008

NTC 2013 SECTION
See pages 3-6

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.

INSTITUTE ADDRESS

The Secretariat, Unit B-13-2,
Block B, 13th Floor, Megan Avenue II,
No. 12 Jalan Yap Kwan Seng,
50450 Kuala Lumpur
Telephone : 603 2162 8989
Facsimile : 603 2162 8990
E-mail : secretariat@ctim.org.my
Website : www.ctim.org.my

PUBLISHING CONSULTANT

Executive Mode Sdn Bhd (317453-P)
Tel: +603-7118 3200, 3205, 3230
Fax: +603-7118 3220
e-mail: executivemode@executivemode.com.my
web: www.executivemode.com.my

PRINTER

BHS Book Printing Sdn Bhd (95134-K)
Lot 17-22 & 17-23, Jalan Satu, Bersatu Industrial Park
Cheras Jaya, 43200 Cheras, Selangor DE
Tel: +603-9076 0816, 9076 0825, 9074 7558
Fax: +603-9076 0785, 9074 7573
e-mail: bhsprint@tm.net.my

Tax Guardian

Tax Guardian is the official journal of the Chartered Tax Institute of Malaysia and is distributed to members and students of CTIM as well as subscribers, both corporate and individual. The contents of *Tax Guardian* do not necessarily reflect the views or opinions of CTIM and no liability is accepted in relation thereto. CTIM does not accept liability for any views or opinions published herein. Advertisements appearing within this journal should not be taken to imply any direct support for or sympathy with the views and aims of CTIM.

ORGANISED BY

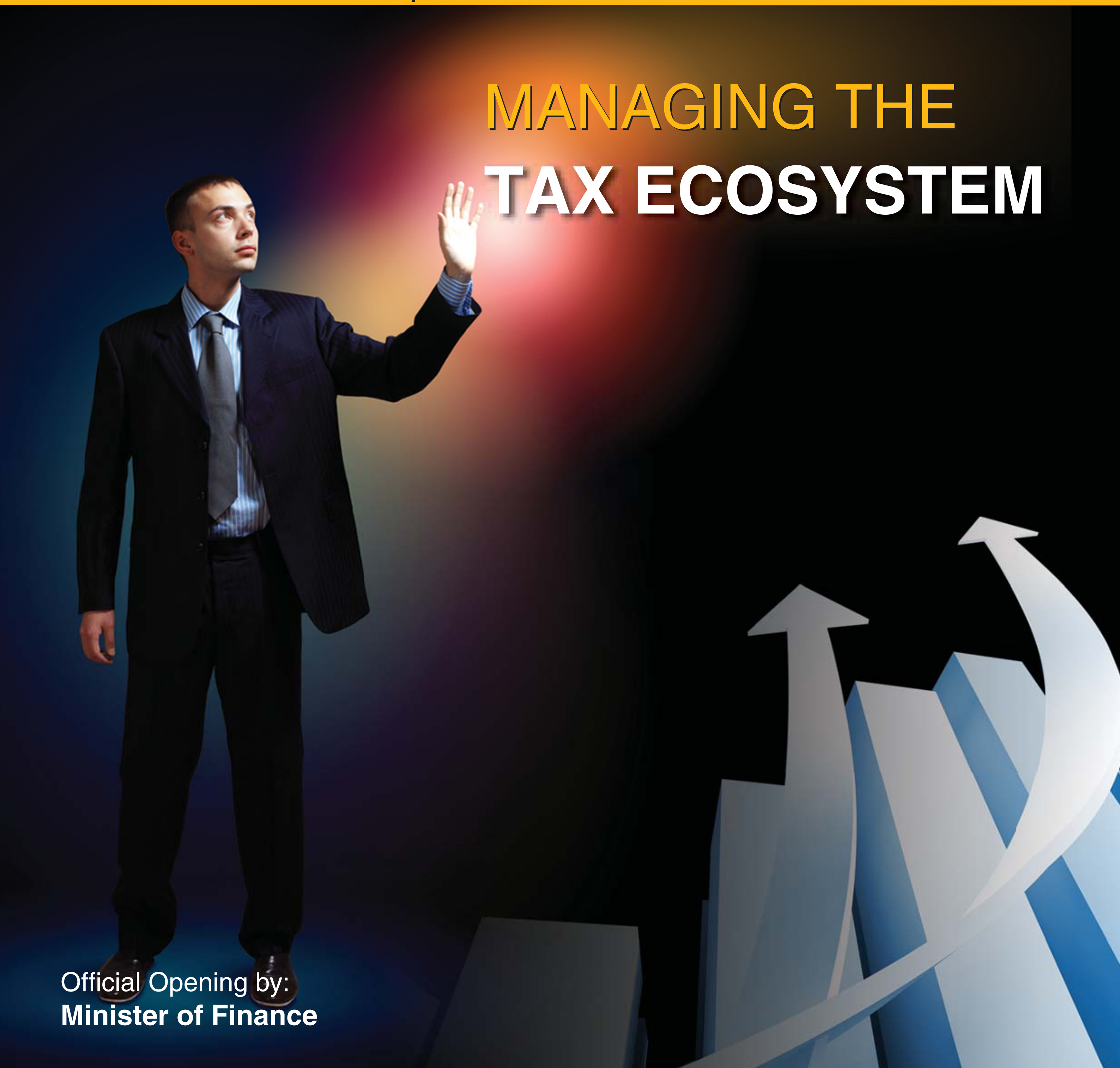
LHDN MALAYSIA

ctim CHARTERED TAX INSTITUTE OF MALAYSIA

PREMIER TAX EVENT OF THE YEAR

NATIONAL TAX CONFERENCE 2013

24 & 25 JUNE 2013 | KUALA LUMPUR CONVENTION CENTRE



MANAGING THE TAX ECOSYSTEM

Official Opening by:
Minister of Finance

DAY 01 PROGRAMME

7.30 - 9.00 am	**Registration & Arrival of Guests**
9.00 - 9.10 am	**Arrival of Guest of Honour** Minister of Finance
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 Hj Mahfar Chief Executive Officer Lembaga Hasil Dalam Negeri Malaysia
9.30 - 10.00 am	**Keynote Address by Guest of Honour** Minister of Finance
10.00 - 11.00 am	**Morning Refreshments / Tour of Exhibition Booths / Press Conference**
11.00 – 12.15 pm	**Economic Challenges for Malaysia** Chairman: YBhg Datuk Dr Rebecca Fatima Sta Maria Secretary General Ministry of International Trade and Industry Speaker: Dr Yeah Kim Leng Senior General Manager / Group Chief Economist Rating Agency Malaysia Berhad Panelist: Professor Dr Zakariah Abdul Rashid Executive Director Malaysian Institute of Economic Research
12.15 – 12.30 pm	**Question & Answer Session**
12.30 – 2.00 pm	**Networking Lunch & Tour of Exhibition Booths**
2.00 – 3.00 pm	**Tax Crime** Chairman: Mr Dzulkifli Ahmad Head of Commercial Crimes Unit Attorney General's Chambers Speaker: Mr Mohd Nizom Sairi Director, Investigation Department Lembaga Hasil Dalam Negeri Malaysia
3.00 - 3.15 pm	**Question & Answer Session**
3.15 - 4.15 pm	**Tax Offences Leading to Criminal Investigation** Chairman: Mr Jeremy Lee Eng Huat Chief Executive Officer Financial Mediation Bureau Speaker: Mr Muazmir Mohd Yusof Senior Revenue Counsel Legal Department Lembaga Hasil Dalam Negeri Malaysia Panelist: Mr S Vijaya Retnam Partner Veizay & Co
4.15 – 4.30 pm	**Question & Answer Session**
4.30 - 5.30 pm	**End of Day 1 & Refreshments**

PROGRAMME DAY 02

8.45 - 9.00 am	**Overview of Day 1** Mr Adzhar Sulaiman Co-Organising Chairman National Tax Conference 2013
9.00 – 10.30 am	**Tax Cases Update** Chairman: Mr Shaharudin Ali Partner Nik Saghir & Ismail Speaker: Mr Abu Tariq Jamaluddin Director, Tax Appeal Division, CEO's Office Lembaga Hasil Dalam Negeri Malaysia Panelist: YBhg Datuk Francis Tan Leh Kiah Council Member Chartered Tax Institute of 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	**Practical Implementation of the Transfer Pricing Rules and Regulations** Chairman: Ms Goh Ka Im Partner Shearn Delamore & Co Speaker: Mr SM Thanneermalai President Chartered Tax Institute of Malaysia Panelist: Ms Salamatunnajan Besah Director, Policy & Compliance Division Lembaga Hasil Dalam Negeri Malaysia
12.30 - 12.45 pm	**Question & Answer Session**
12.45 – 2.15 pm	**Networking Lunch & Tour of Exhibition Booth**
2.15 - 3.45 pm	**Limitation of Tax Avoidance** Chairman: Professor Dr Jeyapalan Kasipillai Council Member Chartered Tax Institute of Malaysia Speaker: Mr Jagdev Singh Senior Executive Director PricewaterhouseCoopers Taxation Services Sdn Bhd Panelist: Dr Nik Abdullah Sani Nik Mohamed Director International Training & Tax Education Centre Malaysian Tax Academy Lembaga Hasil Dalam Negeri Malaysia
3.45 – 4.00 pm	**Question & Answer Session**
4.00 – 4.45 pm	**Round Table Discussion on Current Issues Affecting Taxpayers** Moderator: YBhg Tan Sri Yong Poh Kon President Federation of Malaysian Manufacturers Panelists: YBhg Dato Mohammad Sait Ahmad Deputy Chief Executive Officer (Tax Operations) Lembaga Hasil Dalam Negeri Malaysia Ms Farah Rosley Partner Ernst & Young Tax Consultants Sdn Bhd
4.45 – 5.00 pm	**Question & Answer Session**
5.00 – 5.45 pm	**End of Conference & Refreshments**

NATIONAL TAX CONFERENCE 2013

Closing Date : 10 June 2013

Conference Fees

- * Registration of participants will be confirmed upon receipt of full payment or an acceptable employers guarantee and settlement of previous outstanding dues.
- * Walk–in participant registration is subject to availability of seats and full payment.
- * Certificate of Attendance will be issued upon full attendance and receipt of full payment.
- * Normal rate will be applicable for unpaid early bird registrations after 31 May 2013.

	Early Bird Fee (with payment before or on 31 May 2013)	Normal Fee (after 31 May 2013)
LHDNM officer / CTIM member	RM 1200	RM 1400
Member's Firm Staff Member of Supporting Body Member / Staff of Supporting Sponsor	RM 1300	RM 1500
Non-Member	RM 1400	RM 1600
Overseas Delegates	Not applicable	USD 700

Premier Plus 1 FREE seat for every 10 delegates registered from the same organisation

PARTICIPANT DETAILS *(Please write details clearly)*

Full Name Mr/Ms/Mrs/Madam/Dr ______________________
(As per IC)
I/C No or Passport No ______________ Designation ______________

Organisation ______________________

Address ______________________

____

Tel ______________ Fax ______________

Email ______________ Mobile No. ______________

Personal Assistant *(if any)* ______________________

Dietary requirements: ☐ Normal ☐ Vegetarian

MEMBERSHIP AFFILIATION

Please indicate which body you are associated with and your membership number:

☐ CTIM ☐ MIA ☐ MICPA ☐ MAICSA ☐ MICCI ☐ MFPC
☐ IBBM ☐ IIAM ☐ ACCA ☐ CIMA ☐ CPA Australia ☐ MCCM

Membership number ______________

PAYMENT DETAILS

I / We hereby enclose*

☐ Cash for amount of RM ______________

☐ Cheque No. ______________ for amount of RM ______________
(non-refundable) and made payable to "CTIM-NTC". Please write NTC 2013, your name, contact number at the back of the cheque and mail together with registration form to the Conference Secretariat.

Please debit my
☐ Direct Access-CTIM Visa Card for amount of RM ______________

☐ Direct Access-CTIM Master Card for amount of RM ______________

☐ Master Card / Visa Card for amount of RM ______________

Card Number ☐☐☐☐ ☐☐☐☐ ☐☐☐☐ ☐☐☐☐ Expiry Date ______________

Cardholder's Name ______________ Cardholder's Signature ______________

____
Company Stamp & Signature

Date ______________

Hotel Accommodation NTC 2013 Special Rate.

Please contact the following hotels directly. Reservation forms can be obtained from www.ctim.org.my.

Mandarin Oriental Hotel
Contact Person: Sophia Fong
T: 03-2179 8657 | F: 03-2179 8699
E: SophiaF@mohg.com

Grand Hyatt Kuala Lumpur
Contact Person: Ann Foo
T: 03-2182 1235 | F: 03-2182 1222
E: reservation.kuagh@hyatt.com

Traders Hotel Kuala Lumpur
Contact Person: Calvin Chiang
T: 03-2332 9834 | F: 03-2332 2672
E: convention.thkl@tradershotel.com

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

Maya Hotel
Contact Person : Jamie Cheah
T: 03-2711 8866 | F: 03-2711 2277
E: reservation@hotelmaya.com.my

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

IMPORTANT NOTES

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

Kindly contact the Secretariat for more information.

Conference Secretariat
Chartered Tax Institute of Malaysia
B-13-2, Block B, 13th Floor, Unit 2
Megan Avenue II
No. 12, Jalan Yap Kwan Seng
50450 Kuala Lumpur, MALAYSIA

Contact Person
Ms Yus / Ms Fadeah / Mr Jason / Ms Ally
Tel : 03-2162 8989 Ext 121 / 113 / 108 / 123
Fax : 03-2161 3207 / 2162 8990
E-mail : ntc@ctim.org.my, cpd@ctim.org.my
Website : www.ctim.org.my

Akademi Percukaian Malaysia, LHDNM
Persiaran Wawasan
43650 Bandar Baru Bangi
Selangor, MALAYSIA

Contact Person
Mr Zura Zuwan / Mr Hapiz
Tel : 03-8924 3792 / 03-8924 3642
Fax : 03-8925 7005
E-mail : ntc@hasil.gov.my
Website : www.hasil.gov.my

Cancellation Policy
Conference fees are non-refundable once reservation has been confirmed. If you are unable to attend, a substitute delegate is allowed if advised in writing prior to the Conference. No refund is given for cancellations or withdrawals. Cancelled unpaid registrations will also be liable for full payment of the Conference fees.

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

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

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

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

contents

Tax Guardian

VOL.6/NO.2/2013/Q2
APRIL 2013

Note: The views expressed in the articles contained in this journal are the personal views of the authors. Nothing herein contained should be construed as legal advice on the applicability of any provision of law to a given set of facts.

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:
The Chairman, Editorial Committee
Chartered Tax Institute of Malaysia
Unit B-13-2 Block B, 13th Floor, Megan Avenue II,
No.12 Jalan Yap Kwan Seng, 50450 Kuala Lumpur
Email: *publications@ctim.org.my*

From the **President's Desk**

SM THANNEERMALAI

FOCUS ON BENEFITS OF CTIM MEMBERSHIP

SOARING TAX COLLECTIONS FROM RM109 BILLION (2011) TO RM124 BILLION (2012)

The Inland Revenue Board (IRB) under the leadership of Tan Sri Dato' Dr. Mohd Shukor has done it again! Congratulations to Tan Sri and his team for increasing the tax collections yet again, especially in a difficult world economic environment.

There is no breakdown available in the public domain on the tax collections say, in respect of corporate taxes, personal taxes, stamp duty, RPGT, Petroleum income tax, penalties etc. collected. Greater transparency on the sources of tax collections will help the Chartered Tax Institute of Malaysia (CTIM) analyse the underlying reasons and direct our members to focus and drive their efforts to service those sectors from where the increased tax collections are coming, e.g. in improving the standard of tax compliance and advising taxpayers on boundaries of legitimate tax planning - which will benefit both the taxpayer and the IRB in continuing to improve the tax collections.

The good news here is that the increased tax collections only means that there are now even greater opportunities to increase our services to our clients. I am aware that taxpayers are now increasingly aware of their tax responsibilities and realise that whenever they undertake significant transactions they tend to seek tax advice to plan their tax affairs properly to stay within the law; otherwise the consequences, in the form of tax disallowances and/or penalties for any wrongdoing, can be very expensive. So the answer is: please reach out to your clients and other taxpayers immediately and educate them on the need to improve their tax compliance and to seek proper tax counsel from the members of CTIM, the premier tax body in the country.

QUALITY OF COMMUNICATION TO OUR MEMBERS

Recently, CTIM segregated its members' circulars (the e-CTIMs) into different categories (technical and non-technical) to make it easier for reference.

Revamped website : We have revamped the website with the help of an external consultant and I hope all of you will visit our website and revert back to us with your constructive comments on areas of improvement. Information that is privy to the Institute will be confined to the "Members Only" section and therefore, please ask the secretariat to issue a password immediately to you if you do not have one yet. My plan is to restrict information available within CTIM to members only and therefore if anyone wants such information, I would encourage him/her to join CTIM where one can obtain the most up-to-date information on tax matters in Malaysia.

ENCOURAGE ALL TAX PRACTITIONERS AND THEIR STAFF TO JOIN CTIM

I put out a call to all our members to encourage your friends practising tax or working in industry or in Government to join CTIM as a member. An increased number of members will only add weight to our voice to the authorities and the public at large. We are already well recognised by the authorities in Malaysia and I can assure you CTIM is always present to lead the profession on all tax matters. The time has come for all those who are not members to come and join us.

I have noticed in the past that our members share their membership with others in their practice, e.g. sharing the member password with their colleagues to obtain information from our website. I would urge such members to encourage their colleagues who value our information to join CTIM rather than ride on another member. Our annual membership fee is a mere RM200 and it is the lowest charged amongst the top professional bodies in Malaysia and yet if our members permit such "piggy backing" actions, it is indeed sad. Please encourage your friends and staff to join CTIM and they will soon realise that the annual subscription of RM200 is more than compensated by the frequent e-CTIMs, the *Tax Guardian* (no other professional body produces a dedicated tax journal, and it has become a valuable source of reference for tax practitioners), discounted rates for CPD events and the National Tax Conference (NTC), and numerous other benefits that are only available to a member.

CTIM RESOURCE CENTRE-CUM-TAX LIBRARY

The use of the newly renovated Resource Centre-cum-Tax Library for reference is another benefit to members. I urge you to check it out; besides publications by local authors, you will be pleasantly surprised by the new publications from the OECD, IBFD, CCH and other international tax authorities, which are valuable resources for your practice. The online subscription to CCH and the OECD iLibrary will certainly open you to a priceless amount of technical information.

WE NEED TO HEAR FROM YOU

Finally, just a reminder to all our members: please continue to give us your constructive comments on ways to improve our services to members. All constructive ideas and suggestions are welcome. You can write to me personally or to the secretariat.

Looking forward to hearing from you.

Editor'sNote

DATO' RAYMOND LIEW LEE LEONG

NAVIGATING THE HAZARDS OF TRANSFER PRICING AND WATER SNAKES

There is never a dull day in taxation as new issues continue to challenge us in a business environment that is becoming more and more byzantine. As tax professionals, we have to constantly be on our toes and it is imperative to keep up with the newest knowledge in order to deliver optimum value to our clients and stakeholders. Here at CTIM, we work hard to position *Tax Guardian* as a useful and up-to-date channel for continuing professional development (CPD) that can keep our members abreast of the latest issues.

The complex issue of transfer pricing – specifically intra-group financing and related party loans – continues to command attention, being that it requires tax professionals to demonstrate sound professional judgement and compliance with complicated rules and legislation. Today, intra-group loans are an everyday feature in business, especially among multinational corporations (MNCs) due to the ease of leveraging on internal group resources and increasing globalisation, among other factors. However, the subjectivity involved in pricing such transactions has typically drawn the attention of tax authorities and tax professionals must know how to manage transfer pricing in order to comply with ever-increasing legislation and deliver business value. Our cover story on "Intra-Group Loans and Transfer Pricing" focuses on the relevant legislation – specifically the Malaysian Income Tax (Transfer Pricing) Rules 2012 and the Malaysian TP Guidelines 2012, as well as the guidelines issued by the Organisation for Economic Co-operation and Development (OECD) and other leading markets. We also look at the noteworthy legal cases arising from global transfer pricing disputes.

Meanwhile, the piquantly-titled "Ships and water snakes" is not referring to venomous reptiles on board merchant vessels, but rather the intricacies of shipping income and taxation reforms in the local and international context. Author Dr. Nakha Ratnam Somasundram also takes a look at the prospects for the Malaysian shipping industry in light of the recent budget announcement to scale back the tax exemption on shipping income for shipping operators from 100% to 70%.

As of the time of printing, we are already headed towards tax season. What better time to take a look at the Malaysian personal tax system? In "Malaysian Personal Tax Simplified" Hilda Liow looks at the reforms that have already been put in place to simplify Malaysian personal income tax and encourage improved collection of taxes to finance economic and social development.

Our final main feature for this issue focuses on "Plants and Car Parks", an analysis of the Tropiland case, where it was upheld that a purpose-built multi-storey car park is considered a plant under Schedule 3 of the Income Tax Act 1967. What are the repercussions and impacts of this legal decision?

Here's hoping that members will find this month's issue to be chock-full of valuable knowledge that can help them to deliver value, and in turn optimise the profession and business at large.

Happy reading!

Sincerely,

Editor

IRB DIALOGUE WITH TAX AGENTS IN PERAK

The Inland Revenue Board (IRB) Ipoh Branch organised a half day event to have a dialogue with all tax agents in Perak on 15 January 2013 at their premises. It was attended by 120 tax agents & 80 IRB officers. The dialogue started off with an opening address by Puan Wan Azni, IRBs State Director followed by a short speech by Mr. Chak Kong Keong (representing CTIM) and Mr. Lam Weng Keat (representing MIA).

Before the dialogue proper, Madam Ting Suk Tin from the Investigation Unit presented a briefing on how to file Form Q. Some of the issues raised by the tax agents during the dialogue were as follows :-

- Tax refund
- Penalty on non-compliance with the monthly tax deductions (MTD)
- Assessments raised under Section 90, Income Tax Act 1967, and finalisation of backlog cases.

The IRB also raised some field audit and compliance issues during the dialogue. It was a fruitful dialogue with both parties exchanging views on issues affecting the tax profession.

The dialogue ended with a lunch, and the IRB indicating that they will organise a similar dialogue next year.

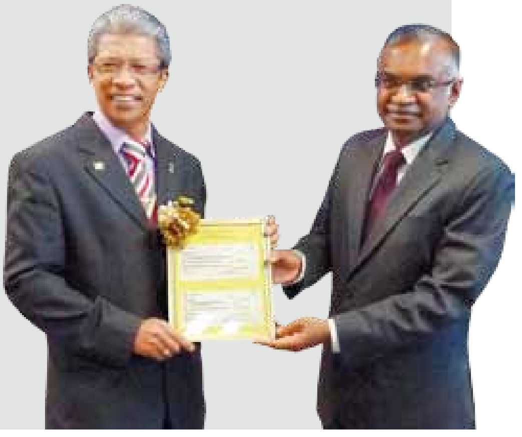
CAREER TALK BY IPOH BRANCH

The Universiti Tunku Abdul Rahman (UTAR), Kampar, Accounting Club organised a career talk for students of the University. The Ipoh Branch representative, Mr. Loo Thin Tuck spoke on pursuing a career in taxation and encouraged students to take up the CTIM professional examinations towards achieving this goal.

A CTIM delegation led by the President paid a visit to Datuk Dr. Rebecca Fatima Sta Maria, Secretary General of the Ministry of International Trade and Industry (MITI). The meeting was held to discuss collaboration on issues relating to taxation and served to open a channel of communication.

On 29 January 2013, the President led a CTIM delegation for a courtesy visit to the Executive Chairman, Audit Oversight Board, Securities Commission, En. Nik Mohd. Hasyudeen Yusoff. The visit reaffirms the beneficial relationship between the two organisations and served to highlight the impact of taxation on some of the work that involves the Securities Commission.

Mr. SM Thanneermalai handing over a mock cheque for IRBs share of profits from the National Tax Conference (NTC) 2012 to Tan Sri Dr. Mohd. Shukor Hj. Mahfar on 7 February 2013 in HASIL, Cyberjaya after a meeting held in which the organisation of the NTC 2013 was discussed.



CPD EVENTS

The first event of the year was held on 7 January 2013 at the Renaissance Hotel, Kuala Lumpur. The workshop on "Tax Audit & Investigation Framework – A legal & practical perspective" was conducted by Mr. Kularaj, who has 24 years of tax experience in the IRB and in private practice. The speaker presented some of the real case studies relating to tax audit & investigation conducted by the IRB. He also conducted a workshop on "Reinvestment Allowance – Practical Issues with Understanding of Public Rulings" on 29 January 2013 at Hotel Istana, Kuala Lumpur.

The workshop on "Tax Planning on Individuals' Income from Employment & Statutory Requirements by Employers" was conducted by Mr. Sivaram Nagappan at all CTIM branches. The speaker provided an understanding of the various tax angles that should be considered in receiving employment-related payments. The various tax issues on the chargeability of employment income and ways to minimise tax exposure were also addressed by the speaker.

Mr. Chow Chee Yen conducted a workshop on "Reinvestment Allowance & Industrial Building Allowances" at various major towns. An overwhelming response was received in Kuala Lumpur, Johor Bahru and Penang. Many participants from the small and medium industries attended this workshop to enhance their knowledge on the latest developments on RA & IBA.

In line with its title; "2012 Top Controversial Tax Issues", numerous controversial tax issues were highlighted and discussed by Mr. Tan Hooi Beng at the workshop conducted on 22 January 2013 at Hotel Istana, Kuala Lumpur. The speaker presented various tax cases in relation to the issues on withholding tax on payment for software, thin capitalisation, transfer pricing and interest-free loan/borrowing arrangement.

CTIM in collaboration with MAICSA organised a workshop on "Tax Planning for Individuals" on 20 February 2013 at MAICSA's Training Room, Kuala Lumpur. The workshop was successfully conducted by Mr. Vincent Josef who highlighted the proper ways to handle the tax matters to avoid additional taxes or penalties.

NEWLY-RENOVATED CTIM RESOURCE CENTRE- CUM-TAX LIBRARY

The Chartered Tax Institute of Malaysia has a newly-renovated Resource Centre-cum-Tax Library, which is bigger and more pleasing and cheery than before.

The attractive premises is matched by equally interesting materials that are meant to delight and inform the visitors - tax practitioners / students / academicians - to the Resource Centre-cum-Tax Library.

Aside from the books on Malaysian taxation by Malaysian/ local authors and publishers (such as CCH), there are publications by OECD, IBFD and various International tax associations and authorities; these include certain publications under The (IBFD)Handbook Series (e.g. Global Individual Tax Handbook, Global Corporate Tax Handbook), The

Mr. Chak Kong Keong, CTIM Perak Branch Chairman, was the first person to use the newly-renovated Resource Centre-cum-Tax Library

(IBFD) Doctoral Series (e.g. Dispute Resolution under Tax Treaties), The (IBFD) International Tax Planning Series, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax administrations, and Transfer Pricing Features of Selected Countries, OECD Model Tax Convention on Income and on Capital and Key Tax Features of Member Countries, (OECD) Consumption Tax Trends 2012 – with particular focus on Canada, India and Brazil; and many more.

With CTIM's subscription to the various well-known resource networks, members get to enjoy online facilities – in short, members get an online link to CCH, Lawnet and OECDiLibrary.

Of course, the regular magazines/ journals/ publications/bulletins of many tax-related organisations are also available at the Resource Centre. These include Taxation in Australia (Tax Institute), Tax Adviser (Chartered Institute of Taxation and Association of Taxation Technicians), the Asia-Pacific Tax Bulletin (IBFD), Accountants Today (MIA) and The Chartered Secretary (MAICSA).

Finally, publications in compact disc format are also available.

As provided for in Article 3(h) of the Memorandum of Association of the Institute, the Resource Centre-cum-Tax Library is for use by members, provisional members and registered students. All publications are for reference within the premises only.

INTRA-GROUP LOANS IS TRANSFER PRICING RELEVANT?

Thanneermalai Somasundaram, Anushia Joan Soosaipillai and Aishwarya Sethi

From a transfer pricing perspective, intra-group financing is one of the main challenges encountered by both tax authorities and taxpayers globally. This holds true even for countries which have specific Transfer Pricing ('TP') Guidelines including Malaysia which issued its Malaysian Income Tax (Transfer Pricing) Rules 2012 and Malaysian TP Guidelines 2012 last year.

An area of intra-group financing which is of particular concern for the TP world is related party loans. Factors such as easy access and convenience while leveraging on internal group resources, increasing globalisation, availability of overseas investment opportunities etc. has resulted in intra-group loans being a common feature in multinational companies. However, the subjectivity involved in pricing such transactions has inevitably resulted in increased focus by tax authorities on transactions pertaining to interest on loans which is also leading to increase in disputes, issue of public rulings etc.

The subsequent paragraphs provide a deeper insight into inter-company loans and issues surrounding it taking into account guidance from

the Malaysian Income Tax (Transfer Pricing) Rules 2012 and Malaysian TP Guidelines 2012 ('the Guidelines'), guidelines issued by the Organisation for Economic Co-Operation and Development ('OECD') and regulations and jurisprudence issued by other jurisdictions.

WHY IS IT IMPERATIVE TO VIEW INTRA-GROUP LOANS FROM A TP PERSPECTIVE?

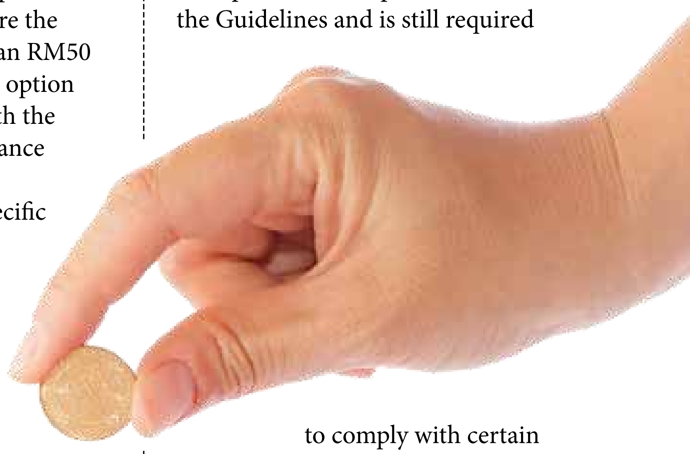
The Guidelines apply to all Malaysian taxpayers entering into related party transactions, requiring them, amongst other requirements to prepare contemporaneous TP documentation.

The Guidelines clearly include intra-group financing transactions within its ambit by classifying such transactions as a form of service provided to related parties. In this regard, Para 23.1 of the Guidelines states the following:

Intra-group financing is another form of service between associated persons, which falls under subsection 140A(2), in the form of financial assistance ***that include loans,*** *interest bearing trade credits, advance or debt and the provision of any security or guarantee.*

Based on the above, it is clear that intra-group loans are included in the intra-group financing transactions category which falls within the scope of the Guidelines. Accordingly, it is important that the transactions pertaining to loans granted or taken from related parties are reviewed from a TP perspective. In other words, such transactions have to comply with the arm's length principle espoused in the Guidelines.

It is worth mentioning here that the Guidelines provide a quantitative threshold in relation to the transactions pertaining to financial assistance. Para 3.1 of the Guidelines requires taxpayers to fully comply with the TP documentation and other requirements as stated in the Guidelines where the financial assistance provided to or received from the related parties exceeds RM50 million. Where the financial assistance is less than RM50 million, the taxpayer has the option of either full compliance with the Guidelines or partial compliance preparing transfer pricing documentation based on specific requirements mentioned in the Guidelines. The other relaxation provided under the Guidelines is in relation to the method of determining the arm's length charge. In such a case, the taxpayer is allowed to apply any method other than the five methods mentioned in the Guidelines provided the outcome can be concluded to be at arm's length. Para 3.2 of the Guidelines in this regard is quoted below:



Any person which falls outside the scope of 3.1 may opt to fully apply all relevant guidance as well as fulfil all Transfer Pricing Documentation requirements in the Guidelines; or alternatively may opt to comply with Transfer Pricing Documentation requirements under paragraph 25.4(a), (d) and (e) only. In this regard, the person is allowed to apply any method other than the five methods described in the Guidelines provided it results in, or best approximates, arm's length outcomes.

Based on the above, it can be observed that even in cases where financial assistance is less than RM50 million, the taxpayer is not completely exempted from the provisions of the Guidelines and is still required to comply with certain requirements i.e. the taxpayer must maintain a partial documentation containing the organisational structure, details of related party transactions (such as terms of transactions, copies of agreements etc.) and the transfer pricing policy. Even though there is a relaxation as far as the use of transfer pricing methods is concerned, the taxpayer would be required to ensure that the results are at arm's length.

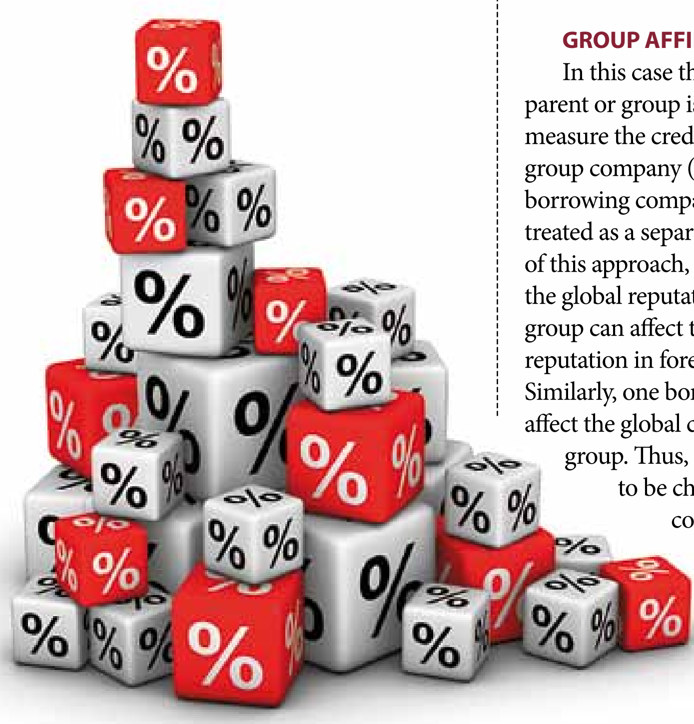
Another important aspect which is related to this discussion is that the tax authorities, by way of a TP audit may require the taxpayer to furnish the records and details justifying the arm's length nature of the transactions pertaining to interest on loan or overdue balances. In case there is a failure to provide the documents or records when called for by the tax authorities at the time of a TP audit or the tax authorities are of the view that the taxpayer has in any way failed to comply with the requirements of the Guidelines (discussed above), the tax authorities may levy penalties which in some cases could be very significant.

DETERMINATION OF ARM'S LENGTH RATE OF INTEREST TO BE CHARGED

Which method to consider for determination of arm's length price?

The Guidelines provide for the application of the Comparable Uncontrolled Price ('CUP') method for determination of an arm's length price for transactions pertaining to inter-company loans. Accordingly, the price charged or paid for the inter-company loan granted to or received from a related company can be compared with the following:

1. *Transactions undertaken by the company or other related companies with independent third parties (can be classified as 'internal comparables'); and*
2. *Transactions undertaken by independent third parties with other third parties (can be classified as 'external comparables'). Indices such as Kuala Lumpur Inter Bank Offered Rate (KLIBOR), prime rates offered by bank and/ or specific rates quoted by banks for comparable loans can be used as a reference point.*



Where there are differences between the related party transactions and the CUP identified, comparability adjustments should be made to eliminate or reduce the effect of such differences in order to determine the arm's length rate.

It is worth mentioning that whilst making comparability adjustments, the taxpayer must ensure the reliability of the selected CUP is not jeopardised. In other words, the taxpayer may have to reconsider the selected CUP as it actually may not be comparable to the related party transactions undertaken or inappropriate for the purpose of comparability analysis.

Approaches to evaluate related party loans

Considering the guidance provided by the OECD Guidelines, the below mentioned approaches have been used by tax authorities and taxpayers over the years to evaluate related party loans. Both the approaches work on the premise that *creditworthiness of the borrower* is a key factor impacting the setting of interest rate charge in case of inter-company loans.

GROUP AFFILIATION APPROACH

In this case the credit rating of the parent or group is taken into account to measure the credit risk of the borrower group company (say a subsidiary). The borrowing company is therefore not treated as a separate entity. In support of this approach, it is assumed that the global reputation of the parent or group can affect the borrowing entity's reputation in foreign jurisdictions. Similarly, one borrowing company can affect the global credit rating of the entire group. Thus, in this case interest rate to be charged to the borrowing company would depend on the interest rate charged to the parent or group from the third parties.

SEPARATE ENTITY APPROACH

Under a "separate entity approach", the creditworthiness of the borrower is verified separately on the basis of its own risk profile. The parent company's credit risk profile or any credit support that a member of a group might provide to the borrower company is not taken into account. This approach is based on the argument that the borrower company should be viewed as a separate entity from the group. Accordingly, the interest rate charged to the borrowing company is based on the third party borrowing cost in a similar situation and such rate would generally be higher than the one used in the "group affiliation approach". This is so because the lender is bearing higher risk when the individual entity's credit ratings are considered as compared to the parent company's ratings or group ratings.

The above approach places reliance on the following paragraph of the OECD guidelines:

By seeking to adjust the profits by reference to the conditions which would have been obtained between independent enterprises in comparable circumstances (i.e., in 'comparable uncontrolled transactions'), the arm's-length principle follows the approach of treating the members of a multinational enterprise ("MNE") group as operating as separate entities rather than as inseparable parts of a single unified business.

A plain reading of the above paragraph suggests that the OECD prefers the separate entity approach. However, there are also other OECD references which provide support to both separate entity and group entity approaches discussed above.

Process of evaluation of arm's length rate of interest

Regardless of the approach adopted, the process of arriving at arm's length interest rates is likely to be similar in most of the cases and is depicted in the diagram as follows:

Credit-worthiness of the borrower to be assessed

Other factors to be considered to enhance comparability i.e. terms of the loan, currency etc.

Estimation of interest rate based on the comparability factors using internal / external comparables

What is the view of the Guidelines?

The Guidelines do not give priority to any particular factor for determination of arm's length rate of interest in case of inter-company loans. However, amongst the various factors, as shown below, creditworthiness of the borrower appears as one of the main factors for undertaking comparability analysis or determining the arm's length interest rate:

Nature and purpose of the financial assistance
Amount, duration and terms of the financial assistance
Type of interest rate (eg: fixed or floating interest rate)
Embedded options
Guarantees involved in the financial assistance
Collateral for the financial assistance
Creditworthiness of the borrower
Location of the lender and borrower

The Guidelines do not elaborate as to what is expected to be determined from each of the above factors. However, based on practice, an indication of the purpose of each factor is provided below:

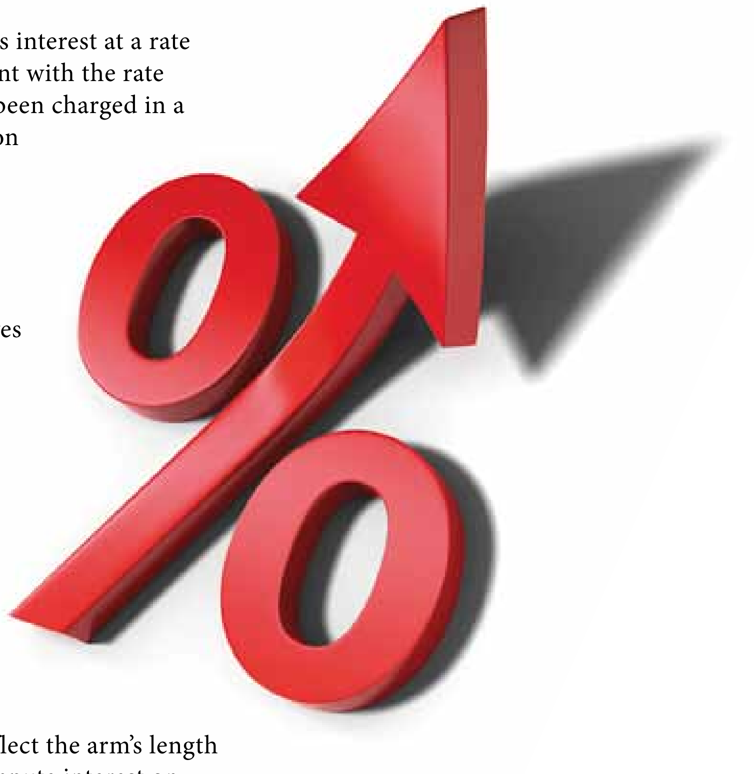
- ***Nature and purpose of the financial assistance*** – While selecting the CUP for the related party transactions undertaken, the taxpayer needs to compare the nature of the loan granted or received. For example, whether it is a term loan, working capital loan etc. The taxpayer also needs to consider the purpose of the loan such as whether it has been granted to finance the business of the related party, to fund the long-term investments etc.
- ***Amount, duration and terms of the financial assistance*** – Another factor which may be considered is the amount of the loan involved as the terms of the loan may differ based on the quantum. The duration of the loan is also important as for example, in case of a short term loan, percentage of interest charged may be higher than in the case of a long-term loan. In addition, terms and conditions of the related party loan should be similar to those in the case of third party loans to ensure that the CUPs selected are reliable. For example, a related party loan granted without a security when compared with a third party loan with a security may require a comparability adjustment to be made so that the reliability of the comparability analysis is improved.
- ***Type of interest rate*** – The rate of interest may also have an impact on the comparability analysis. For example, a loan granted on a fixed rate of interest may have a higher interest payment as compared to a loan granted on a floating rate of interest. Hence, it is imperative to consider this factor while undertaking comparability analysis.
- ***Embedded options*** – Embedded options are provisions that grant rights to the lender to take certain actions in the future to mitigate its risks. Such embedded options could be in the form of capping the floating interest rate, maintaining the rights in relation to prepayment of principal amount etc. For example, in case such options are incorporated in the third party loan agreement, however, the related party loan agreement is silent in this regard, then a higher interest rate may be received from the related party as compared to the one received by the third party (other factors remaining similar).

- ***Guarantees involved*** – Generally loans with guarantees involve lesser risk as compared to loans without guarantees. Accordingly, the returns in the case of the latter should be more as compared to the former. Hence, this factor has to be taken into consideration while evaluating the arm's length price for the related party loan.
- ***Collateral involved*** – Similar to the above, loans involving collateral are considered to be involving less risk as compared to those without collateral. Accordingly, interest rates may be revised upwards or downwards after taking into account the effect of this factor.
- ***Creditworthiness of the borrower*** – The credit rating of the borrower should be analysed while determining the arm's length rate of interest. For example, in cases where credit rating is low, the risk of default is higher. Hence, the interest rate should be higher in this case.
- ***Location of the lender and the borrower*** – Difference in the geographical location of the borrower and lender may have an impact on the comparability analysis. Factors to determine the interest rates may differ from location to location. For example, in the case of developed economies, loans may be available at a lower rate of interest as the risk of default may be lower as compared to developing economies. Hence, while conducting the comparability analysis, comparability adjustments may have to be made to reduce the effect of location differences.

The above list is not meant to be exhaustive and there may be other factors depending on a case to case basis which may be considered for the purpose of conducting a comparability analysis.

WHAT IF THE ARM'S LENGTH PRINCIPLE IS NOT ADHERED TO BY THE TAXPAYER?

As per the Guidelines, the taxpayers should charge or pay the related parties interest at a rate which is consistent with the rate that would have been charged in a similar transaction between third parties dealing at arm's length in cases where a taxpayer grants loans to or receives loans from a related party.



However, in cases where the interest rate charged or paid for a related party loan is not at arm's length, the tax authorities may make a TP adjustment to reflect the arm's length interest rate or impute interest on such related party loans. Thus, as per the Guidelines, the TP adjustment or imputation of interest may be made in the following cases:

- ***Grant of loan to a related party, if there is no consideration or it is less than that would have been provided by a third party.***

Example:

Holding company *(located in Malaysia)*	*1.Grants working capital loan @ 6% p.a. for 5 years* *2. No collateral or guarantees involved* → *Rate charged by a third party financial institution @ 8%p.a. Land and building being collateral for the loan.*	**Subsidiary company *(located in Thailand)***

Thus, based on the facts of the above case, the tax authorities may make the following adjustments to the interest charged by the holding company from its subsidiary:

i. Adjustment to the overall rate of interest at which the loan is granted as it is less than the rate at which funds could be granted to a third party. Such adjustments will bring the interest rate at par with the third party rate.

ii. As no security has been provided by the related party, such loans can be considered as a relatively higher risk loan as compared to the third party loans where land and building have been provided as collateral. Accordingly, an additional adjustment may be made by the tax authorities to account for the higher risk involved in the case of an intra-group loan.

- **Receipt of loan from a related party, if the consideration is more than what would have been provided to a third party.**

Example:

Subsidiary company *(located in Malaysia)*	*Loan received for the purchase of fixed assets@ 8% p.a for 6 years. Credit rating –Medium risk* → *Rate charged by a third party financial institution @ 7%p.a. Credit rating of borrower-high risk*	**Holding company *(located in USA)***

In this case, the tax authorities may substitute the loan arrangement with an interest rate that reflects the current third party situation and may make the following adjustments:

i. Adjustment to the overall rate of interest at which the loan has been received as it is more than the rate at which funds could be received from the third party. Such an adjustment will bring the interest rate at par with the third party rate.

ii. Third party financial institution charges the rate of 7% p.a. to the borrowers with high risk credit rating whereas the related party in the example has medium risk rating. Accordingly, an additional adjustment may be made by the tax authorities to further bring down the interest rate from the 7% p.a. level to account for this situation.

Thus, based on the Guidelines, determination of arm's length charge is required (based on the methods or approaches discussed above) in all cases where there has been a grant or receipt of loan between the related parties. However, there may be some exceptions to this rule which have been discussed in detail in the following section.

CAN THERE BE AN EXCEPTION TO THE RULE OF CHARGING ARM'S LENGTH RATE OF INTEREST?

As mentioned earlier, , determination of arm's length charge is mandatory in all cases where the funds have been granted to or received from a related party. However, there may be some situations where the financing arrangements are structured in a way that either the interest charge is not required for a particular period or is built into the financing instrument, accordingly, interest payout is not warranted upfront.

Such exceptional situations (mentioned below) may also occur in case of related parties, and if so, the related parties may not be deemed to have avoided tax and may be considered to be compliant with the arm's length principle. It is worth mentioning that these situations (other than the one relating to re-characterisation of loan as described below) do not find reference in the Guidelines. Such scenarios have been gathered based on a general understanding of various funding arrangements present in the marketplace.

A. Grant of bullet loans

In case of bullet loans, the borrower agrees to pay interest to the lender on an ad hoc basis. The terms of the agreement between the lender and the borrower could be drafted in line with the above stated arrangement. Where the bullet loans have been granted, generally there should be a higher interest payout in another period or at the end of the loan to compensate for this interest

free period. For example, in case of a three year loan agreement between the lender and the borrower, the borrower may agree to pay the entire principal and interest at the end of the tenure. Accordingly, there will not be any actual interest payout during the tenure of the loan. However, at the end of the tenure, a relatively higher interest rate would be charged as compared to the normal interest bearing loan to account for the higher risks borne by the lender by not charging any interest during the currency of the loan.

Another variety of a bullet loan could be where the loans may be structured in a way that interest is paid in irregular periods initially, coupled with the higher rate of interest at a later period. In this case, even though the interest has been charged irregularly, the loan transaction between the parties can be said to have a commercial justification as a higher interest is being paid later on. Accordingly, if a similar situation arises in case of related parties, the transactions between the related parties may be considered to be at arm's length.

B. Structuring through convertible bonds

Convertible bonds are the financial instruments that can be converted into equity later at a pre-determined price. Such bonds carry a very low or nil interest rate as the lender derives returns subsequently from an expected share price appreciation. Thus, there is no immediate interest payout in this case and there is enough commercial justification for structuring a loan in this manner. However, if such a situation arises in a related party scenario, the tax authorities may argue that there are two elements attached to such bonds i.e. equity element and debt element and that for the transfer pricing purposes the returns from the equity portion and the debt portion should be separated and accordingly, an arm's length interest rate should be imputed in case of the debt portion. In such a case, the taxpayer would be required to have a detailed analysis in place to prove that the returns earned from such instruments are comparable to those earned by third parties in a similar situation.

In a nutshell, it should be kept in mind that such zero interest must be there only for a certain part of the entire life span of the loan. Such zero interest periods must be compensated with a higher interest charge at a later part of the tenure or any other period during the currency of the loan as agreed between the parties involved.

DOCUMENTATION REQUIREMENTS FOR RELATED PARTY LOANS

As mentioned earlier, transactions pertaining to related party loans attract the attention of transfer pricing authorities all over the world. It is due to factors such as the complexity involved in determination of transfer prices, lack of proper documents substantiating the arm's length price, lack of specific guidance by tax authorities to the taxpayers and subjectivity involved in general that such transactions are

considered the soft targets by the tax authorities. In order to avoid disputes, it is imperative that taxpayers at least ensure that the pricing policy has been appropriately documented and that the transactions have been undertaken based on such policy.

It is worth mentioning in this regard that the Guidelines, require the taxpayers to document the terms of related party loans and to substantiate that the interest charge has been made at an arm's length price based on a comparability analysis. Further, the taxpayers are required to review their loan agreements on a periodic basis to ensure that the terms and conditions of the agreement comply with the arm's length principle.

In addition to the general documentation requirements including maintenance of details of related party transactions, functions, assets and risks analysis, selection of transfer pricing method etc, there are certain specific documentation requirements prescribed in case of transactions pertaining to financial assistance (including related party loans). Such requirements have been stated below:

- Loan agreement
- Documents/ details supporting general documentation requirements
- Currency of loan
- A copy of the accounts of the borrower *(where Malaysian entity is the lender)*

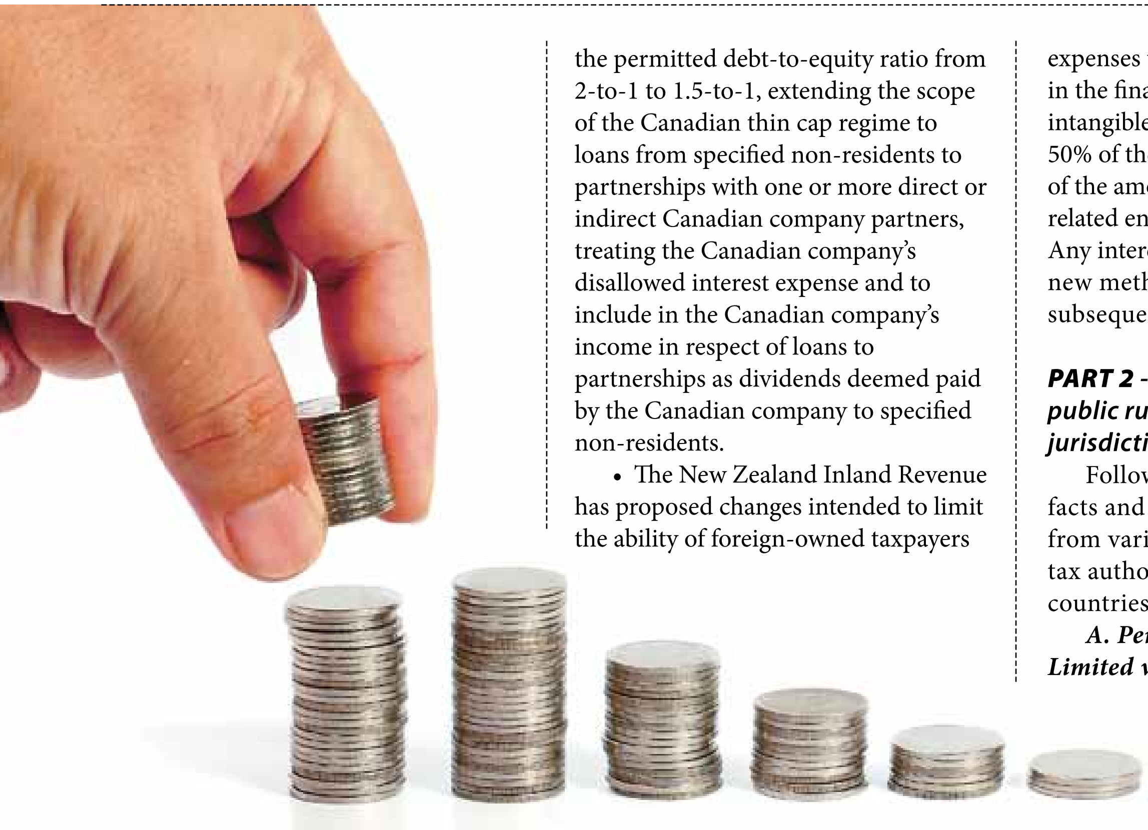
Thus, the Guidelines provide specific guidance in relation to the documents to be maintained in case of transactions pertaining to related party loans. A lot of the above requirements may be cumbersome in practice, however, it is recommended that the taxpayers maintain as much details as they can, failing which it may lead to unnecessary disputes, additional taxes to be levied along with the huge penalties etc.

DEVELOPMENTS AND DISPUTES AROUND THE WORLD

***PART 1** - Snippets from different parts of the world*

There are a variety of issues requiring guidance in case of related party loans (common ones being method to be used for determination of arm's length price, approach to be followed for evaluation, how to get the appropriate third party comparables, how to harmonise thin capitalisation rules with transfer pricing rules etc.) which may lead to the potential disputes between the tax authorities and the taxpayers.

This is one of the reasons why the tax authorities around the world are putting in place various measures to



reduce the number of disputes with the taxpayers. These measures are being brought into place by making amendments or issuing clarification in relation to the existing legislation (such as TP regulations or thin capitalisation rules) or introducing new guidelines. This has resulted in various developments in different parts of the world in relation to the financial transactions arena. Following is the snapshot of some of these recent developments around the world:

- Brazil introduced amendments to its TP rules to provide that interest paid to a related party, arising from a loan agreement between the related parties, whether or not registered with the Central Bank of Brazil, is deductible for income tax purposes only up to an amount not exceeding the London Interbank Offered Rate for six-month U.S. dollar deposits, increased by an annual "spread" to be defined by the Finance Minister.
- Canada has proposed changes to its thin capitalisation rules by reducing the permitted debt-to-equity ratio from 2-to-1 to 1.5-to-1, extending the scope of the Canadian thin cap regime to loans from specified non-residents to partnerships with one or more direct or indirect Canadian company partners, treating the Canadian company's disallowed interest expense and to include in the Canadian company's income in respect of loans to partnerships as dividends deemed paid by the Canadian company to specified non-residents.
- The New Zealand Inland Revenue has proposed changes intended to limit the ability of foreign-owned taxpayers to reduce their tax liability through excessively debt-funding their New Zealand operations.
- Sweden introduced rules restricting the deductibility of interest in case of related party loans as of 1 January 2009, and is now introducing more stringent rules. For example, the restriction currently applies only to interest expense on intra-group loans related to intra-group acquisitions of shares. However, the scope of the interest deduction restriction would be broadened to include all intra-group debt, regardless of the purpose or origin of the loan.
- Poland recently introduced amendments to its thin capitalisation rules to expand the scope of the thin capitalisation rules to loans provided by entities that are not related to the taxpayer directly. An alternative method of calculating the thin capitalisation limits has also been introduced wherein taxpayers would be able to select the method to apply in limiting deductible interest expenses to 5% of the assets presented in the financial statements (excluding intangible assets) but no more than 50% of the operating profit, irrespective of the amount of liabilities involving related entities and the share capital. Any interest not deducted under the new method could be deducted in the subsequent five years.

PART 2 - Jurisprudence and public rulings issued in various jurisdictions

Following is the summary of facts and key principles arising from various TP Rulings issued by tax authorities of the respective countries:

A. Perot Systems TSI (India) Limited vs. Deputy Commissioner of Income Tax ('DCIT') and VVF Ltd vs. DCIT (decisions pronounced by Income Tax Appellate Tribunal ['ITAT'] of India)

In the above two cases the facts and principles arising from the cases are similar. Accordingly, these cases have been bundled together for the purpose of analysis.

Facts and key principles arising from the cases

- The taxpayers granted interest free foreign currency loans to their related parties (in case one of Perot Systems TSI (India) Ltd, one of the related parties was located in a tax haven i.e. Bermuda).
- Tax authorities made the TP adjustment on the pretext that such debt funding has not been made based on arm's length principle. The view of the tax authorities was upheld by the ITAT.
- In a third party scenario, loans will not be granted without interest as there cannot be a valid business reason for the same.
- In case of a loan granted to a related party located in a tax haven, there is a clear cut case of shifting profits

outside India as Bermuda is a tax haven.

- The loan agreement did not mention any clause which makes the loan as quasi-equity. Moreover, the loan was actually characterised as a short-term loan repayable on demand and it had a separate clause on interest charge to be made.
- Thin capitalisation rules in the jurisdiction of the loan recipient would not have an impact on the arm's length chargeability of interest by the lender and accordingly, an arm's length interest should be charged. It is worthwhile to note that this may lead to double taxation for the group as a whole.

CONCLUSION

- Based on the above, it is clear that interest free loans are not considered as arm's length unless robust documentation is in place to prove the substance and commercial justification for such loans.

B. Finnish Supreme Administrative Court ('SAC') Ruling (KHO 2010/3092 (73) 2010)

Facts and key principles arising from the case

- The Ruling focused on determination of arm's length interest rate to be charged by the lender to its related party. The Finnish SAC held that the taxpayer did not comply with the arm's length principle as it previously received loans from a third party at a lower rate of interest.
- The SAC in this Ruling concluded that the average interest rates of all the group's loans are not acceptable.
- The interest rate should be based on the creditworthiness of the borrower (taxpayer in this case) and based on the taxpayers own loans. As per SAC, considering the facts and circumstances of this case, group loans approach could not be applied. Apparently, the SAC did not completely rule out the application of group loans approach depending on case to case analysis.
- Ideally, the interest rate charged in a related party situation should be comparable to the one charged in a third party situation. In case of any differences, the taxpayer should be able to present reasonable justifications and grounds to support such difference.

CONCLUSION

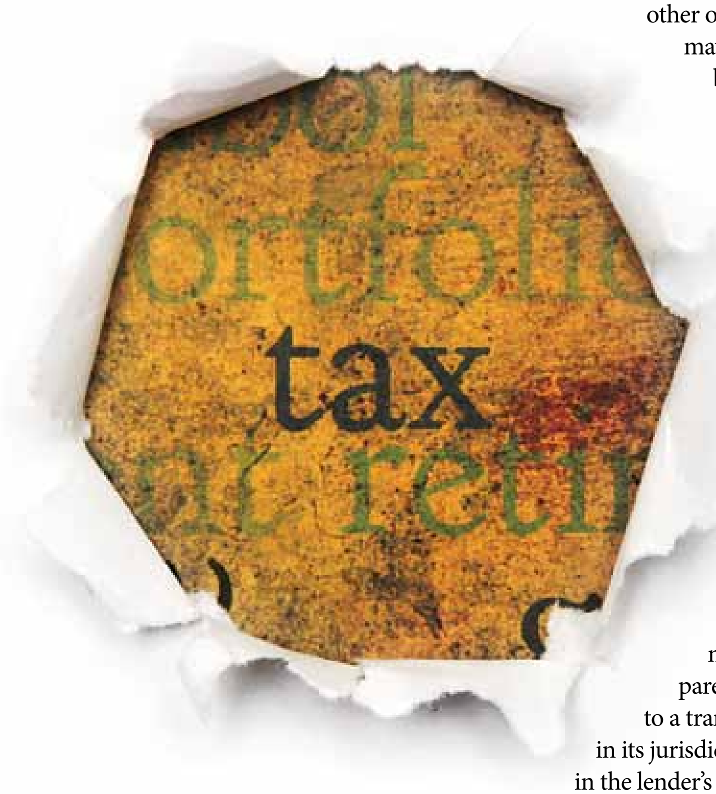
- Based on the above, one can conclude that considering the group affiliation approach for ascertaining the creditworthiness of the borrower may be used depending on the facts of the case. However, the preference has been given to separate entity approach.
- Interest rate to be charged from a related party should be determined based on the third party rates, otherwise reasonable justification must be provided for the difference in rates.

C. Taxation Ruling TR 2010/ 7 issued in public interest by Australian Tax Office

Facts and key principles arising from the Ruling

- One of the key issues dealt by the Ruling is in relation to the interaction of TP rules with thin capitalisation rules. In this regard, the Ruling states that where the related party borrower does not have excess debt for thin capitalisation purposes, the transfer pricing provisions can still be applied to adjust the allowable deductions in relation to interest and other costs incurred in relation to the debt funding based on the arm's length principle espoused in the TP guidelines.
- The next key issue in this case was how to determine the arm's length rate of interest for the related party debt funding. In this regard, the Ruling states that where data is available in relation of comparable third party loans between the independent third parties dealing at arm's length, then Comparable Uncontrolled Price ('CUP') method would be the most appropriate method.
- In absence of a reliable CUP, market interest rates applicable to borrowers (based on their credit risk profile rating) may be used. While considering the market interest rates, creditworthiness of the related party borrower also has to be seen and compared with the third party borrower's ratings.

- However, the Ruling also mentions that use of market rates approach (based on the credit rating of the related party borrower) may not provide reliable results in case it is not commercially viable to incur the finance costs relating to interest on loan or after taking into account such costs, an arm's length return is not left with the related party borrower.



- While discussing the most appropriate method to determine the arm's length interest charge, the Ruling mentions that the credit rating of the related party borrower may be based on credit rating of the parent or group and states that in case the operations of the borrower are core to the group, the credit rating of the borrower can be assumed to be the same as that of the parent or group.

CONCLUSION

- The above positions taken in the Ruling give rise to a controversy which has been explained as follows. Where the debt funding arrangement negatively impacts the profit position of the borrower such that the tax authorities may conclude that it does not make commercial sense for the related party borrower (located in Australia), the tax authorities suggest that the pricing of the debt funding should be based on a hypothetical balance sheet that is less geared than is actually the case. The other option is that the borrower may derive an interest rate by assuming that its cost of funding is similar to that of its ultimate parent company. Either method will result in a lesser debt deduction than would be the case if one were to derive an arm's length price based on the actual gearing or credit rating of the related party borrower.
- The application of the above approach may also result in the parent (lender) being exposed to a transfer pricing adjustment in its jurisdiction if the tax authorities in the lender's jurisdiction consider the interest that the parent company receives on the loan to be below the arm's length interest rate, in turn leading the group to double taxation.

CONCLUSION

Based on the above, it is clear that there is a lot of activity happening around the world in case of intra-group loan transactions both from taxpayer's and tax authorities' ends. In spite of developments happening across the globe in this arena, there is still a lot of ambiguity considering the unique issues arising in this area relating to methods to be applied for determination of arm's length price, harmonisation between thin capitalisation rules and TP rules etc. are making the task even more challenging for the tax authorities and the taxpayers.

Considering all the above, it is recommended that taxpayers maintain robust documentation (following the guidance issued by the tax authorities in their jurisdiction) including the details of related party loan transactions, pricing policy, methods applied, commercial justification of the loan transactions etc. Further, the borrower and lender should periodically review their pricing policy to reflect developments, if any based on the similar situation in case of a third party scenario. Lastly, it is also imperative that supporting documents such as agreements, minutes of the meetings, resolutions passed etc. in relation to the related party loans should also be maintained. All the above details or documents etc. may be used by the taxpayer in order to support its tax position in case of a potential dispute.

THANNEERMALAI SOMASUNDARAM
Senior Executive Director
PricewaterhouseCoopers Taxation Services Sdn Bhd
thanneermalai.somasundaram@my.pwc.com

ANUSHIA JOAN SOOSAIPILLAI
Executive Director
PricewaterhouseCoopers Taxation Services Sdn Bhd
anushia.joan.soosaipillai@my.pwc.com

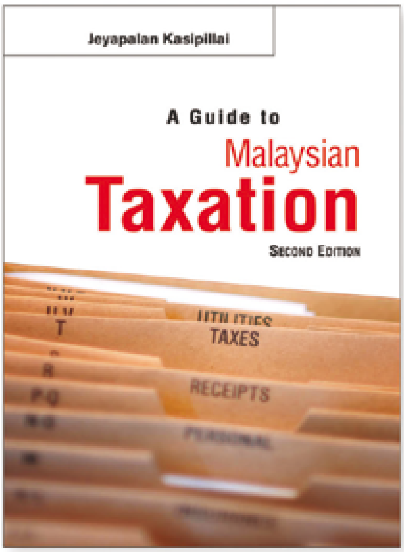
AISHWARYA SETHI
Senior Consultant
PricewaterhouseCoopers Taxation Services Sdn Bhd
aishwarya.sethi@my.pwc.com

MALAYSIAN TAXATION SECOND EDITION

A Guide to Malaysian Taxation and **A Guide to Advanced Malaysian Taxation** are all-inclusive books covering every aspect of taxation. The foundations of the works are legislations extracted from the Income Tax Act 1967. The books cover all the latest amendments including those arising from the Budget 2013 and recently issued exemption orders. These books will prove invaluable for the individual taxpayers, accountants, business consultants and corporate managers, foreign investors and professionals wanting to invest in Malaysia as well as students pursuing taxation papers in tertiary institutions. The worked examples, questions and answers, and clear exposition of the applicable law will provide a firm grasp of the law and its practice.

The law is stated as at 1 February 2013.

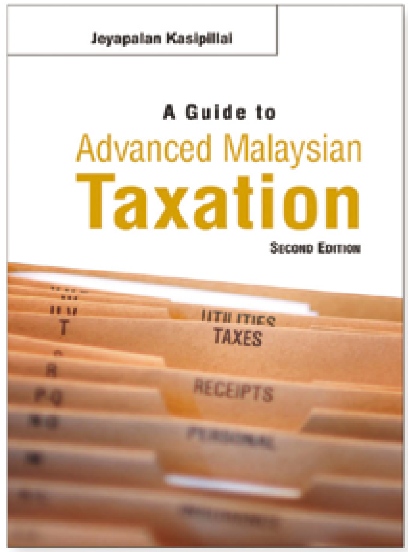
A Guide to Malaysian Taxation



ISBN 9789675771675
PRICE RM80.90 | FORMAT PAPERBACK
TRIM SIZE 7.5" X 10.25" | PAGES 574 PP

Table of Contents

A Guide to Advanced Malaysian Taxation



ISBN 9789675771682
PRICE RM80.90 | FORMAT PAPERBACK
TRIM SIZE 7.5" X 10.25" | PAGES 640 PP

Table of Contents

Mc Graw Hill Education | Higher Education

For more information, please contact McGraw-Hill Education at (603) 7627 6888 or via email at msia_mhe@mcgraw-hill.com

SHIPS AND WATER SNAKES

PART 1

Dr. Nakha Ratnam Somasundaram

THIS ARTICLE, THE FIRST OF THREE PARTS, TAKES A BRIEF LOOK AT THE TAXATION OF SHIPPING OPERATIONS IN MALAYSIA UNDER THE INCOME TAX ACT 1967 (AS AMENDED) (ITA) HIGHLIGHTING SOME OF THE PERTINENT ISSUES IN RELATION TO THE EXEMPTION OF SHIPPING INCOME AND THE APPLICATION OF THE RULES, AND EXPLANATIONS AS CONTAINED IN THE PUBLIC RULING NO. 10 OF 2012 (THE RULING) ON THE TAX TREATMENT OF MALAYSIAN SHIPS[1].

It will also take a brief look at the state of the shipping industry, both domestic and international, and the prospects for the Malaysian shipping industry to weather the tax storm in light of the 2012 budget announcement to scale back the tax exemption on shipping income for shipping operators from 100% to 70%[2].

TAXATION OF SHIPPING OPERATORS[3] - SHIPPING INCOME AND OTHER INCOME

The law under which shipping income is taxed in Malaysia is Section 54(2) (a)[4]. It provides for the taxation of the business income of a resident[5] person from the transportation of passengers or cargo by sea, on a world scope[6].

However, where the business income is not derived from the operations of transporting passengers or cargo by sea, or is derived from investment (dividend, interest and rent), such income shall be deemed to constitute a separate and distinct business and source of that person, and would be taxed on a territorial basis.

EXEMPTION OF SHIPPING INCOME OF A RESIDENT OPERATOR FROM A MALAYSIAN SHIP PUBLIC RULING NO. 10 OF 2012

Malaysian resident sea operators and exempt shipping income

It was proposed in Budget 2012[7] that a resident person carrying on the business of transporting passengers or cargo by sea on board a Malaysian ship, or the letting out on charter a Malaysian ship owned by him on a voyage or time charter would be exempted on 70% of the statutory income. The balance of the 30% statutory income shall be deemed the total income of the operator[8]. The amendment is to come into effect from year of assessment 2012[9].

Prior to the amendment, the statutory income from shipping operations of resident sea operators is fully exempted from income tax.

In the following paragraphs, the taxation of shipping income of a resident operator from a Malaysian ship is examined in the context of the Public Ruling No. 10 of 2012.

Definition of Malaysian ship

'Malaysian Ship' as defined under Section 54A (6)[10] means a sea-going ship (i.e. a ship that goes beyond port limits) and registered as such under the Malaysian Shipping Ordinance 1952 (MSO)[11]. For income tax purposes, it excludes vessels such as ferry, barge, tug-boat, supply vessel, crew boat, lighter, dredger, fishing boat or other similar vessel[12].

Qualifying person and business

Under Section 54A (1) of the ITA 1967, where a person[13] who is resident in Malaysia for the basis year for a year of assessment carries on the business of transporting passengers or cargo by sea on a Malaysian ship or letting out on charter a Malaysian ship owned by him on a voyage or time charter basis, the statutory income for that year of assessment from that business shall be exempt from tax.

It should be noted that if the operator leases out ships on a voyage of time charter, such income would also be exempted provided the operator is the legal owner of the Malaysian ship.

Business of transporting passengers and cargo by sea

For purposes of Section 54(2)(a) the gross income of a resident person from the business of transporting passengers or cargo by sea is ascertained by reference to his income from wherever derived or accrued i.e. on a world scope. It is not necessary that the income derived from outside Malaysia be remitted to Malaysia. Such income would be taxed under Section 4(a) but could be exempted under Section 54A (1) (a) if the qualifying conditions are fulfilled i.e. the business of transporting passengers or cargo by sea has to be carried on by a resident person on a Malaysian ship[14].

Operators carrying on the business of transporting passengers or cargo by sea on a non-Malaysian ship or a ship not registered under the MSO do not qualify for this exemption.

With effect from the year of assessment 1984, a resident person carrying on the business of letting out on charter a Malaysian ship *owned* by him on a voyage or time charter would also be exempted from income tax[15].

Time charter and voyage charter are not defined in the ITA. The ruling however explains that time charter refers to the chartering of a ship (charter here refers to the charter of the *whole* ship) based on a specific period for the use of the ship. Voyage charter on the other hand refers to the chartering of a ship (also the *whole* ship) based on a particular voyage from one port or place to another. The voyage would be for the whole time and the whole distance between the ship's port or place of departure and the final port or place of arrival. In practice, for both the time and voyage charters, ship owners normally supply the crew and provide the services of equipping, bunkering, and maintenance of the ship. The possession and control of the ship remain in the hands of the ship owners.

1 The Public Ruling No. 10/2012 on Tax Treatment of Malaysian ships was issued on 13 December 2012 by the Inland Revenue Board, Malaysia. According to the Board, a Public Ruling as provided for under Section 138A of the Income Tax Act 1967 is issued for providing guidance for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General of Inland Revenue in respect of the particular tax law, and the policy and procedure that are to be applied. A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling.

2 The 2012 Budget proposed among other things, that the income tax exemption for shipping companies be reduced from 100% to 70% of the statutory income; and the balance 30% of the statutory income shall be deemed to be total income and chargeable to tax. Also, see footnote 9.

3 A person carrying on the business of transporting passengers or cargo by sea or air is known as an 'operator' [Section 54(2)(b)].

4 Section 54(2) (a) reads as follows: Subject to Section 54A where a person is resident for the basis year for a year of assessment, his gross income and adjusted income or adjusted loss for the basis period for that year of assessment from the business of transporting passengers or cargo by sea or air, his statutory income for that year of assessment from the business shall be ascertained by reference to his income therefrom wherever accruing or derived.

5 The resident status of an individual is determined under Section 7, (a quantitative approach based on the period of stay in Malaysia) while that of a company is determined under Section 8 (a qualitative determination based on the concept of 'management and control exercised in Malaysia').

6 Under the Income Tax Act 1967 (as amended) tax is charged on income accruing in, or derived from Malaysia or received in Malaysia from outside Malaysia [Section 3][also referred to as the 'territorial basis']; however income received in Malaysia from outside Malaysia is exempted under Para 28 of Schedule 6.

7 The Budget 2012 was presented by the Prime Minister and Minister of Finance, YAB Dato' Sri Mohd. Najib Tun Razak on 7 October 2011.

8 This deeming of the 30% of the shipping income as total income chargeable to tax is quite similar to the treatment of the income of a pioneer business where the portion of the pioneer business income not exempted is treated as a 'deemed total income' – the effect being that no further deductions are available against that 'deemed total income'.

9 It is understood that following a lobby from the shipping industry, the Government has reconsidered its decision to scale down the tax exemption to 70% and thereafter deferred the implementation of the amendments for two years from the year of assessment 2012. Hence, the scaled down exemption of 70% will only kick in from year of assessment 2014 unless the current two year full exemption is further extended (Steve Chia: PricewaterhouseCoopers Taxation Services Sdn Bhd, Kuala Lumpur).

10 All sections mentioned in this article refer to the Income Tax Act 1967 (as amended) unless otherwise specified.

11 In the case of Ketua Pengarah HDN v Labuan Ferry Corporation Sdn Bhd (2010) MSTC 30-003 the High Court held that a vessel must be registered under the MSO first before it could be labeled as a 'Malaysian Ship' so that an exemption (if any) could be claimed.

12 A vessel registered as a Malaysian Ship with the Certificate of Registry under the MSO 1952 is not necessarily a Malaysian ship under the ITA 1967 because the definition of Malaysian ship in the MSO 1952 differs from that in the ITA 1967, and hence the list of the types of vessels excluded for income tax purposes. In shipping lingo, vessels such as barge, tug-boat, supply vessel, crew boat and lighters are known as offshore support vessels (OSV) and are not recognised as a 'Malaysian ship'.

13 'Person' includes a partnership [Section 54A(6)].

14 The exemption is from the year of assessment 1984 and subsequent years of assessment.

15 The exemption with effect from the year of assessment 1999 is under Section 54A(1)(b) while the exemption for the years of assessment 1984 to 1998 is a retrospective exemption granted under the Income Tax (Exemption) (No. 29) Order 1998 [P.U. (A) 473].

The ruling further emphasises that only the business of the transportation of passengers and cargo on a Malaysian ship qualifies for exemption and sets out several examples where business of cruise tours and businesses operated using non-Malaysian ships *do not qualify.*

Strangely, cruise tours on board a Malaysian ship are treated by the Inland Revenue Board (IRB) as not a business of the transportation of passengers but a business of recreation or leisure (and therefore not qualifying for an exemption) – but some tax practitioners spoken to by the writer beg to disagree. In view of the importance of the tourism industry to the country, the IRB could review this aspect of the law.

EXEMPTION OF STATUTORY INCOME FROM A MALAYSIAN SHIP

Where the business of a person who is resident for the basis year for a year of assessment qualifies for exemption under Section 54A(1)(a), the tax exemption is given in respect of 100% of the statutory income for that year of assessment from that business. As mentioned earlier, this would be applicable until year of assessment 2013.

In arriving at the statutory income, the capital allowance on the relevant ship, and any other asset owned and used in the business, is *deemed* to have been claimed[16]. The effect of this approach is the reduction of the exempt income by the amount of the capital allowance.

It should be noted that before the amendment to this effect came into being, shipping operators chose *not* to claim capital allowance as a tax planning measure to increase the available tax exempt income.

Example

Malaysian Shipping Sdn Bhd is a Malaysian resident company carrying on the business of transportation of cargo by sea on a Malaysian ship. It closes its accounts on 31 December each year. For the year ended 31 December 2012, it has a net profit of RM50 million. Other income includes interest of RM600,000 and rental from a property, RM400,000. The expenses incurred are all allowable except depreciation of RM3 million on a ship and other related assets used in the business. The company had donated RM1 million to an unapproved institution during the relevant basis year.

The tax liability of Malaysian Shipping Sdn Bhd for the year of assessment 2012 would be computed as follows: **(see Table 1)**.

MALAYSIAN SHIP AS A SINGLE SOURCE

Under Section 54A, the income derived from the use of all the ships in the business of carrying passengers or cargo by sea on a seagoing vessel registered under the MSO shall be treated as consisting of *one business source*. The income from the various ships would be combined and the capital allowance of each of the different Malaysian ships would be allowed as a deduction against the combined adjusted income.

Example

Satu Malaysia Shipping Sdn. Bhd., is a resident Malaysian shipping company (financial year end: 31 Dec) that operates two seagoing vessels (Ship 1 and Ship 2) for the transportation of passengers and cargo from Port Kelang to Hong Kong. The company qualifies for exemption under Section 54A. For the year ended 31 December 2012, the gross income for Ship 1 is RM120 million and for Ship 2 is RM70 million.

Ship 1 is entitled to capital allowance of RM35 million and Ship 2 is entitled to RM25 million; the total operating expenditure is RM80 million.

The computation of the statutory and the exempt income for the year of assessment 2012 would be as follows: **(see Table 2)**.

[16] Effective from the year of assessment 2009 [Section 54A (1A)]. Under Para 77 of Schedule 3, a person must make a claim for an allowance in a return submitted to the Director General of Inland Revenue , failing which no allowance would be allowed.

MALAYSIAN SHIPPING SDN BHD
COMPUTATION OF CHARGEABLE INCOME

Year of assessment 2012	*RM000*	*RM000*
Net profit as per P&L Account		50,000
Less:		
Interest	600	
Rental	400	1,000
		49,000
Add: Disallowable expenditure		
Depreciation	3,000	
Donation	1,000	4,000
		53,000
Less: Capital allowance		20,000
Statutory income		33,000
[Amount exempted and credited to exempt account]		
Other income		
Interest		600
Rental		400
Aggregate income and chargeable income		1,000
Tax		RM
Tax at 25% on RM1,000,000		250,000.00

Table 1

SPECIAL TREATMENT FOR CAPITAL ALLOWANCES AND LOSSES

Section 54A provides special treatment for capital allowances and losses from the business of transporting passengers and cargo on board a Malaysian ship. However where the treatment under this section is in conflict or inconsistent with the provision of the ITA, then it is provided in Section 52 that those provisions would be void to the extent of the inconsistency.

Thus if there are any excess capital allowances from a Malaysian ship, these allowances shall be available as a deduction *only* against the exempted income under Section 54A. The unabsorbed capital allowances cannot be deducted from the shipping income of a non-exempt shipping business income, for example from the business income of a ferry operation that is not exempted.

Similarly, current year losses incurred, if any, are deducted from the exempted income of the shipping business - and *cannot* be deducted from the aggregate of the non-exempt shipping business activities or other sources of income.

Example

Malaysian Neptune Shipping Sdn Bhd operates two Malaysian ships transporting cargo from Malaysia to India and the Middle East and one ferry that carries passengers between Penang and Langkawi. In addition, it has income from a rental source and interest from a fixed deposit. The company closes its accounts on 31 December each year. A donation in the relevant years was made to an approved institution[17]. Assuming the following other information for the years of assessment 2011 and 2012 is available, then the computation of the capital allowance, losses, exempted shipping income and the chargeable income would be as follows: **(see Table 3)**.

It would be noted that the current year adjusted loss from the qualifying shipping operations in the year of assessment 2011 is *not allowed* a deduction against the aggregate income in that particular year of assessment, but is instead carried forward to be deducted against the exempted statutory income from shipping operations in the following year of assessment i.e. in the year of assessment 2012.

Likewise, the excess of the capital allowance from the shipping operations in the year of assessment 2011 is not deducted from the adjusted income from the ferry operations (which does not qualify for exemption), even though it is from the same business of shipping operations. This balance of the capital allowance is carried forward and allowed against the exempted shipping income in the following year of assessment in 2012.

Unabsorbed adjusted loss brought forward from a previous year of assessment cannot be used to set off against the aggregate of statutory income from all business under Section 43(2); it is only available for deduction against the *exempt* income of the Malaysian ship in the relevant year. In this sense, the computation of the exempt income from the business of transporting passengers and cargo on a Malaysian ship could be tricky as the standard rules are not followed.

SATU MALAYSIA SHIPPING SDN. BHD.

Year of assessment 2012	***RM'000***	***RM'000***
Gross income from ship 1	120,000	
Gross income from ship 2	70,000	190,000
Less: Operating expenses		80,000
		110,000
Less: Capital allowances		
Ship 1	35,000	
Ship 2	25,000	60,000
Statutory income		50,000
[Amount exempted and credited to exempt account]		

Table 2

[17] *The issue of the deduction of donation under Section 44(6) made to an approved institution is a little murky at the moment in view of the Court of Appeal decision in Ketua Pengarah Hasil Dalam Negeri v Perbadanan Kemajuan Ekonomi Negeri Johor [(2003) MSTC 4059]. In that case, a statutory body was granted exemption on all its income except dividend income. During the year in question, the taxpayer made an approved donation for which a full deduction was sought against the taxable dividend income at the aggregate income stage. The IRB however restricted the donation by apportioning it between the exempted income and the taxable dividend income. The taxpayer appealed and the High Court held that the IRB is not entitled to apportion the donation as it did. On further appeal to the Court of Appeal, it was held that although not expressly provided for, the power to apportion is implied in Section 33(1) and reference was made to the case of Daya Leasing Sdn Bhd v KPHDN [(2005) 4,124]; and that the IRB was not incorrect in apportioning the donation as between the exempted income and the dividend income (Ref: Veerinder on Taxation (2nd Ed) CCH, p. 607). In working out the computation in this example, the donation for the year of assessment 2011 is fully allowed as there is no exempted income from the shipping operations i.e. it is Nil; while for the year of assessment 2012 an apportionment of the donation was made as between the exempted statutory income from the shipping operations and the other taxable income based on the above mentioned case law. The writer stands corrected on the matter. The writer is also of the view that this is an area (among others) that the law should be made crystal clear- and not rely on implied aspects of the law - so that tax liability could be computed without any room for doubt and head scratching while corporate social responsibility is given full scope…or '10% scope' as it stands.*

Disposal of Malaysian ship

Where a person carries on a business of transporting passengers or cargo by sea and the income from such activity or activities is exempted from income tax under Section 54A, the treatment of any balancing allowance or balancing charge that may arise in respect of the disposal of any of the ships used in the business would be as follows:

i. In the case of a balancing allowance, it shall be deducted against the adjusted income from the shipping business exempted under Section 54A. Any unabsorbed balancing allowance would be carried forward to the following year of assessment and will be deducted against the adjusted income from the shipping operations.

ii. Where the disposal gives rise to balancing charge, the amount would be added back to the adjusted income as a charge. However, the total amount so added back should not exceed the amount of allowance actually given, irrespective of whether it has been absorbed or utilised.

YEAR OF ASSESSMENT 2011		
Adjusted income	***RM000***	***RM000***
Ship 1		810,000
Ship 2 (Adjusted loss: 45,000)		0
Total adjusted income		810,000
Less: Capital allowances		
Ship 1	607,500	
Ship 2	648,000	
	1,255,500	
Less: amount absorbed	810,000	810,000
Unabsorbed capital allowance c/f	445,500	
Statutory income-exempted under Section 54A		0
Adjusted income from ferry operations		567,000
Less: Capital allowance		32,400
		534,600
Rent	10,800	
Interest	2,000	12,800
		547,400
Less: Approved donation		1,800
Aggregate/chargeable income		545,600
YEAR OF ASSESSMENT 2012		
Adjusted income	***RM000***	***RM000***
Ship 1		1,620,000
Ship 2		800,000
Total adjusted income		2,420,000
Less: Capital allowances		
Ship 1	243,000	
Ship 2	324,000	
Unabsorbed capital allowance b/f	445,500	1,012,500
Statutory income from shipping operations		1,407,500
Less: Unabsorbed loss b/f		45,000
Statutory income-exempted under Section 54A		1,362,500
Adjusted income from ferry operations		729,000
Less: Capital allowance		48,600
		680,400
Rent	40,500	
Interest	900	41,400
		721,800
Less: Approved donation		
900x721,800/(1,362,500+721,800)		312
Aggregate/chargeable income		721,488

Table 3

More than one qualifying business activity

Under Section 54(1)(a) the business of transporting passengers or cargo by sea and the letting on hire a Malaysian ship on a voyage or time charter are treated as two different and distinct business activities, and both qualifying for exemption under Section 54A. In such a situation, the capital allowance and or adjusted loss in respect of a Malaysian ship used in one business could be deducted against the exempt income of the other business.

This manner of determining the adjusted income from a business is an apparent departure from the normal rules where capital allowance in respect of a particular business is business specific and therefore cannot be cross utilised. However, in the case of shipping, the deduction is permitted under Sections 54A (2) (a) and 54A (2) (b) and one needs to be alert.

Example

Assume the following information is available in respect of a shipping company that qualifies for exemption on both the shipping business that it carries on: **(see Table 4).**

This is another instance where the standard rules are not followed.

SEPARATE ACCOUNTS FOR MALAYSIAN SHIPS

Under Section 54A(3)(a) where a person carries on a business and in respect of which the shipping income is tax exempt, the operator must maintain separate accounts for the income derived or deemed to be derived from each of the Malaysian ships from that business.

The expenses of the shipping operations would be classified into direct and indirect expenses. In case of direct expenses, the expenses as ascertained would be allowable against the relevant ship.

And where the expenses are common

to the business, for example, general administrative expense, these will be apportioned on a gross income basis. The DGIR apparently has powers to allocate the expenses incurred to a ship such amounts as might be reasonable and properly have been incurred in the normal course of the business[18].

The interest expenses incurred in respect of the purchase of a ship or more than one ship are to be treated as direct expense and allocated accordingly to the relevant ship.

EXEMPT INCOME, EXEMPT ACCOUNT AND DIVIDENDS

The exempt income of a Malaysian ship must be credited to an exempt account as provided for under Section 54A (3) (b). Any dividends paid out from this account would be debited to this account and it shall not exceed the credit available in the account [Section 54A (3) (c)] .

Assuming the company pays out more than the sum available in the exempt account, only the amount upto the credit available would be exempt in the hands of the recipients – any excess would be chargeable to tax in the hands of the recipient. In such a case, an assessment or an additional assessment would be made upon that person to recover the tax and the exempt account would be debited with such an amount.

GROUP RELIEF LOSSES

The provision of Section 44A shall not apply to a company enjoying tax exemption of its shipping income for the particular basis year for a year of assessment.

EXEMPTION OF INCOME DERIVED FROM SOURCES OUTSIDE MALAYSIA

A resident company carrying on the *business of sea and air transport* is not eligible for exemption on its income derived from sources outside Malaysia and received in Malaysia from outside Malaysia. And where such income is taxed, the person may resort to relief on the taxes suffered in the foreign country, under the double taxation agreement if any, or claim for unilateral relief.

Under Section 54A (1) (a) (2) *only* the business of transporting passengers or cargo by sea by a resident operator is assessed on a world scope. Hence, any other business income or investment based income would be taxed on a modified territorial scope i.e. on the basis that the income is accrued, derived, or received in Malaysia from outside Malaysia. In the case of an income from a source from a non-shipping venture or an investment based income from outside Malaysia remitted to Malaysia would be exempted under Para 28 of Schedule 6.

TAX AUDIT

Under the self-assessment system, resident shipping companies may be audited to ensure compliance with the tax law. Where a company has claimed income tax exemption, such a company when being audited, needs to support their claim for exemption by making available to the revenue authorities relevant documents and evidence of the following[19]:

i. That the company is resident in Malaysia;
ii. That it is carrying on the business of transporting cargo and passengers by sea and that it is entitled to claim an exemption under Section 54A(1)(a);
iii. A certificate of registry and domestic shipping license issued by the Marine Department;
iv. Documents pertaining to port clearance issued by the Royal Malaysian Customs Department, documents pertaining to shipping routes, charter party contracts or agreements ; and
v. Other relevant documents.

		BUSINESS 1 - TRANSPORTING CARGO	BUSINESS 2 - LETTING OUT SHIPS ON HIRE
YA 2012		*RM000*	*RM000*
Adjusted income/(loss)		**(500,000)**	2,000,000
Capital allowance		80,000	140,000

The computation of the statutory income for the year of assessment 2012 would be as follows:

		RM000
Business 1		0
Business 2		2,000,000
Total adjusted income		2,000,000
Less: Capital allowance		
Ship in business 1	80,000	
Ship in business 2	140,000	220,000
		1,780,000
Less: Adjusted loss from business 1		**(500,000)**
Statutory income to be credited to an exempt account		1,280,000

Table 4

[18] *Public Ruling No. 10/2012 Para 10*
[19] *See Para 15 of the Public Ruling No. 10/2012*

Dr. Nakha Ratnam Somasundaram *is a Tax Specialist with the Multimedia University, Cyberjaya Campus. He was the former State Director of the Inland Revenue Board, Kelantan, and Tax Consultant of Chua and Chu of Kota Bharu. He can be contacted at nakharatnam@yahoo.com. The writer wishes to gratefully acknowledge the assistance rendered by* ***Mr. Steve Chia Siang Hai****, Senior Executive Director of Pricewaterhouse-Coopers Taxations Services Sdn. Bhd. for reviewing this article.*

FeatureArticle

MALAYSIAN PERSONAL TAX SIMPLIFIED

Hilda Liow Wun Chee

AS THE YEAR OF ASSESSMENT 2012 INCOME TAX RETURN FILING DEADLINE FALLS DUE, THE INDIVIDUAL TAXPAYER WILL BE ENTERING INTO THE NINTH YEAR OF FILING INDIVIDUAL TAXES UNDER THE SELF ASSESSMENT SYSTEM, WHERE THE INDIVIDUAL TAXPAYER IS RESPONSIBLE FOR COMPUTING AND ASSESSING HIS/HER OWN TAX LIABILITY AND ENSURING FINAL TAX SETTLEMENTS BY THE REQUISITE DUE DATE OF 30 APRIL / 30 JUNE.

Is our tax system simple enough to encourage compliance? Is it competitive compared to the Asia region after a decade of innovative changes? The general taxpayer that bemoans "confusion, unfairness, unnecessary trouble" would not think so. The country's regulators, have, on their part, tried multiple ways to reduce such "suffering at the hands of the Inland Revenue Board". It is imperative, therefore, that we as professionals are tasked, on the one hand, to educate the individual taxpayers, and on the other, to provide constructive recommendation and feedback to the regulators to bridge that mindset gap.

In the last two years, one such initiative was visible through forums convened to canvass possible ways to simplify the individual tax system and to achieve competitive personal tax rates in the region. To this end, we saw, what is hoped, the beginning of such effort taking shape. The 2013 Budget introduced, effective from 1 January 2013, reduced graduated personal tax rates applicable to a tax resident. One income band was collapsed and four others had a 1 per cent tax rate reduction each. The monetary value of the rate savings may not be significant but we should focus on the small steps being taken towards achieving a competitive tax system in the region.

What could we propose to further the quest for our tax system to become more competitive? Let us look at three aspects.

TRENDS IN TAX RATES

WIDER TAX BANDS

The Malaysian personal income tax scale rates are considered "steep", in that, a resident taxpayer could hit the highest tax rate relatively quickly. The income tax rate tables for resident individuals for the Years of Assessment 2012 and 2013 are as follows:

YA 2012

CHARGEABLE INCOME RM	TAX RATE %	TAX PAYABLE RM
First 2,500 Next 2,500	0 1	0 25
First 5,000 Next 15,000	 3	25 450
First 20,000 Next 15,000	 7	475 1,050
First 35,000 Next 15,000	 12	1,525 1,800
First 50,000 Next 20,000	 19	3,325 3,800
First 70,000 Next 30,000	 24	7,125 7,200
First 100,000 Above 100,000	 26	14,325

YA 2013

CHARGEABLE INCOME RM	TAX RATE %	TAX PAYABLE RM
Removed		
First 5,000 Next 15,000	0 2	0 300
First 20,000 Next 15,000	 6	300 900
First 35,000 Next 15,000	 11	1,200 1,650
First 50,000 Next 20,000	 19	2,850 3,800
First 70,000 Next 30,000	 24	6,650 7,200
First 100,000 Above 100,000	 26	13,850

Looking at the YA 2013 chargeable income bands and the respective rates; firstly, there remains a steep 8 per cent increase for the RM50,000 to RM70,000 chargeable income bands. Secondly, the 26 per cent highest tax rate is relatively easy to reach, being applicable to individuals with chargeable income above RM100,000. Under our progressive tax system, the middle income group succumbs to maximum tax at a low income threshold of RM100,000. This makes us less attractive compared to developed nations like Singapore and Hong Kong.

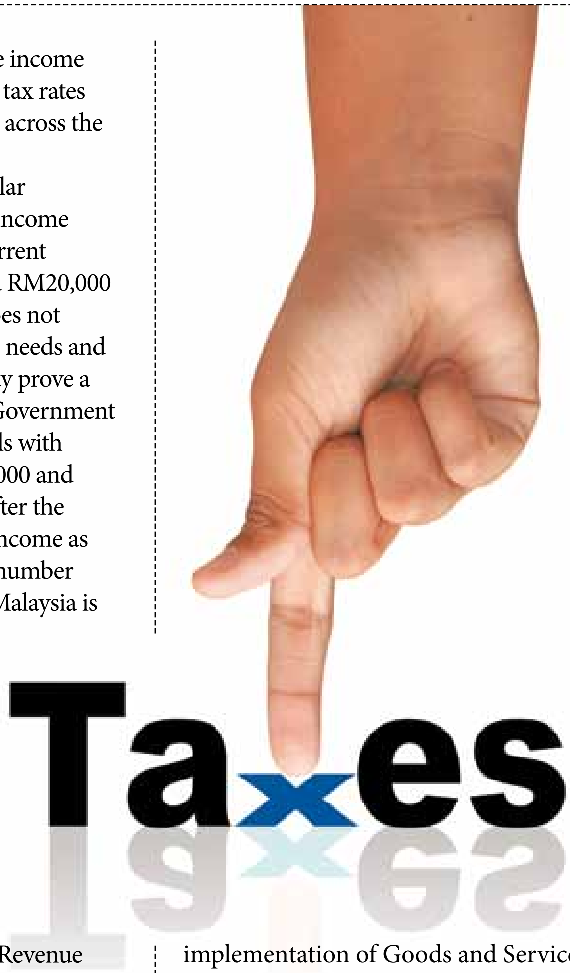
For example, the Singapore personal income tax rates for YA 2013 (calendar year 2012) as shown on the right demonstrate that a taxpayer that earns around RM100,000 only pays less than RM2,000 in tax.

Singapore has a gentler increase in the resident scale rates compared to us due to its wider chargeable income bands. Only S$20,000 chargeable income and above is subject to tax in Singapore and the highest 20 per cent tax rate is

CHARGEABLE INCOME RM	TAX RATE %	TAX PAYABLE RM
First 20,000 Next 10,000	0 2	0 200
First 30,000 Next 10,000	 3.5	200 350
First 40,000 Next 40,000	 7	550 2,800
First 80,000 Next 40,000	 11.5	3,350 4,600
First 120,000 Next 40,000	 15	7,950 6,000
First 160,000 Next 40,000	 17	13,950 6,800
First 200,000 Next 120,000	 18	20,750 21,600
First 320,000 Above 320,000	 20	42,350

only applicable for chargeable income of S$320,000 and above. The tax rates are also relatively well-spread across the chargeable income bands.

Could we consider a similar approach for our chargeable income bands as well since, under current socio-economic conditions, a RM20,000 annual chargeable income does not provide the quality of life one needs and deserves. In actual fact, it may prove a challenge for the Malaysian Government to only start taxing individuals with chargeable income of RM20,000 and above instead of beginning after the first RM5,000 of chargeable income as it is widely reported that the number of tax-paying individuals in Malaysia is already disproportionately low compared against the working population of Malaysia.



In order to balance the loss of overall tax revenue to the Government if the widening of tax bands is implemented, consideration should be given to reducing the Inland Revenue Board's administration costs if the lowest income groups were to be eliminated from becoming taxable. Furthermore, if tax is only payable on chargeable income of RM20,000 and above, the current tax rebate of RM400 for self/spouse could be removed.

For those who dare wish for more, there is always the lowering of the highest tax rate, which is currently 26 per cent. But even if the highest tax bracket of 26 per cent is retained, our tax system could be more competitive if the highest income band is raised. This could be achieved by making the highest tax rate only applicable for individuals, for example, with chargeable income above RM250,000, instead of the current application of the highest tax bracket on chargeable income above RM100,000.

Urgent review on our applicable resident individual scale rate tax is needed, especially with the expected implementation of Goods and Services Tax (GST) looming in the horizon. The review has to include, in some way, the flattening and broadening of the personal income tax scale rates. Merging and collapsing certain rate bands and perhaps withholding final tax at source from majority taxpayer groups could result in increased tax compliance and reduced tax enforcement efforts by the Inland Revenue Board ensuring a system that should not result in a significant revenue loss for the Government.

FLAT TAX FOR SPECIAL CATEGORIES OF INDIVIDUALS

The flat tax system is not an unknown concept in Malaysia. Other than the 26 per cent non-tax resident flat tax, the 15 per cent employment income flat tax was introduced for qualified Knowledge Workers residing in Iskandar Malaysia since the Year of Assessment 2010, and more recently, for Returning Experts under TalentCorp's Returning Expert Programme.

Let us explore the implications. What if the 15 per cent flat tax rate was applied for the Malaysian individual taxpayer, or a wider earning population of Malaysia? Would a flat rate tax system put us on a level playing field with countries in our region? Would the 15 per cent flat income tax put Malaysia in a favourable position compared to Singapore and Hong Kong (countries which enjoy the lowest personal tax rates in the region)? In the table below, we provide an analysis of individual tax at different income levels under the following circumstances:

- Malaysian individual taxpayer enjoying a flat tax of 15 per cent similar to the rate currently enjoyed in respect of employment income by individuals with Knowledge Worker or Returning Expert status;
- Malaysian resident taxed under the current individual tax system;
- Singapore resident taxed under the current Singapore individual tax system; and
- Hong Kong resident taxed under the current Hong Kong individual tax system.

The different income levels have been chosen to present the income points for each country where the 15 per cent effective tax rate starts. For example, at an income level of S$20,000 per month, a Hong Kong tax resident would have an effective tax rate of 15 per cent, similar to the flat tax incentive enjoyed by a Malaysian with Knowledge Worker or Returning Expert status. Whereas, the 15 per cent effective tax rate is reached when a Singapore resident individual earns above S$35,000. **(see Table 1)**

From the analysis, the appeal of the

flat tax to high income earners is obvious because every extra ringgit earned is taxed at the same rate no matter how much one earns. The 15 per cent flat rate tax is a radical approach currently adopted by the Government to attract foreign talent under the Iskandar Malaysia and TalentCorp programmes. It is strategically aimed at overseas talent in the higher income cluster, enticing them to work in Malaysia with the special flat rate concession that puts Malaysia at par with countries that enjoy the lowest personal tax rates in the region. Aimed at highly-skilled

>

Table 1

SGD4,000 PER MONTH (EQUIVALENT TO RM9,984)

2012	TOTAL SALARY	TAX LIABILITY	ETR*
Malaysia (flat rate 15% tax)	RM119,808	RM16,621	14%
Malaysia (current resident rate)	RM119,808	RM17,135	14%
Singapore (current resident rate)	SGD48,000	SGD1,040	2%
Hong Kong (current resident rate)	HKD301,046	HKD20,818	7%

SGD10,000 PER MONTH (EQUIVALENT TO RM24,959)

2012	TOTAL SALARY	TAX LIABILITY	ETR*
Malaysia (flat rate 15% tax)	RM299,508	RM43,576	15%
Malaysia (current resident rate)	RM299,508	RM63,857	21%
Singapore (current resident rate)	SGD120,000	SGD7,835	7%
Hong Kong (current resident rate)	HKD752,616	HKD97,585	13%

SGD20,000 PER MONTH (EQUIVALENT TO RM49,918)

2012	TOTAL SALARY	TAX LIABILITY	ETR*
Malaysia (flat rate 15% tax)	RM599,016	RM88,502	15%
Malaysia (current resident rate)	RM599,016	RM141,729	24%
Singapore (current resident rate)	SGD240,000	SGD27,770	12%
Hong Kong (current resident rate)	HKD1,505,232	HKD225,529	15%

SGD35,000 PER MONTH (EQUIVALENT TO RM87,357)

2012	TOTAL SALARY	TAX LIABILITY	ETR*
Malaysia (flat rate 15% tax)	RM1,048,284	RM155,893	15%
Malaysia (current resident rate)	RM1,048,284	RM258,539	25%
Singapore (current resident rate)	SGD420,000	SGD62,150	15%
Hong Kong (current resident rate)	HKD2,634,156	HKD395,123	15%

** ETR = Effective Tax Rate*

*** The calculations (on the right) have been performed on the basis that the individuals are single, have no other income and are based on 2012 income tax rules.*

**** The calculations (on the right) have not taken into consideration the change in tax rates effective from 2013*

SGD1 : MYR2.4959 Inland Revenue Board average exchange rate

SGD1 : HKD6.27180 Spot-rate on 01/03/2013 (www.oanda.com)

talents, many also advocate that the flat tax sharpens an individual's incentive to work. A progressive income tax system, they claim, deters extra effort from society's best-paid, and therefore, most productive members.

A single bracket tax system is also, by far, one of the simplest tax systems to understand and administer. By taking a constant cut from an individual taxpayer's earnings, administering the system would be exceptionally painless.

Clearly, the flat rate tax system has its benefits, which is worth considering, and in view that the country has already adopted the flat tax model for a small population of individual taxpayers, it would not be difficult to expand it to impact a larger group of income earners in Malaysia.

SIMPLIFYING AND CONSOLIDATING TAX RELIEFS

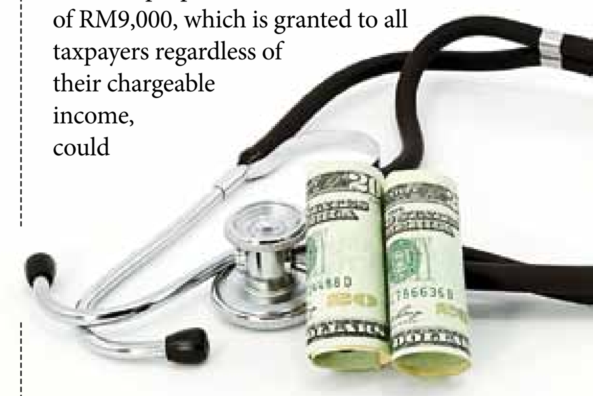
There will always be those individuals that hope the Government will take steps to mitigate the hardship of the general public reeling under the onslaught of inflationary pressures. There is, therefore, a yearly anticipation for offerings in the form of tax reliefs for the common man to put money back into his/her pocket, however small the value. Despite that, it is time for the Government to reflect on more substantive and sustainable reliefs instead of getting the public excited with "little goodies"

The reliefs available to a Malaysian resident taxpayer for the Year of Assessment 2013 are listed as follows: **(see Table 2)**.

Although, there is a call to reduce the number of personal reliefs available to simplify the tax system, the scope for the Government to do so could be limited as each relief was announced by the Government for a specific purpose. For example, the RM6,000 Skim Simpanan Pendidikan Nasional (SSPN) relief is available as an incentive for Malaysians with children to save for their children's education in the SSPN. Likewise, to promote sports activity and healthy living for Malaysians, the RM300 relief for purchase of sports equipment is given to encourage more individuals to participate in such activities. Since these reliefs are maintained to cater for the needs of specific stakeholders, taxpayers should endeavour to maximise their claims.

The consequence of maintaining an extensive list of reliefs is the overwhelming administrative efforts needed to keep track of, and claim, the reliefs. Are there ways then to reduce the number of reliefs, and consequently, the need to track and substantiate these reliefs?

In a scale rate tax system, if there is gradual increase in tax rates and an equitable spread in chargeable income bands as proposed above, the self relief of RM9,000, which is granted to all taxpayers regardless of their chargeable income, could



be removed. It should be noted that Singapore does not have self relief.

In a study of selected countries in the region carried out by CTIM, Malaysia has the highest number of personal reliefs. It is, therefore, timely that the country looks into ways to streamline the types of available reliefs and reduce the administrative costs of policing taxpayers' compliance in this aspect of their tax management. One way of doing this is to group some of the smaller and more insignificant reliefs into broad categories such as "aged parents", "personal enhancements", etc. and doing away with reliefs which are not efficient to control and monitor, for example, the reliefs for expenses incurred on books, sports equipments and broadband subscriptions.

	RM
Self	9,000
Medical treatment, special needs and carer expenses for parents	5,000
Basic supporting equipment for disabled self, spouse, child or parent	5,000
Disabled individual	6,000
Education fees (self)	5,000
Medical expenses on serious diseases for self, spouse or child	5,000
Purchase of books/magazines/journals/similar publications	1,000
Purchase of personal computer (once every 3 years)	3,000
Net deposit in Skim Simpanan Pendidikan Nasional	6,000
Purchase of sports equipment for any sports activity	300
Payment of broadband subscription	500
Interest on housing loan	10,000
Spouse	3,000
Disabled spouse	3,500
Child - Under the age of 18 years	1,000
Child - 18 years & above and in higher education	6,000
Disabled child	5,000
Life insurance and provident fund	6,000
Private Retirement Scheme and Deferred Annuity	3,000
Education and medical insurance	3,000

Table 2

SIMPLIFYING TAX FILING

As we are discussing the avenues to simplify the personal income tax system, the tax filing forms for April 2013 filing have been simplified. For the Year of Assessment 2013, the tax return forms, for example the Form BE has been reduced to two simple and friendly pages for taxpayers to fill in with particulars and information. Individuals qualifying for the flat tax of 15 per cent under the Knowledge Worker and Returning Experts incentives, and non-tax resident individuals file separate return forms where the calculation of tax has been made easier for the individual to understand.

Going forward, one recommendation would be to make the tax return forms more user-friendly by allowing submissions in dual-language return forms. Currently, the resident tax return forms (Form B/BE/BT) are in Bahasa Malaysia and the non-tax resident return forms (Form M/MT) are in English. Going forward all tax return forms should be in dual languages to cater for both Malaysian and non-Malaysian taxpayers who could be required to file any of the resident or non-resident return forms. A more user-friendly tax filing system would ensure that both local and foreign taxpayers take full cognisance of their income tax filing obligations.

The Inland Revenue Board is already looking into ways to make certain types of taxes withheld at source final with no further requirement for the individual to submit tax return forms unless the taxpayer has other income to report. The management of the Monthly Tax Deduction ("MTD") with the introduction of the MTD software and PCB calculator which requires the employers to administer monthly deductions capturing all cash and non-cash remuneration as well as personal reliefs of employees, on election basis, is a clear step the country is making towards reducing the filing responsibilities of the individual taxpayer.

Emulating a true Pay-As-You-Earn system, which countries like the United Kingdom have long since been operating under, the correct amount of tax is deducted and paid at source on all the income of a taxpayer, making a tax return redundant. A tax return may be required only if the taxpayer's affairs are complicated and to determine any amount of tax payable or refundable.

In recent years, we have seen an increased focus by the regulators on the penalty regime to instil greater compliance in the requirement to file income tax returns by requisite deadlines. This new focus has created insurmountable discontentment among taxpayers and the profession, especially the late filing penalty introduced for failure to submit tax returns. It has certainly been thought unfair on occasions where the Inland Revenue Board has liberally put into operation the new penalty rates without consideration for any taxes paid at source, such as employment taxes deducted through the MTD system.

The simplification of the tax filing process by deeming taxes withheld at source as final could be one of the methods to resolve taxpayer discontent and to avoid the necessity for the tax authorities to impose late filing penalty. There should also be consideration for the deeming of employees' Annual Income Statement as final assessments thereby eliminating the requirement for certain groups of individuals to file annual tax return forms. This is already practised in Singapore under the Auto-Inclusion Scheme for Employment Income for qualifying groups of employees.

CONCLUSION

For the Government to build a stronger fiscal position from tax revenues in a regime where certain initiatives like GST need to be in the picture, the Government's changes in the personal tax system cannot be mere tinkering like the changing of rates and introducing of personal reliefs. Instead, the Government should look to implement bold reforms that achieve changes that are both forward-looking and lasting in impact; reforms like eliminating tax for the lowest level income earners; collapsing or widening certain income bands and simplifying reliefs into three or four main categories. These reforms, coupled with increased administrative expediency and competitiveness would lead to attraction of the right talent to our country without a reduction in the overall tax revenue to the country.

Hilda Liow Wun Chee *is an Executive Director at PwC International Assignment Services (IAS) Sdn. Bhd., part of a regionalised business which includes the combined IAS practices in China, Hong Kong, Malaysia, Singapore, Taiwan, Thailand and Vietnam." She can be contacted at hilda.liow.wun.chee@my.pwc.com*

OF PLANTS AND CAR PARKS: AN ANALYSIS OF *TROPILAND*'S CASE

Datuk D.P. Naban & Siti Fatimah Mohd Shahrom

Ketua Pengarah Hasil Dalam Negeri v Tropiland Sdn Bhd[1] is a recent landmark decision of the Court of Appeal which unanimously affirmed the decision of the High Court that a purpose built multi-storey car park was a "plant" within the meaning of Schedule 3 of the Income Tax Act 1967 ("the Act").

Paragraph 2(1) of Schedule 3 of the Act provides that qualifying plant expenditure is capital expenditure incurred on the provision of plant or machinery used for the purposes of a business. The word "plant" is not defined in the Act. In determining whether an equipment or a structure is a "plant", courts in the Commonwealth examine the facts of each case including the nature of the taxpayer's business and functionality of the equipment or structure in the taxpayer's business.

[1] *The authors successfully represented Tropiland Sdn Bhd with their solicitors before the Court of Appeal (Civil Appeal No. P-01-542-2010). The Court of Appeal's decision was delivered on 13 August 2012 and is reported as (2013) MSTC 30-054.*

FACTS OF THE CASE

Tropiland was a taxpayer whose principal activities consisted of property development, car park operation and letting out of premises. In 1984, the taxpayer contracted with the Penang Development Corporation ("PDC") under a 30-year privatisation scheme to build a multi-storey car park on a piece of land owned by PDC. It was also the taxpayer's responsibility to ensure that the multi-storey car park shall be primarily used as a car park, the purpose and function of which shall be to service the users and occupiers of Kompleks Tun Abdul Razak. The lease agreement provided that the taxpayer shall build the multi-storey car park in accordance with the plans, elevations and specifications as stipulated in the lease agreement and shall employ the services of named architects, civil and structural engineers, mechanical and electrical engineers and quantity surveyors as consultants. In constructing the multi-storey car park, the taxpayer incurred capital expenditure amounting to approximately RM10 million and claimed capital allowance on the premise that the car park was a plant for use in its business.

Pursuant to an audit, the Revenue disallowed the taxpayer's capital allowance claim on the car park. The Revenue's contention in *Tropiland* was that the multi-storey car park was the taxpayer's business setting and hence, it was not a plant and does not qualify for capital allowance. The taxpayer being aggrieved by the Revenue's decision, appealed to the Special Commissioners of Income Tax, who dismissed the appeal. Convinced that the car park ought to qualify for capital allowance, the taxpayer appealed to the High Court, which ruled in favour of the taxpayer. This prompted the Revenue to mount an appeal to the Court of Appeal.

WHAT IS A "PLANT"?

As the law does not supply a definition of the word "plant", we need to look at its ordinary meaning as guided by our superior courts and courts in the Commonwealth, which prescribe a set of guidelines for application to any particular set of circumstances.

In the present case, both the High Court and the Court of Appeal had, on the onset, adopted the meaning of "plant" described in *Yarmouth v France*[2], which is the *locus classicus* on the meaning of "plant and machinery", in which it was held:

*"There is no definition of plant in the Act; but, **in its ordinary sense, it includes whatever apparatus is used by a businessman for carrying on his business,** - not his stock in trade which he buys or makes for sale, but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business..."*

Otherwise known as the "apparatus test", the primary issue to be determined was whether the multi-storey car park was an apparatus for the purpose of the taxpayer's business.

However, it is pertinent to note that an apparatus for the conduct of the business must be distinguished from the structure within which the business is carried out. The premise or structure in which a business is carried out cannot be considered a "plant". This is described as the "premises test"[3].

The courts have also adopted another test known as the "settings test" in construing whether an item could be regarded as "plant"[4]. Essentially, what this means is that if the subject was a part of the setting in which the business is carried on (and which cannot be regarded as part of the apparatus used for carrying on the business), then it cannot qualify as "plant". However, something which forms part of the setting of a trade may nevertheless be a "plant" if it is more a part of the apparatus than a part of the setting[5].

Another test formulated by the courts is the "functional test" in which the courts seek to ascertain if the subject matter performed a functional purpose in the trade[6].

TROPILAND'S POSITION

In determining whether the multi-storey car park qualified as "plant", the issue which needed to be addressed

---

2 *(1887) 19 QBD 647.*

3 *see Wimpy International v Warland [1989] BTC 58 and Lingfield Park (1991) Ltd v Shore (HM Inspector of Taxes) [2004] CA 89.*

4 *see J. Lyons & Co Ltd v Attorney General [1944] 1 Ch 281.*

5 *see Jarrold v John Good & Sons Ltd [1963] 1 WLR 214.*

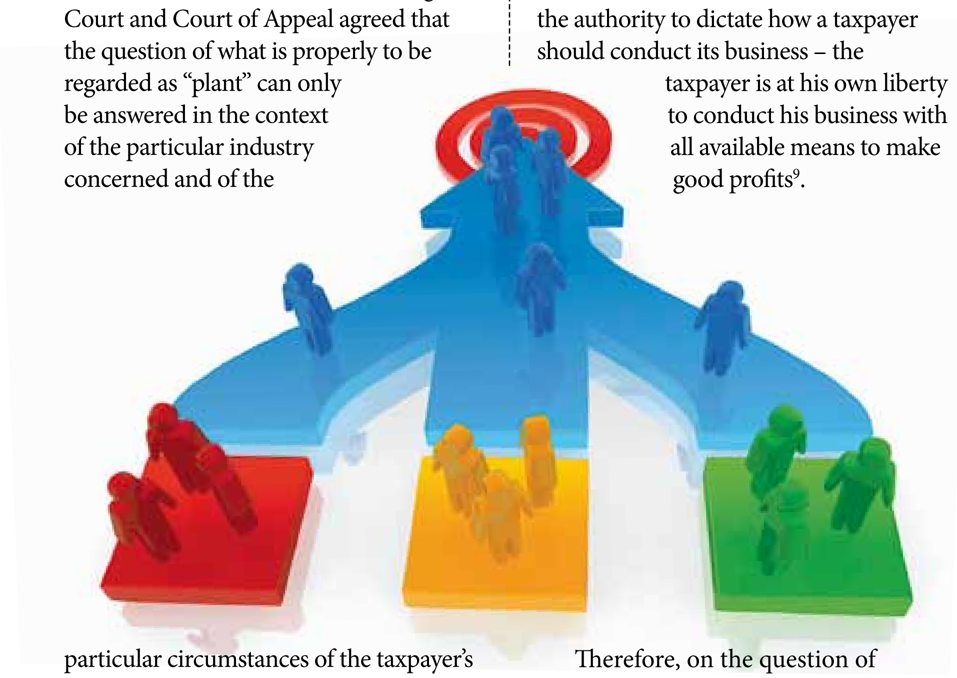
6 *see Commissioners of Inland Revenue v Scottish Newcastle Breweries Ltd [1982] 2 All ER 230.*

was whether the taxpayer carried on its business ***with*** or ***in*** the purpose built multi-storey car park?

In *Tropiland*'s situation, the Revenue had argued that it had a legitimate basis to disallow the capital allowance claimed on the multi-storey car park on the basis that the land could still be used as a car park without a need for a building. The taxpayer contended that in considering whether an apparatus is a "plant", it had to be considered in relation to trading activities as a whole and/or all its constituent parts and appurtenances had to be viewed as a whole. Both the High Court and Court of Appeal agreed that the question of what is properly to be regarded as "plant" can only be answered in the context of the particular industry concerned and of the particular circumstances of the taxpayer's own trade. There is thus a need to take a holistic approach in every case. The need to refrain from viewing the taxpayer's business in a fragmented fashion was reinforced in *W Nevill & Co Ltd v Federal Commissioner of Taxation*[7], where the High Court of Australia held:

"In my opinion, the answer to this contention is to be found in a recognition of the fact that it is necessary, for income tax purposes, to look at the business as a whole set of operations directed towards producing income."

Although it may be true that the land could still be used as a car park without a need for a building, the Revenue failed to take into account that it was not an option available to the taxpayer. As previously highlighted, under the privatisation lease agreement, the taxpayer must build a multi-storey car park within the parameters and conditions set by PDC. The High Court and Court of Appeal in *Tropiland* recognised the need to consider the obligations of the taxpayer under the agreement, which did not occur in vacuum. In essence, the Revenue must look at the economic purpose of the agreement[8]. More importantly, it is trite law that the Revenue does not have the authority to dictate how a taxpayer should conduct its business – the taxpayer is at his own liberty to conduct his business with all available means to make good profits[9].



Therefore, on the question of whether the taxpayer conducted its business *with* the multi-storey car park, it was held by the Court of Appeal that in light of the above, it was clear that the multi-storey car park was indeed the taxpayer's apparatus.

On whether the taxpayer conducted its business *in* the multi-storey car park, the Court of Appeal endorsed the High Court's finding which had held that, in view of the peculiarity of the facts and service industry of the taxpayer, there was a definite tilt towards the multi-storey car park being regarded as a tool of the taxpayer's trade rather than a mere setting. The car park was therefore held to not be the taxpayer's place of business.

LARGE AND PERMANENT STRUCTURES

The learned High Court Judge had opined that the operating of the car park was the taxpayer's business and therefore the multi-storey car park essentially only performed one primary function, which was to provide the means by which the taxpayer derived its revenue. The learned High Court Judge further opined that one of Parliament's intentions in allowing capital allowance was for the improvement of infrastructure and ultimately contributing towards economic growth and activity.

Whilst agreeing with the decision of the High Court, the Court of Appeal considered and was further persuaded by a plethora of cases where large and permanent structures were held to be a "plant" rather than a "setting" or a "place of business". The examples are as follows:

a. In *Commissioner of Inland Revenue v Barclay Curle & Co Ltd*[10], the English House of Lords viewed a dry dock as a "plant" and not a mere setting or part of the premises despite its large size because it was the means by which the operation of the business was performed.
b. Ornaments used purely in the creation of the right atmosphere for the interiors of a hotel were held to be apparatus and therefore a hotelier's "plant" by the English House of Lords in *Inland Revenue Commissioners v Scottish &*

7 *(1937) 56 CLR 290.*
8 *see Newey v Revenue & Customs Commissioners [2010] SFTD 836.*
9 *see Re Magna Alloys & Research Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia [1980] FCA 150 and Ronpibon Tin NL & Tongkah Compound NL v Federal Commissioner of Taxation [1949] 78 CLR 47.*
10 *[1969] 1 All ER 732.*

Newcastle Breweries Ltd[11].

c. In Northern Ireland, from poultry houses[12] to stands at a racecourse[13], the courts took the view that such assets constitute a "plant" on the basis that they were necessary for the businesses to be carried out respectively and their function was one which was active and ongoing.

d. In *Schofield (HM Inspector of Taxes) v R&H Hall Ltd*[14], the primary issue was whether a silo could be considered a "plant". The Court of Appeal in Northern Ireland took into account the nature of the business and the function of the silos in the trade. The silos were held to be "plant" as they were specially built for the purposes of the business, without which the business could not have functioned.

e. In *Wangaratta Woollen Mills Ltd v Commissioner of Taxation of the Commonwealth of Australia*[15], the High Court of Australia was of the view that a dyehouse was more than a convenient setting for the business operations as it played a part in the manufacturing process as a tool in the trade.

Besides the above, in various circumstances, a swimming pool[16], cold stores[17] and mezzanine platforms in warehouse[18] have also been held to be a "plant".

MOVING FORWARD IN LIGHT OF *TROPILAND*

Both the High Court and Court of Appeal arrived at their respective decisions by giving weight to the nature of the taxpayer's business. The taxpayer was a car park operator bound by the terms of the lease agreement with PDC which required the construction of a multi-storey car park. Although on the surface of things, the car park may appear to be a premise on which the business was carried out, cases aforementioned as well as the nature of the taxpayer's business seemed to have proved otherwise.

The cases pointed that large assets need not necessarily be a "premise", but could instead qualify as a "plant". The multi-storey car park did not stop short on being a premise or a place of business on which the business was being conducted. Instead, it was the means by which the taxpayer's business was operated. The multi-storey car park was found to be a part and parcel of the taxpayer's business and served to fulfil the function of a "plant". It was also not merely a "setting" as it played an integral and essential role in providing the means by which the business was operated.

The multi-storey car park was also of utmost importance for the purposes of carrying out the taxpayer's car park business, as the exclusion of it would have equated to the closure of the taxpayer's business in its entirety. Further, it was a means by which the taxpayer had derived its revenue. The revenue, being the payments received from car park operation, was the sole and primary form of revenue for the taxpayer.

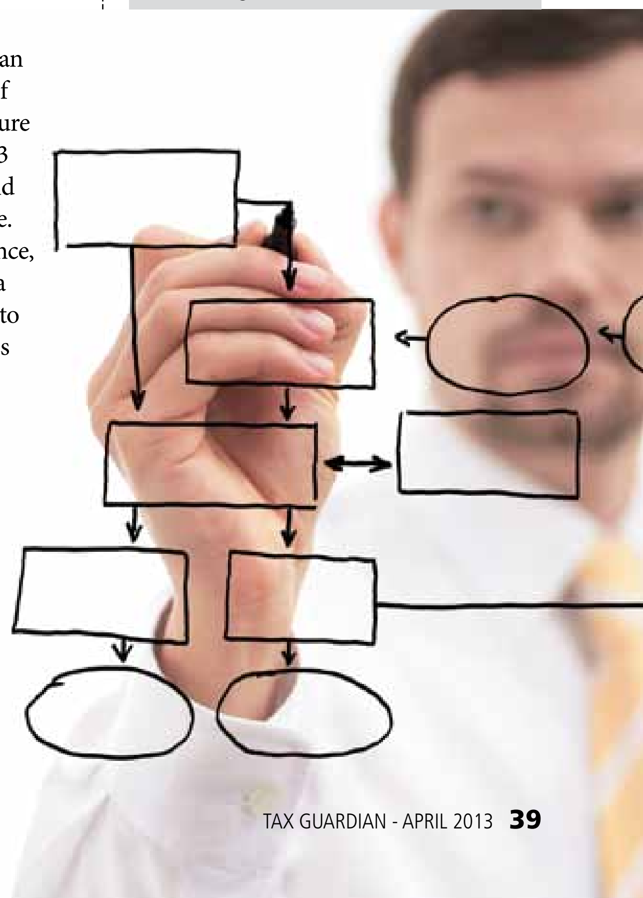
CONCLUSION

The determination of whether an asset is a "plant" for the purposes of claiming qualifying plant expenditure under Paragraph 2(1) of Schedule 3 of the Act received much clarity and elucidation from the *Tropiland* case. Large assets which may, at first glance, give the impression that it may be a premise would not be so if proven to be the means with which a business is operated or the tool used in the operation of a business.

All is not lost for the Government and the Revenue as was aptly opined by the learned High Court Judge in *Tropiland*, by offering such flexibility to the claiming of qualifying plant expenditure, it would encourage the construction of infrastructure, which would in turn improve economic activity, thus resulting in increased revenue generated by businesses. This increase in revenue would ultimately see the increase in tax revenue collections by the Revenue.

11 [1982] 2 All ER 230.
12 see O'Srianain (Inspector of Taxes) v Lakeview Ltd 3 ITR 219.
13 see O'Grady (Inspector of Taxes) v Roscommon Race Committee 5 ITR 317.
14 49 TC 538.
15 [1969] 119 CLR 1.
16 see Cooke (Inspector of Taxes) v Beach Station Caravans Ltd [1974] 1 WLR 1398.
17 see Commissioner of Inland Revenue v Waitaki International Ltd [1990] 3 NZLR 27.
18 see Hunt (Inspector of Taxes) v Henry Quick Ltd; King (Inspector of Taxes) v Bridisco Ltd [1992] STC 633.

Datuk D.P. Naban *is a tax partner in Lee Hishammuddin Allen & Gledhill.* ***Siti Fatimah Mohd Shahrom*** *is an up and coming tax lawyer with Lee Hishammuddin Allen & Gledhill. They can be contacted at tax@lh-ag.com*



The technical updates published here are summarised from the selected government gazette notifications published between 16 November 2012 and 15 February 2013 including Public Rulings and guidelines issued by the Inland Revenue Board (IRB), the Royal Customs Department and other regulatory authorities.

INCOME TAX

Income Tax (Exemption) (No. 7) Order 2012

The Income Tax (Exemption) (No. 7) Order 2012 [P.U.(A) 420] was gazetted on 28 November 2012 and came into operation on 8 October 2011. It applies to applications received by the Malaysian Investment Development Authority (MIDA) from 8 October 2011 until 31 December 2015 and to private schools that commenced operations on or after 8 October 2011. The Order grants a private school an investment tax allowance of 100% on qualifying capital expenditure incurred within a period of 5 years that may be set off against 70% of the school's statutory income.

Income Tax (Exemption) (No. 8) Order 2012

The Income Tax (Exemption) (No. 8) Order 2012 [P.U.(A) 421] was gazetted on 28 November 2012 and came into operation on 8 October 2011. It applies to applications for investment tax allowance received by MIDA from 8 October 2011 until 31 December 2015 and to private and international schools that commenced operations on or after 8 October 2011. The Order grants investment tax allowance of 100% on qualifying capital expenditure incurred within a period of 5 years that may be set off against 70% of the statutory income.

Income Tax (Exemption) (No. 9) Order 2012

The Income Tax (Exemption) (No. 9) Order 2012 [P.U.(A) 422] was gazetted on 28 November 2012 and came into operation on 14 July 2010. It applies to applications received by MIDA from 14 July 2010 until 31 December 2015 and to qualifying capital expenditure incurred from the year of assessment 2010. The Order grants an international school an investment tax allowance of 100% on qualifying capital expenditure incurred within a period of 5 years that may be set off against 70% of the school's statutory income.

Income Tax (Deduction for Contribution by Licensed Insurers to the Malaysian Motor Insurance Pool) Rules 2012

The Income Tax (Deduction for Contribution by Licensed Insurers to the Malaysian Motor Insurance Pool) Rules 2012 [P.U.(A) 419] gazetted on 28 November 2012 are deemed to have effect from the year of assessment (YA) 2011 until YA 2015. The Order provides a double deduction on the contributions made by licensed insurers to the Malaysian Motor Insurance Pool.

Income Tax (Exemption) (No. 11) Order 2012

The Income Tax (Exemption) (No. 11) Order 2012 [P.U.(A) 451] was gazetted on 19 December 2012 and takes effect from YA 2013 until YA 2015. The Order provides 100% tax exemption on the statutory income derived from "domestic tours" by tour operators licensed under the Tourism Industry Act 1992.

Income Tax (Exemption) (No. 10) Order 2012

The Income Tax (Exemption) (No. 10) Order 2012 [P.U.(A) 447] was gazetted on 18 December 2012 and took effect from 24 April 2012. The Order exempts ASEAN

Infrastructure Fund Limited (AIFL) from all the Income Tax Act 1967 provisions, including a non-resident employee from income tax on all gains or profits derived from his employment with AIFL.

Finance Act 2013

The Finance Act 2013 was gazetted on 10 January 2013 and it adopts all the changes proposed in the Finance (No. 2) Bill 2012.

Income Tax (Industrial Building Allowance) (Kindergarten) Rules 2013

The Income Tax (Industrial Building Allowance) (Kindergarten) Rules 2013 [P.U.(A) 1] gazetted on 28 December 2012 takes effect from YA 2013. The Rules provide that a building constructed for or purchased by a kindergarten operator for use as a kindergarten approved by the Ministry of Education qualifies for an industrial building allowance of 10% annually on the qualifying building expenditure.

Income Tax (Exemption) Order 2013

The Income Tax (Exemption) Order 2013 [P.U.(A) 3] gazetted on 2 January 2013 takes effect from YA 2013. The Order provides for 100% tax exemption on the statutory income derived from the business of operating a child care centre for a period of 5 consecutive years.

Income Tax (Industrial Building Allowance) (Child Care Centre) Rules 2013

The Income Tax (Industrial Building Allowance) (Child Care Centre) Rules 2013 [P.U.(A) 2] gazetted on 2 January 2013 takes effect from YA 2013. The Rules provide that a building constructed for or purchased by a child care centre operator for the child care business qualifies for an industrial building allowance of 10% annually on the qualifying building expenditure.

Income Tax (Accelerated Capital Allowance) (Security Control Equipment and Monitoring Equipment) Rules 2013

The Income Tax (Accelerated Capital Allowance) (Security Control Equipment and Monitoring Equipment) Rules 2013 [P.U.(A) 4] gazetted on 28 December 2012 takes effect from YA 2013 until YA 2015. The Rules provide for an initial allowance of 20% and an annual allowance of 80% of the capital expenditure incurred in the installation of the specified security control and monitoring equipment.

Income Tax (Exemption) (No. 2) Order 2013

The Income Tax (Exemption) (No. 2) Order 2013 [P.U.(A) 7] gazetted on 10 January 2013 provides for a 100% tax exemption from YA 2013 to YA 2015 on the statutory income derived from a "group inclusive tour" by a company resident in Malaysia and licensed under the Tourism Industry Act 1992.

Income Tax (Exemption) (No. 3) Order 2013

The Income Tax (Exemption) (No. 3) Order 2013 [P.U.(A) 13] gazetted on 18 January 2013 provides for a 100% income tax exemption on the statutory income derived from the operation of a kindergarten registered with the Ministry of Education Malaysia for a period of 5 consecutive years. The 5-year exemption period commences from YA 2013 for an existing kindergarten and for a new kindergarten, the period commences from the date the first invoice is issued.

Income Tax (Deduction for the Provision of Child Care Centre) Rules 2013

The Income Tax (Deduction for the Provision of Child Care Centre) Rules 2013 [P.U.(A) 15] gazetted on 18 January 2013 which takes effect from YA 2013, provide for a double deduction of expenses as listed in the Rules such as the provision and maintenance of the child care centre and child care allowance for staff incurred in operating a child care centre registered with the Department of Social Welfare under the Child Care Centre Act 1984.

Income Tax (Industrial Building Allowance) (Tun Razak Exchange Marquee Status Company) Rules 2013

The Income Tax (Industrial Building Allowance) (Tun Razak Exchange Marquee Status Company) Rules 2013 [P.U. (A) 27] gazetted on 31 January 2013 provide that a commercial building constructed or purchased by a Tun Razak Exchange Marquee status company in the Tun Razak Exchange for the purposes of a business as specified in the Schedule shall be treated as an" industrial building" and thus qualifies for industrial building allowance. The Rules will take effect from the YA 2014.

Income Tax (Exemption) (No. 4) Order 2013

The Income Tax (Exemption) (No. 4) Order 2013 [P.U. (A) 28] gazetted on 31 January 2013 provides for a 70% tax exemption on the statutory income derived by an approved developer for a period of 5 years from the disposal of a building or from the rental of a building constructed in the area referred to in the approved development plan for the Tun Razak Exchange. This Order takes effect from YA 2013.

Income Tax (Accelerated Capital Allowance) (Tun Razak Exchange Marquee Status Company) Rules 2013

The Income Tax (Accelerated Capital Allowance) (Tun Razak Exchange Marquee Status Company) Rules 2013 [P.U. (A) 29] gazetted on 31 January 2013 provide for an initial allowance of 20% and an annual allowance of 40% of the renovation costs as specified in the Schedule incurred by a Tun Razak Exchange Marquee status company for a building located in the Tun Razak Exchange. The Rules take effect from 1 January 2014 until 31 December 2020.

Income Tax (Deduction for Relocation Costs For Tun Razak Exchange Marquee Status Company) Rules 2013

The Income Tax (Deduction for Relocation Costs For Tun Razak Exchange Marquee Status Company) Rules 2013 [P.U. (A) 30] gazetted on 31 January 2013 provide that relocation costs as specified in the Schedule that are incurred by a Tun Razak Exchange Marquee status company to relocate the whole or part of the business to the Tun Razak Exchange shall be allowed a deduction provided the relocation takes place not later than 31 December 2020. The Rules take effect from YA 2014.

Income Tax (Deduction for Rental Payments) (Tun Razak Exchange Marquee Status Company) Rules 2013

The Income Tax (Deduction for Rental Payments) (Tun Razak Exchange Marquee Status Company) Rules 2013 [P.U. (A) 31] gazetted on 31 January 2013 provide for an additional deduction of half of the rental payments incurred by the Tun Razak Exchange Marquee status company for renting a commercial building for its business in the Tun Razak Exchange. The additional deduction takes effect from YA 2014 and is not available on rental payments after 31 December 2020.

Public Ruling No. 9/2012: Taxation of Real Estate Investment Trusts / Property Trust Funds

Public Ruling No. 9/2012 issued on 26 November 2012 provides a comprehensive explanation on the tax treatment of real estate investment trusts (REITs) and property trust funds (PTFs).

Public Ruling No. 10/2012: Tax treatment of Malaysian ship

Public Ruling No. 10/2012 issued on 13 December 2012 provides a comprehensive explanation on the tax treatment of the income of a resident person from the operation of a Malaysian ship prior to YA 2014.

Public Ruling No. 11/2012: Employee Share Scheme Benefit

Public Ruling No. 11/2012 issued on 13 December 2012 explains the tax treatment of a benefit arising from an employee share scheme. It replaces Public Ruling 4/2004 – Employee Share Option Scheme Benefit dated 9 December 2004.

Public Ruling No. 12/2012: Share Schemes Benefit for Cross Border Employees

Public Ruling No. 12/2012 issued on 24 December 2012 provides for the tax treatment of a benefit arising from an employee share scheme received by Malaysian employees who are seconded to work overseas and foreign employees who are seconded to work in Malaysia.

Deferment of the implementation of thin capitalisation

The Inland Revenue Board (IRB) announced that the implementation of the thin capitalisation provision introduced in the Income Tax Act 1967 (ITA) with effect from 1 January 2009 will be deferred until 31 December 2015.

Petroleum (Income Tax) (Deduction for Participation in an Approved Career Fair) Rules 2013

The Petroleum (Income Tax) (Deduction for Participation in an Approved Career Fair) Rules 2013 [P.U.(A) 14] gazetted on 18 January 2013 are effective from YA2012 until YA 2016. The Rules provide for a double deduction of prescribed expenses incurred in participating in career fairs abroad organised or endorsed by Talent Corporation Malaysia Berhad and approved by the Minister.

REAL PROPERTY GAINS TAX

Real Property Gains Tax (Exemption) Order 2012

The Real Property Gains Tax (Exemption) Order 2012 was gazetted on 26 November 2012 [P.U.(A) 415] and came into operation on 1 January 2013. The Exemption Order provides that with effect from 1 January 2013, the Real Property Gains Tax rate is increased from 10% to 15% for disposals made within a period of two years from the date of acquisition and increased from 5% to 10% for disposals made between the second and fifth year from the date of acquisition.

Real Property Gains Tax (Exemption) (No. 2) Order 2012

The Real Property Gains Tax (Exemption) (No. 2) Order 2012 [P.U.(A) 448] was gazetted on 18 December 2012 and took effect from 24 April 2012. The Order exempts the AIFL from all provisions of the Real Property Gains Tax Act 1976 in respect of disposals of chargeable assets after 24 April 2012.

STAMP DUTY

Stamp Duty (Remission) (No. 3) Order 2012

The Stamp Duty (Remission) (No. 3) Order 2012 [P.U.(A) 416] was gazetted on 26 November 2012 and extends for another two years the Stamp Duty (Remission) (No. 2) Order 2010 [P.U.(A) 423] that had expired on 31 December

2012. The Order remits 50% of the stamp duty chargeable on any loan agreement executed between a Malaysian citizen and a financier for the purchase of a residential property costing not more than RM400,000.

Stamp Duty (Remission) (No. 4) Order 2012

The Stamp Duty (Remission) (No. 4) Order 2012 [P.U.(A) 417] was gazetted on 26 November 2012 and extends for another two years the Stamp Duty (Remission) (No. 3) Order 2010 [P.U.(A) 475] that had expired on 31 December 2012. The Order remits 50% of the stamp duty chargeable on the instruments of transfer for a residential property not exceeding RM400,000 purchased by a Malaysian citizen.

Stamp Duty (Exemption) (No. 5) Order 2012

The Stamp Duty (Exemption) (No. 5) Order 2012 [P.U.(A) 449] was gazetted on 18 December 2012 and took effect from 24 April 2012. The Order exempts all instruments executed by the AIFL from stamp duty under the Stamp Act 1949.

Stamp Duty (Exemption) (Order) 2013

The Stamp Duty (Exemption) (Order) 2013 [P.U. (A) 32] gazetted on 31 January 2013 provides for an exemption of stamp duty chargeable under the First Schedule Item 22 of the Stamp Act 1949 on service agreements executed between a service provider and a Tun Razak Exchange Marquee status company. The exemption applies to instruments executed on or after 1 January 2014 but not later than 31 December 2022.

Stamp Duty (Exemption) (No. 2) Order 2013

The Stamp Duty (Exemption) (No. 2) Order 2013 [P.U. (A) 33] gazetted on 31 January 2013 provides for an exemption of stamp duty on any instrument of transfer for the purchase of commercial property by a Tun Razak Exchange Marquee status company, any loan agreement executed between a Tun Razak Exchange Marquee status company and a bank or financial institution to finance the purchase of a commercial property, and any lease agreement for the lease of a commercial property entered into by a Tun Razak Exchange Marquee status company. The Order applies to agreements executed on or after 31 January 2013 but not later than 31 December 2020.

LABUAN

Labuan Business Activity Tax Act (Exemption) Order 2012

The Labuan Business Activity Tax Act (Exemption) Order 2012 [P.U.(A) 450] was gazetted on 18 December 2012 and took effect from 24 April 2012. The Order exempts the AIFL from all provisions under the Labuan Business Activity Tax Act 1990.

Revised guidelines on establishing a LICTC under the GIFT programme

The Guidelines on the establishment of a Labuan International Commodity Trading Company (LICTC) under the Global Incentives for Trading (GIFT) programme dated 31 October 2011 were revised on 15 January 2013 and took effect from 1 January 2013. The revised guidelines extend the GIFT programme to other commodities such as agricultural products, refined new materials and chemicals, and that a LICTC set up purely as a liquefied natural gas trading company be granted a 100% income tax exemption on chargeable profits for the first three years of operation (provided the LICTC is licensed before 31 December 2014).

CUSTOMS AND EXCISE DUTIES

Customs (Prohibition of Exports) Order 2012 Customs Act 1967 [P.U. (A) 491/2012]

Effective from 1 March 2013, the Customs (Prohibition of Exports) Order 2012 came into operation and the Customs (Prohibition of Exports) Order 2008 [P.U. (A) 87/2008] is revoked.

Please see P.U. (A) 491/2012 for details.

Customs (Prohibition of Imports) Order 2012 Customs Act 1967 [P.U. (A) 490/2012]

Effective from 1 March 2013, the Customs (Prohibition of Imports) Order 2012 came into operation and the Customs (Prohibition of Imports) Order 2008 [P.U. (A) 86/2008] is revoked.

Please see P.U. (A) 490/2012 for details.

Customs Duties (Goods under the Free Trade Agreement Malaysia-Australia) Order 2012 Customs Act 1967 [P.U. (A) 487/2012]

The Customs Duties (Goods under the Free Trade Agreement Malaysia-Australia) Order 2012 came into operation on 1 January 2013. Under this Order, the importation of goods (as specified in the Second Schedule) originating from Australia 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) 487/2012 for details.

Customs (Provisional Anti-Dumping Duties) (No.2) Order 2012 Countervailing and Anti-Dumping Duties Act 1993 and Customs Act 1967 [P.U. (A) 456/2012]

Effective from 24 December 2012 to 22 April 2013, the importation of goods listed below from the exporters (as specified) from the following countries is subject to anti-dumping duties:-

No	HS Code/ (AHTN Code)	Description of goods	Country	Exporter/producer	Rate of duty (% of the export price)
	3920.20.200 (3920.20.10 00)	Biaxially oriented polypropylene (BOPP) film	Chinese Taipei	1) Others	20.42%
			Thailand	1) A.J. Plast Public Company Limited	Nil
				2) Thai Film Industries Public Company Limited	Nil
				3) Others	9.41%
			People's Republic of China	1) Guangzhou Shunlung Industrial Corporation	6.87%
				2) Zhejiang Kinlead Innovative Materials Co.Ltd	Nil
				3) Others	17.63%
			Republic of Indonesia	1) Others	12.55%
			Socialist Republic of Vietnam	1) Formosa Industries Corporation	10.41%
				2) Others	21.43%

Please see P.U. (A) 456/2012 for details.

Excise Duties Order 2012 Excise Act 1976 [P.U. (A) 350/2012]

Effective from 31 October 2012, the Excise Duties Order 2012 came into operation and the Excise Duties Order 2004 [P.U. (A) 5/2004] is revoked.

Please see P.U. (A) 350/2012 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.*

CASE 1

Port Dickson Power Berhad v Ketua Pengarah Hasil Dalam Negeri (Judicial Review Application No. R1-25-23-11)

FACTS

The taxpayer was an independent power producer licensed by the Malaysian government to exclusively supply electricity to Tenaga Nasional Berhad. The taxpayer was required to finance, design, construct, commission, own and operate a power plant and other relevant facilities in Port Dickson ("the Project"). The Project was among the first generation of independent power plants in Malaysia and there was thus an element of substantial risk on its viability.

The Project needed a sum in excess of RM600 million. The taxpayer appointed financial advisers to advise on the capital structure of the taxpayer and in procuring financing for the Project. Upon the recommendation of the financial advisers, the taxpayer raised funds for the Project by way of:

- equity amounting to RM300,000.00;
- shareholders' borrowings by way of loan stock amounting to RM149.7 million; and
- third party borrowings for the balance sum.

Besides raising some of the required financing, the loan stock also paved the way for the taxpayer to obtain third party borrowings as they served as collateral for the external financiers. The loan stock was subordinated, unconvertible, redeemable and unsecured against the third party borrowings so as to assure the external financiers that they will be paid first before the loan stockholders. Under the loan stock instrument, the taxpayer had an obligation to pay interest at the rate of 12% per annum to the subscribers of the loan stock and had the right to redeem the loan stock. Interest was incurred by the taxpayer in servicing the loan stock, which was deducted by the taxpayer under Section 33(1) of the Income Tax Act 1967 ("ITA") as expenses wholly and exclusively incurred in the production of its income.

The Revenue invoked Section 140(1) of the ITA and disallowed the interest on the loan stock paid by the taxpayer to its loan stockholders in the years of assessment 2004 and 2005. The Revenue contended that there was an issue of thin capitalisation and that the loan stock instrument was a scheme to avoid tax by incurring interest expenditure. The Revenue raised notices of additional assessment with penalty. The taxpayer challenged the Revenue's decision on the grounds that the decision was without any legal basis and thus, the additional assessments were illegal.

ISSUES

The main issues before the High Court were:

- Whether the Revenue lacked the jurisdiction to invoke Section 140(1) of the ITA; and
- Whether the Revenue had breached its mandatory statutory duty under Sections 140(1) and 140(5) of the ITA.

DECISION

According to the High Court, the crux of the taxpayer's case was concerned with the issue surrounding the proper, or rather improper invocation of Section 140(1) of the ITA by the Revenue. First, the notices of additional assessment issued by the Revenue were bad in law because they had not specified nor particularised which of the limbs under the subparagraph the Revenue had resorted to. Second, the Revenue had not shown its grounds for believing that it was necessary to invoke Section 140(1) of the ITA.

The High Court held that the ability of the Revenue to ascertain the grounds for entertaining the necessary belief would greatly assist the court in identifying the particular paragraph of Section 140(1) of the ITA under which the taxpayer had committed the impugned act of understating its assessments for the years 2004 and 2005.

The other ground noted by the High Court was that the Revenue had failed in its statutory duty to give particulars of adjustment concurrently with the notices of additional assessment. In this case, the particulars were only given to the taxpayer on 21 April 2011, which was well beyond and distinct from the service on the taxpayers of the impugned notices of additional assessment dated 30 December 2010. Relying on the decisions of the superior courts such as *DGIR v Hup Cheong Timber (Labis) Sdn Bhd [1985] CLJ (Rep) 107 and DGIR v Rakyat Berjaya Sdn Bhd [1984] 1 MLJ 248*, the High Court ruled that the failure to comply with the mandatory provision as contained under Section 140(5) of the ITA had rendered the decision of the Revenue null and void.

The High Court also found that the Revenue had misconceived or otherwise misconstrued the agreement that had become the basis upon which the taxpayer was required to pay the interest of 12% for the loan stocks. There was no suggestion that the loan stock agreement was a sham designated to facilitate the taxpayer in avoiding payment of tax to the Revenue. The High Court endorsed the following passage in *Westmoreland Investment Ltd v Macniven (Inspectors of Taxes) [2001] 1 All ER 865:*

"Money raised by borrowing belongs to the borrower; it is as much his money as any other money of his. Expenditure is incurred by the taxpayer whatever the source of his finance with which he intends to meet it."

The High Court observed that the mere reason the taxpayer in Westmoreland Investment Ltd had to borrow in order to pay for the interest that accrued did not mean that the payment of interest was not genuine. According to the High Court, the financiers were local companies of good repute and there was nothing in the evidence of the Revenue to suggest otherwise. If the whole financial structure and the obligation of the taxpayer to service the interest were indeed a sham, then the burden or the onus ostensibly rests with the Revenue to prove that it was so. In the absence of any such proof put forth by the Revenue to the effect that the interest payments were not what the taxpayer had made them out to be, then the High Court is not entitled to disregard their legal effect and treat them as something else.

The High Court added that the law was so clear that a taxpayer is entitled to mitigate his incidence of tax as long as he does not, in so doing, evade or avoid having to pay the necessary tax. Cases are replete in that regard in that it is never the province of either the Revenue or even the courts to tell people how to conduct their business. The law is settled too in that there is no room for an official or public body to commit an error of law. If it does so, it exceeds its jurisdiction and its purported act becomes *ultra vires*.

In these circumstance, the High Court granted an order of certiorari to quash the impugned notices of additional assessment and declared that the taxpayer was entitled to deduct the interest expenditure arising from the issuance of loan stock under Section 33(1)(a) of the ITA.

CASE 2

O Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax (Appeal Nos. PKCP (R) 46 & 92/2010)

FACTS

The taxpayer was in the business of manufacturing and selling pre-cast concrete products. The taxpayer had five factories in Malaysia, which were located in Batu Gajah, Senai, Nilai, Kuantan and Sungai Petani. The mixer trucks and batching plant were located in the taxpayer's factory but was operated by a subsidiary company which supplied the labour. The taxpayer paid the subsidiary company a fee for the services.

The taxpayer claimed capital allowance on the capital expenditure incurred on the mixer trucks and batching plant. The taxpayer also claimed reinvestment allowance on the capital expenditure incurred by the taxpayer on the Disputed Items (as defined below).

Subsequent to a field audit, the Revenue disallowed the capital allowance claims on the mixer trucks and batching plant on the basis that the taxpayer did not operate or use the mixer trucks and batching plant on their own, and also disallowed the reinvestment allowance claims made by the taxpayer on the Disputed Items.

ISSUES

The main issues before the Special Commissioners of Income Tax ("SCIT") were as follows:

- Whether the following items claimed by the taxpayer qualify for reinvestment allowance:

Factory:
- Fencing
- Maintenance parts storage area
- Office
- Bridge
- Road
- "Pile shoe" fabrication yard

Plant and machinery:
- Mixer trucks
- Batching plant
- Cranes
- Tipper lorries
- Compressor

- Weigh bridge *(collectively referred to "Disputed Items")*

- Whether the mixer trucks and batching plant claimed by the taxpayer qualify for capital allowance.

DECISION

The crux of the appeal was whether the Revenue was correct in law to disallow the capital allowance claims for the mixer trucks and batching plant and the reinvestment allowance claims in relation to Disputed Items.

a. Capital allowance

In order to claim capital allowance, the taxpayer must satisfy the following conditions:

- Capital expenditure is incurred on the provision of machinery and plant used for the purposes of a business (see paragraph 2 of Schedule 3 of the ITA); and
- The taxpayer is the owner of the machinery or plant at the end of the basis period and the machinery or plant is still in use for the purposes of business (see paragraph 15 of Schedule 3 of the ITA).

In this case, there was no dispute that the mixer trucks and batching plant were plant and machinery. The SCIT found as a fact that the taxpayer had indeed incurred capital expenditure on the mixer trucks and batching plant, that the taxpayer was the owner of the mixer trucks and batching plant at the material time, and that they were used for the purposes of the taxpayer's manufacturing business. The Revenue had disallowed the capital allowance claim purely on the basis that the mixer trucks and batching plant were not physically operated by the taxpayer itself, but operated by a subsidiary. In deciding in favour of the taxpayer, the SCIT found as follows:

- The Revenue failed to note that the subsidiary was merely a labour contractor for which consideration was paid for its labour. This was done by the taxpayer for better management of its business;
- The Revenue also failed to take into account that the use of the taxpayer's mixer trucks and batching plant in its factories by the subsidiary was for the preparation of ready mix concrete for the taxpayer;
- The subsidiary's labour was at all material times under the taxpayer's instruction and supervision;
- The products were made in accordance with the taxpayer's specification.

The SCIT held that the law only requires the mixer trucks and batching plant to be used for the taxpayer's business. There is no legal requirement for the taxpayer to physically operate the mixer trucks and batching plant. In arriving to this conclusion, the SCIT relied on the Supreme Court decision in *National Land Finance Cooperative Society Ltd v Director General of Inland Revenue [1993] 4 CLJ 339:*

"…In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used…"

b. Reinvestment allowance

On the issue of reinvestment allowance, in deciding in favour of the taxpayer, the SCIT relied on the High Court decision of *Ketua Pengarah Hasil Dalam Negeri v Success Electronics & Transformers Manufacturer Sdn Bhd (Rayuan Sivil No. R1-14-14-09)*, where it was held that reinvestment allowance cannot be restricted to "production area" alone. In Success Electronics, the High Court held that the meeting room, office spaces, toilets, staircases, void area, lift lobby, *surau*, warehouse, lightning adjustment and installations of air conditioning, electrical fitting and partition walls were part of the factory. Applying the ratio in Success Electronics, it was held that as the word "factory" was not defined for the purposes of reinvestment allowance, the ordinary and usual meaning of "factory" is to be applied. In this regard, the SCIT found that the Revenue was wrong to have imposed the condition of "production area" and further held that the Revenue's internal ruling imposing such condition had no legal effect.

In relying on the case of *Director General of Inland Revenue v C. Company of Malaysia Bhd [1980] 10 MTJ 64,* the SCIT considered the "entirety test". It was found that the Disputed Items were part of the entirety of the factory, which formed part of an integral part of the taxpayer's factory and had a role to perform in ensuring that the factory functions as a manufacturing hub. Without the Disputed Items, the factory would not be able to function adequately in undertaking the manufacturing activity.

In considering the House of Lords decision in the case of *Inland Revenue Commissioners v Scottish & Newcastle Breweries Ltd [1982] 2 All ER 230*, the SCIT also considered the "functional test" and held that the Disputed Items were integrated and connected with the taxpayer's factory and manufacturing activity. The Disputed Items enabled the taxpayer to implement the expansion and modernisation of its manufacturing activity.

***Siti Fatimah Mohd Shahrom** is an up and coming tax lawyer with Lee Hishammuddin Allen & Gledhill. She can be contacted at sfs@lh-ag.com*

The column only covers selected developments from countries identified by CTIM and relates to the period 16 November 2012 to 15 February 2013.

CHINA (PEOPLE'S REP.)

Views on transfer pricing issues

During the Eighth Session of the UN Committee of Experts on International Cooperation in Tax Matters held from 15-19 October 2012 in Geneva, the issue of a practical transfer pricing (TP) manual for developing countries was discussed. Below is a summary of some of the matters raised by China:

- The lack of reliable comparables due to the limited number of public companies and limited information. Unadjusted foreign comparables are rarely applicable to developing countries.
- Where there is a lack of adequate local comparables, the transitional net margin method (with proper adjustments) is commonly used in arriving at the arm's length price. However, a different method such as profit split may be more appropriate for certain businesses such as the electronic manufacturing services sector. Considering the assets (the workforce and factories) in China, a risk-based approach may not be appropriate to tackle TP issues.
- A key area of concern is "Location specific advantages" (i.e. location savings and market premium). Examples mentioned include the automobile industry and contract R&D services.
- Foreign companies involved in contract manufacturing and contract research services usually have the comparative advantage of cheap labour, natural resources, local talent, etc. Thus, in allocating profits, a holistic view of risk and function is advocated by China.

Further, China raised the problem of lack of experience and knowledge on operations of multinationals. China currently has more than 200 officials dealing with TP issues and intends to increase this number to 500 in the coming years. A reinforced TP team, a specialist panel reviewing substantial cases, a centralised approval system and a national information system will ensure that Chinese TP investigations operate properly.

As a solution for dealing with TP issues specific to developing countries, China recommends the expansion of the statute of limitations for TP cases and clear rules on contemporaneous documentation and penalties, etc.

All relevant documents of this meeting may be available on the UN website.

New tax treatment of dividends derived by individuals from listed companies published

On 16 November 2012, the Ministry of Finance (MoF), the State Administration of Taxation (SAT) and the Security Supervision Committee, introduced a new tax treatment of dividends derived by individuals from the companies listed on Shanghai or Shenzhen Stock Exchanges. Cai Shui [2012] No. 85 is effective from 1 January 2013 and is summarised below:-

Under the Circular, for the purposes of individual income tax, dividends distributed by listed companies will be taxed depending on the holding period of the underlying shares:

- Shares held for more than one year - Effective tax rate of 5% *(25% of the dividends will be taxable at the standard rate of 20%)*
- Shares held between one month and one year - Effective tax rate of 10% *(50% of the dividends will be taxable at the standard rate of 20%).*
- Shares held less than one month - No reduction *(Dividends taxed at 100% at the standard rate of 20%.)*

Listed companies are required to withhold the tax at the effective rate of 5% upon dividend distribution. The remaining outstanding tax will be withheld at the time of disposal by the security company trading the shares on behalf of the individual.

INDIA

CBDT issues circular relating to profits derived from export of computer software

The Indian Central Board of Direct Taxes issued Circular No. 1/2013 dated 17 January 2013 clarifying issues relating to the export of computer software [Note: the Indian Income Tax

Act 1961 (ITA) provides tax benefits to eligible units set up in India on profits derived from export of computer software under Sections 10A, 10AA and 10B]. The Circular is summarised below:

- Software developed on-site at a client's place abroad would be eligible for tax benefits provided there is a direct and intimate nexus between the unit in India and on-site development at client's place.
- Income from deputation of employees for development of software abroad would also be eligible for tax benefits if the above stated nexus is developed and to an otherwise eligible unit in case of a transfer of such unit or undertaking (aka "slump sale"), subject to fulfilment of prescribed conditions.
- Maintenance of a separate book of accounts for eligible units is not mandatory provided the required details regarding the claim and the quantum of exemption, pertaining to the eligible units, is available for the tax authorities to verify.

The Circular further states that other issues concerning development centres and safe harbour provisions relating to IT sector is under consideration and will be discussed subsequently.

all the prescribed conditions are fulfilled.

- A separate Master Service Agreement is not required for each statement of work. However, the tax benefit would be denied if it is established that there has been splitting up or reconstruction of an existing business or non-fulfilment of any other prescribed condition.
- Research and development activities pertaining to software development would be covered under the definition of "computer software".
- Tax benefit will not be denied

Expert Committee issues final report on GAAR – details

Following the Expert Committee (the Committee) on General Anti-Avoidance Rules (GAAR)'s final report to the Indian Government on 30 September 2012, the following main decisions have been taken by the Indian Government:

- The provisions on GAAR will come into force from the financial year of 1 April 2016.
- An arrangement, the main purpose of which is to obtain a tax benefit (and not "one of the main purpose" as previously stated), would be considered as an impermissible avoidance arrangement.
- GAAR will apply when the tax benefit exceeds USD0.5 million (INR30 million) in a year.
- Where a part of the arrangement is an impermissible avoidance arrangement, it will be ensured that GAAR will be restricted to that part which is impermissible.
- GAAR will not apply to Foreign Institutional Investors (FIIs) that choose not to take any tax treaty benefit. GAAR will also not apply to non-resident investors in FIIs.
- While determining whether an arrangement is an impermissible avoidance arrangement, it will be ensured that the same income is not taxed twice in the hands of the same taxpayer in the same year or in different assessment years.
- Where GAAR and SAAR are both in force, only one of them will apply to a given case, and guidelines will be made regarding the applicability of one or the other.
- The tax auditor will be required to report any tax avoidance arrangement.
- The tax authorities will be required to issue a show cause notice, containing reasons, to the assessee before invoking the provisions of GAAR.
- Time limits will be provided for action by the various authorities under GAAR.
- The Approving Panel (AP) shall consist of a Chairperson who is or has been a Judge of a High Court; one Member of the Indian Revenue Service not below the rank of Chief Commissioner of Income tax; and one Member who shall be an academic or scholar having special knowledge of matters such as direct taxes, business accounts and

international trade practices.

- The AP may have regard to the (a) period or time for which the arrangement had existed; (b) the fact of payment of taxes by the assessee; and (c) the fact that an exit route was provided by the arrangement. Such factors may be relevant but not sufficient to determine whether the arrangement is an impermissible avoidance arrangement.
- The directions issued by the AP shall be binding on the Taxpayer as well as the tax authorities. Currently it is only binding on the tax authorities.

INDONESIA

Tax authority's strategy for 2013

The Directorate General of Taxes (DGT) has announced its plans to achieve increased revenue target in 2013. It plans to issue new regulations for thin capitalisation, based on article 18(1) of the Income Tax Law. The ratio is expected to be 1:3 and there could be different ratios for different business sectors.

There will be more focus on the tax compliance of income tax and VAT. One of the strategies is to improve the collection of tax information. Several business sectors will be prioritised, including mining and plantation, in which tax information in regards to income tax will be improved. DGT plans to re-run another national tax census in 2013 that was already run in the previous years to draw in more taxpayers.

For VAT, re-registration of taxable persons, which was conducted in 2012, will be continued by the new numbering system of VAT invoice, which will be effective in April 2013, pursuant to DGT Regulation No. PER-24/PJ/2012 dated 22 November 2012. The new numbering system will be controlled by DGT as a means to improve VAT compliance.

The government is finalising its plan to impose 1% of final income tax from the gross revenue for small and medium-sized enterprises whose income is below IDR4.8 billion.

SINGAPORE

Stamp duty changes – details

The Inland Revenue Authority of Singapore (IRAS) issued two e-tax Guides on 11 January 2013, detailing further changes which apply to the existing Additional Buyer's Stamp Duty (ABSD) and introducing a Seller's Stamp Duty (SSD) on Industrial Properties.

From 12 January 2013, the ABSD on the acquisition of residential property changed as follows:

- rate for foreigners and entities buying residential property is increased from 10% to 15%;
- 5% ABSD applies to Singapore permanent residents (SPR) upon the acquisition of their first residential property;
- rate for SPR buying their second and subsequent residential property is increased to 10%;
- 7% ABSD applies to Singapore citizens buying their second residential property; and
- rate for Singapore citizens buying their third and subsequent residential property is increased to 10%.

The existing Buyer's stamp duty continues to be payable by all property buyers.

In addition, a SSD will be imposed on industrial properties which are bought or acquired on and after 12 January 2013 and sold or disposed of within three years. The existing SSD on residential properties remains unchanged. Where the Date of Purchase/Acquisition or Date of Change of Zoning / Use is on or after 12 January 2013, the SSD on industrial properties will be as follows:

HOLDING PERIOD	SSD PAYABLE
Up to 1 year	15% of consideration or market value, whichever is higher
1 to 2 years	10% of consideration or market value, whichever is higher
2 to 3 years	5% of consideration or market value, whichever is higher
More than 3 years	Nil

Further details can be found on the IRAS website.

Rights-based approach for software payments – e-Tax Guide issued

IRAS issued an e-Tax Guide (the Guide) on the software payments on 8 February 2013. The Guide reiterates the rights-based approach, which draws a distinction between the transfer of a "copyright right" and the transfer of a "copyrighted article" from the owner to the payer, with effect from 28 February 2013. With this, the withholding tax exemptions under Section 13(4) of the ITA for certain payments for software and rights to use information are abolished.

The Guide clarifies the following:

- A transaction involves a copyright right if the payer is allowed to commercially exploit (as defined in the Guide) the copyright.
- A copyrighted article is transferred if the rights are limited to those necessary to enable the payer to operate the software or use the information or digitised goods for personal consumption or for use within his business operations. Such payments are not treated as royalty and hence are not subject to withholding tax when made to non-residents. However, where the payments constitute income derived from a trade or profession of the non-resident in Singapore, or is effectively connected with a permanent establishment of that person in Singapore, he will be required to file an income tax return to declare the income which is subject to tax in Singapore.
- Where a payer obtains multiple rights, the primary purpose of the payment will be examined to determine if a payment is for the right to use a copyrighted article or a copyright right.
- Payment for the transfer of partial rights in a copyright is treated as a royalty, which is subject to withholding tax if made to a non-resident.
- Payment for the complete alienation of the transferor's copyright right in the software, information or digitised goods is treated as business income or capital gains, which is not subject to withholding tax.

The full Guide can be found at the IRAS website.

High Court decision on Singapore's general anti-avoidance rule

Further to the decision of the Income Tax Board of Review (ITBR) in the case of *AQQ v. The Comptroller of Income Tax ([2011] SGITBR1)*, the High Court decision has become available.

The main issues before the High Court were whether the ITBR had applied the correct approach in applying Section 33 of the Income Tax Act (ITA) (the general anti-avoidance rule (GAAR)), and whether the financing arrangement was covered by the GAAR.

In line with the decision and grounds of the ITBR, the High Court found that Singapore's GAAR did apply to the financing arrangement and that the financing arrangement involved in the business restructuring was not carried out for bona fide commercial reasons, but had, as one of its main purposes, the avoidance of tax. However, the Judge disagreed with the approach taken by the ITBR in arriving at this conclusion, specifically on the approach taken to apply the respective subsections of Section 33. The ITBR's ultimate conclusion however, in that Section 33 is applicable to the financing arrangement, was upheld by the High Court.

The Judge went on to hold that the scope of the application of Section 33 allowed the Comptroller to disregard only the interest expense arising from the tax-abusive financing arrangement. Furthermore, the portion of interest expense that should be disallowed is that which relates to the absence of an actual borrowing transaction. Interest expenses incurred in respect of real loans, which existed in substance, should have been allowed as a deductible expense.

Proceeds of tax evasion to be criminalised – MAS Consultation

The Monetary Authority of Singapore (MAS) issued a consultation paper on the designation of tax crimes as money laundering predicate offences in Singapore. The consultation period begun on 9 October 2012 and closed on 9 December 2012.

Under this initiative, a broad range of serious tax crimes will be designated as money laundering predicate offences from 1 July 2013. With the designation, financial institutions must apply all the Anti-Money Laundering/Countering the Financing of Terrorism measures, to prevent the laundering of proceeds from serious tax crimes.

This involves the conduct of rigorous customer due diligence and transactions monitoring, as well as, proper reporting of suspicious transactions. Financial institutions must adequately identify and assess tax-related risks and take action to appropriately manage and mitigate those risks.

VIETNAM

Foreign contractor tax (FCT) – clarifications

The General Department of Tax recently issued clarifications on FCT as follows:

PURCHASE OF SOFTWARE

Official letter (OL) 3738/TCT-CS dated 26 October 2012 provides that where a piece of equipment, with software (and the right to use that software), is purchased from a foreign supplier, the purchase of that software will be subject to FCT at 10% (CIT only). The value of the software and the right to use must be identifiable and the payment must qualify as a royalty for the transfer of technology or intellectual property.

LOAN INTEREST

Pursuant to OL 3929/TCT-CS dated 8 November 2012, loan interest which is incurred before 1 March 2012 (i.e. based on the loan contract) is subject to the deemed CIT rate of 10% even if payment is made after 1 March 2012. Therefore, loan interest arising after 1 March 2012 will be subject to deemed CIT at 5%.

RE-INSURANCE

OL 3998/TCT-CS dated 12 November 2012 states that the applicable deemed CIT rates for payments in respect of reinsurance contracts depend on when the payments are incurred and not paid. Thus payments incurred up to 29 February 2012 are subject to a deemed CIT rate of 2%, whereas a deemed CIT rate of 0.1% will apply to payments incurred from 1 March 2012.

BUSINESS LICENCE TAX

OL 3639/TCT-KK dated 17 October 2012 clarifies that foreign contractors who do not have a presence in Vietnam (as per the Law on Investment and the Law on Commerce), despite generating income in Vietnam, are not required to pay business licence tax.

Conversion of Corporate Income Tax ("CIT") incentives

From 1 January 2012, companies were no longer entitled to enjoy incentives based on the export criteria, as a result of Vietnam's WTO commitments. Thus, the MoF has issued Circular No. 199/2012/TT-BTC ("Circular 199") on 15 November 2012, on the alternative CIT incentives available to these affected companies. Circular No. 199 supplements the earlier issued Decree 122/2011 and applies from the 2012 tax year. In general, the principle remains the same, i.e. that the affected companies can select alternative CIT incentives and may apply them for the remaining period based on either: (i) the regulations effective during the period from the enterprise's incorporation until the end of the 2006 tax year; or (ii) the regulations effective at 1 January 2012.

Circular No. 199 also provides guidance on the conversion of CIT incentives in some special cases and also provides a number of specific examples.

In order to enjoy an alternative incentive, an enterprise must notify the local tax authority of the alternative CIT incentives (via the prescribed form) by the submission deadline for the 2012 final CIT return. Where an enterprise has already declared/notified alternative CIT incentive which is not in line with Circular No. 199, it is allowed to make an adjustment and submit a revised notification to the local tax authority.

MALAYSIA

On 26 December 2012, the India - Malaysia Income Tax Treaty (2012) entered into force.

Rachel Saw is a Senior Research Associate at the International Bureau of Fiscal Documentation (IBFD). The International News reports have been sourced from the IBFD's Tax News Service. For further details, kindly contact the IBFD at ibfdasia@ibfd.org

TAX REFORMS CONTINUE WORLDWIDE DESPITE ECONOMIC TURMOIL, ELECTRONIC FILING INCREASING ESPECIALLY

A NEW REPORT FROM THE WORLD BANK, IFC, AND PwC FINDS THAT GOVERNMENTS CONTINUE TO REFORM THEIR TAX SYSTEMS DESPITE GLOBAL ECONOMIC UNCERTAINTY, WITH 31 ECONOMIES HAVING TAKEN STEPS FROM JUNE 2011 THROUGH MAY 2012 TO MAKE IT EASIER AND COST LESS FOR SMALL AND MEDIUM BUSINESSES TO PAY TAXES.

The Paying Taxes 2013 study looks at tax regimes in 185 economies and finds that the most common tax reform is the introduction or improvement of online systems for tax compliance, which occurred in 16 economies.

"Electronic filing and payment reduces paperwork and complexity in tax systems and can help increase tax compliance and reduce the cost of tax administration," said Augusto Lopez Claros, Director, Global Indicators and Analysis, World Bank Group. "The report finds that over the last several years there has been a gradual reduction in the number of payments and in the number of hours spent by a medium-sized company to comply with its tax obligations. This reduction across all regions of the world in the burden of tax administration is a welcome development."

ELECTRONIC FILING AND PAYMENT REDUCES PAPERWORK AND COMPLEXITY IN TAX SYSTEMS AND CAN HELP INCREASE TAX COMPLIANCE AND REDUCE THE COST OF TAX ADMINISTRATION."

Augusto Lopez Claros, Director, Global Indicators and Analysis, World Bank Group.

The report finds that on average a medium company pays a Total Tax Rate of 44.7 per cent of profits, making 27.2 payments, and spending 267 hours to comply with its tax requirements. In the eight years since the study began, the time to comply has fallen by 54 hours, almost seven working days, and the number of payments has declined by more than six, while the Total Tax Rate has fallen nearly 1 per cent for each year.

"We are seeing tension between the need for governments to raise tax revenue and at the same time provide a system that encourages economic activity and growth," said Andrew Packman, a tax partner at PwC UK. "Governments seeking to create a more business-friendly tax climate need to focus not only on rates, but also on minimising the time and effort needed to comply."

An economic analysis undertaken by PwC senior economic adviser Andrew Sentence and featured in the report shows that in economies where action was taken to reduce complexity in tax administration – both in terms of the number of payments and the time taken to deal with tax matters – there has tended to be higher economic growth.

Reforms continue around the world. However, the report finds that the number of economies reforming has fallen from 35 in 2011 to 31 in the most recent study. The focus continues to be on reducing the administrative burden of the tax system. In 2011, the time to comply fell by an 8-hour day and the number of payments dropped by almost two, while the Total Tax Rate fell by only 0.3 per cent.

Paying Taxes 2013 measures all mandatory taxes and contributions that a medium-sized firm must pay in a given year. Taxes and contributions measured include the profit or corporate income tax, social contributions and labour taxes paid by the employer, property taxes, property transfer taxes, dividend tax, capital gains tax, financial transactions tax, waste collection taxes, vehicle and road taxes, and other small taxes or fees.

OTHER BUSINESS DEDUCTIONS

Siva Subramanian Nair • continuation from vol.6/no.1

We continue with our discussion on the deductibility of business expense where the Income Tax Act 1967 does not contain an express provision relating to such expense. This article will focus on foreign exchange losses. This is a complement of the tax treatment of foreign exchange gains which was discussed in the Learning Curve of the *Tax Nasional* [Vol. 15/2006/Q1].

In ascertaining the deductibility of such losses, the first task is to determine whether the transaction entailing this loss is a capital or revenue transaction. Examples of capital transactions include purchase of fixed assets and settlement of loan whereas that of revenue transactions is settlement of loan interest, purchase of stocks, and payment of technical fees. In terms of tax treatment, foreign exchange losses in respect of capital transactions DO NOT rank for a deduction.

These are of course dependant on the nature of the business. In the case of a bank or finance company, money is regarded as their stock-in-trade and any loans taken from overseas for the purpose of on-lending to customers is regarded as revenue in nature and accordingly any foreign exchange loss arising will rank for a deduction. However, banks and finance companies also borrow funds to supplement their own share capital, in which case it will be capital in nature and a similar classification will be endowed on any foreign exchange losses arising.

However, for revenue transactions, a further distinction has to be made as to whether they are realised or unrealised. Realised means the debt has been settled or payment has been effected whereas unrealised means the liability to pay is still outstanding i.e. the loss is a mere recognition for accounting purposes for example, conversion at year-end to facilitate the preparation of final accounts.

This is summarised in the table below.

DEDUCTIBILITY OF FOREIGN EXCHANGE LOSSES	CAPITAL	REVENUE
Realised	Not deductible	Deductible
Unrealised	Not deductible	Deductible

The same principle applies to hedging or forward contracts; where the underlying transaction is trade in nature than its revenue otherwise it is capital. Similarly, with speculations or long-term investments; generally they will be classified as capital and accordingly any foreign exchange loss will not be allowable as a deduction but the situations changes in the case of a person involved in the business of speculation or companies where their business necessitates the placement of funds in very short-term investments because the urgent need for cash can arise at any time. Banks for instance, need high liquid investments as a line of defence against heavy withdrawals or if there is a run on the bank! In these cases it would be a revenue transaction.

In the case of intercompany dealings (involving cross border transactions) trade debts will be regarded as a revenue item and foreign exchange loss will be allowable. However, where the debt remains unpaid after the ordinary credit period in respect of such trading activities or worse, if its converted into an interest-bearing loan then any exchange difference arising from the subsequent settlement of the loan will now be regarded as a capital loss and in consequence lose its eligibility to rank for a deduction.`

It is not always easy to determine whether the loss is revenue or capital as is clearly demonstrated in the case of *Beauchamp v F.W. Woolworth plc. (1989) STC 51* detailed as follows:

FACTS OF THE CASE

The taxpayer company took a loan of 50 million Swiss francs. This was converted into sterling and used in the Woolworth's business but on repayment several years later there was a loss of 11,000,000 sterling due purely to a fall in the value of sterling. The company sought to deduct this loss in its trading accounts.

DECISION OF THE COURTS

The Special Commissioners

Allowed the claim on the grounds that the loans represented a temporary facility to overcome cash flow problems rather than a permanent addition to capital.

The High Court

Disallowed the claim on grounds that the relevant factor was not the purpose of the loan but rather the terms of the loan i.e. it was for a fixed term of five years and obviously constituted an addition to the company's capital.

The Court of Appeal

In reversing the decision of the High Court, they placed more emphasis on the purpose of the loan rather than its form.

The House of Lords

Held that the exchange losses were on a capital account and therefore, not deductible.

Depreciation in the value of the currency but this does not arise due

to an exchange loss but because it has a remote relation to the business activity of the company, qualifies to be included in the company's financial statement. This definitely does not rank for a deduction as illustrated in the following case.

L. Sdn. Bhd. v Comptroller General of Inland Revenue (1973) 1, MLJ 57.

FACTS OF THE CASE

A company incorporated in Sabah was involved in the business of dealing in land. It remitted part of the proceeds of its sales to banks in England where it was held in deposit and current accounts. Consequent to a sterling devaluation exercise, the balance in the company's bank accounts depreciated by an amount of Malaysian dollars (now Ringgit Malaysia) 595,840 and this was reflected in the income statement for the year-ended 31/5/1968 as "Loss on Sterling Devaluation".

DECISION OF THE COURT

The learned judge at the Federal Court, Ali F.J. in rejecting the claim for a deduction remarked that in this case "*…it is difficult to conceive how the taxpayer can be said to have suffered any loss on the exchange as there was no foreign debt which had to be paid*".

We shall now look at how this topic is tested in examinations.

Sometimes the question is posed in a very simple manner as in the case of CTIM December 2007 Tax II Question 1 where a manufacturing company incurred a realised foreign exchange loss on the purchase of machinery of RM2,800.

SOLUTION

The amount is added back to the profit before tax since it relates to the acquisition of a fixed asset which is capital in nature.

Some questions provide a net effect in the income statement but the details show both a realised gain and a loss on foreign exchange as illustrated in CTIM December 2011 Tax II Question 1 where a company

involved in a manufacturing business had the following foreign exchange transactions:

- gain realised on purchase of raw material from Korea of RM45,000 and
- a loss realised on settlement of purchase price for factory equipment of RM30,000

SOLUTION

Candidates were required to indicate Nil in the minus column in respect of the gain on raw material since it was realised and revenue in nature and add back the loss on factory equipment because it relates to a capital transaction.

This approach was also used in CTIM December 2006 Tax II Question 1 where the income statement showed a loss on foreign exchange (net) of RM14,000 detailed as follows:

		ADDED BACK AMOUNT *(CLAIMED)*
	RM	RM
Realised loss on foreign exchange – purchase of tools	12,000	12,000 *(Capital)*
Unrealised loss on foreign exchange – trade debts payables	7,500	7,500 *(unrealised)*
Realised gain on foreign exchange – purchase of raw materials	(3,000)	Nil *(realised & revenue)*
Unrealised gain on foreign exchange – trade debts payables	(2,500)	(2,500) *(unrealised)*
	14,000	17,000

Another avenue of questioning was provided in CTIM December 2005 Tax II Question 1 which in addition to providing a detailed analysis of the "Foreign exchange loss of RM28,000" also indicated in the following under "Other information" :

Prior year unrealised foreign exchange loss on the purchase of trading stocks now realised of RM8,600.

SOLUTION

Therefore, in addition to addressing the adjustment for the details on the foreign exchange loss of RM28,000, candidates were required to adjust for the RM8,600.

As the amount was unrealised in the previous year, it would not have been deductible and would have been added back in that year's tax computation, but now it is realised and being revenue in nature, ranks for a deduction.

However, since the amount is not in the income statement, it should be deducted in the current tax computation.

Yet another path pursued by Examiners is to provide details of a foreign exchange loss in respect of a fixed asset in the income statement and then provide details of the cost of that fixed asset under other information, requesting the candidate to compute the qualifying expenditure in respect of that asset and in consequence compute the capital allowances for that year. In this case, candidates should add back the foreign exchange loss since it is capital in nature **BUT** remember that it qualifies to be part of the qualifying expenditure and accordingly should be added to the purchase price.

For example in CTIM December 2011 Tax II Question 1 shown above, where there was a loss realised on settlement of purchase price for factory equipment of RM30,000 and the purchase price of the factory equipment was say, RM120,000, the qualifying expenditure will be RM150,000.

This concludes our discussion on the deductibility of foreign exchange losses.

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

FURTHER READING

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

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: April 2013 – June 2013

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
APRIL 2013								
Workshop: Minimising Withholding Tax Exposure & Maximising the Benefits of Double Taxation Agreements in Cross Border Transactions	2 Apr	9a.m. - 5p.m.	Penang	Sivaram Nagappan	335	385	435	8 WS / 029
Workshop: Tax Saving Opportunities for Exporters; Exemptions and Double Deductions	4 Apr	9a.m. - 5p.m.	Kuala Lumpur	Richard & Thenesh	175 *(after 50% training subsidy)*	400	460	8 WS / 027
Workshop: Insights to Malaysia's First Transfer Pricing Litigation: MM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri	5 Apr	9a.m. - 5p.m.	Ipoh	Saravana Kumar & Siti Fatimah	335	385	435	8 WS / 044
Workshop: Insights to Malaysia's First Transfer Pricing Litigation: MM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri	8 Apr	9a.m. - 5p.m.	Johor Bahru	Saravana Kumar & Siti Fatimah	335	385	435	8 WS / 043
Transfer Pricing: Intangibles and Intra-Group Financing	8 - 10 Apr	9a.m. - 5p.m.	Kuala Lumpur	IBFD	1,680 *(after 50% training subsidy)*	-	-	24 JV / 006
Workshop: Minimising Withholding Tax Exposure & Maximising the Benefits of Double Taxation Agreements in Cross Border Transactions	9 Apr	9a.m. - 5p.m.	Kota Kinabalu	Sivaram Nagappan	335	385	435	8 WS / 030
Workshop: Insights to Malaysia's First Transfer Pricing Litigation: MM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri	10 Apr	9a.m. - 5p.m.	Penang	Saravana Kumar & Siti Fatimah	335	385	435	8 WS / 045
Workshop: Withholding Tax; the Basic and the Advanced	11 Apr	9a.m. - 5p.m.	Kuala Lumpur	Richard & Thenesh	175 *(after 50% training subsidy)*	400	460	8 WS / 028
Workshop: Insights to Malaysia's First Transfer Pricing Litigation: MM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri	15 Apr	9a.m. - 5p.m.	Kuala Lumpur	Saravana Kumar & Siti Fatimah	350	400	460	8 WS / 046
Workshop: Minimising Withholding Tax Exposure & Maximising the Benefits of Double Taxation Agreements in Cross Border Transactions	16 Apr	9a.m. - 5p.m.	Kuching	Sivaram Nagappan	335	385	435	8 WS / 031
IRB-CTIM Roadshow 2013	16 Apr	9a.m. - 1p.m.	Johor Bahru	Various Speakers	250	300	350	4 RS / 002
IRB-CTIM Roadshow 2013	17 Apr	9a.m. - 1p.m.	Penang	Various Speakers	250	300	350	4 RS / 003
Seminar: Tax Appeal Procedures and Related Matters	18 Apr	9a.m. - 5p.m.	Kuala Lumpur	SC & CAT	Early Bird 400 Normal 450	Early Bird 450 Normal 500	Early Bird 500 Normal 570	8 SE / 002
Workshop: Tax Planning for Individuals	23 Apr	9a.m. - 5p.m.	CTIM Training Room	Vincent Josef	250	350	400	8 WS / 050
IRB-CTIM Roadshow 2013	24 Apr	9a.m. - 1p.m.	Kota Kinabalu	Various Speakers	250	300	350	4 RS / 004
IRB-CTIM Roadshow 2013	25 Apr	9a.m. - 1p.m.	Kuching	Various Speakers	250	300	350	4 RS / 005
Seminar: Anti-Avoidance Half-Day Seminar	29 Apr	9a.m. - 1p.m.	Kuala Lumpur	SM Thanneermalai & Vijey M Krishnan	125 *(after 50% training subsidy)*	300	350	4 SE / 001

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: April 2013 – June 2013

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
APRIL 2013								
Budget Seminar (re-run)	30 Apr	9a.m. - 5p.m.	CTIM Training Room	TBA	-	-	-	-

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
MAY 2013								
Workshop: Minimising Withholding Tax Exposure & Maximising the Benefits of Double Taxation Agreements in Cross Border Transactions	3 May	9a.m. - 5p.m.	Kuala Lumpur	Sivaram Nagappan	350	400	460	8 WS / 032
Workshop: Insights to Malaysia's First Transfer Pricing Litigation: MM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri	3 May	9a.m. - 5p.m.	Melaka	Saravana Kumar & Siti Fatimah	335	385	435	8 WS / 047
Workshop: Minimising Withholding Tax Exposure & Maximising the Benefits of Double Taxation Agreements in Cross Border Transactions	7 May	9a.m. - 5p.m.	Johor Bahru	Sivaram Nagappan	335	385	435	8 WS / 033
Workshop: Common Tax Issues Facing the SMEs	9 May	9a.m. - 5p.m.	Kuala Lumpur	Farah Rosley	350	400	460	8 WS / 052
Workshop: Minimising Withholding Tax Exposure & Maximising the Benefits of Double Taxation Agreements in Cross Border Transactions	14 May	9a.m. - 5p.m.	Ipoh	Sivaram Nagappan	335	385	435	8 WS / 034
Workshop: Minimising Withholding Tax Exposure & Maximising the Benefits of Double Taxation Agreements in Cross Border Transactions	16 May	9a.m. - 5p.m.	Melaka	Sivaram Nagappan	335	385	435	8 WS / 035
Workshop: Insights to Malaysia's First Transfer Pricing Litigation: MM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri	27 May	9a.m. - 5p.m.	Kota Kinabalu	Saravana Kumar & Siti Fatimah	335	385	435	8 WS / 048
Practical Aspects of International Tax Planning	27 - 31 May	9a.m. - 5p.m.	Kuala Lumpur	IBFD	2,400 *(after 50% training subsidy)*	-	-	40 JV / 007
Workshop: Insights to Malaysia's First Transfer Pricing Litigation: MM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri	29 May	9a.m. - 5p.m.	Kuching	Saravana Kumar & Siti Fatimah	335	385	435	8 WS / 049
Public Holiday ***(Labour Day : 1 May 2013, Wesak Day: 24 May 2013)***								
JUNE 2013								
NATIONAL TAX CONFERENCE 2013	**24 - 25 June**	**9a.m. - 5p.m.**	**Kuala Lumpur**	**Various Speakers**	**Early Bird 1,200 Normal 1,400**	**Early Bird 1,300 Normal 1,500**	**Early Bird 1,400 Normal 1,600**	**25**

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 three days notice will be given.

ENQUIRIES : Please call Fadeah, Yus, Jason, Ally or Nur at 03-2162 8989 ext 113, 121, 108, 123 and 106 respectively or refer to CTIM's website ***www.ctim.org.my*** for more information on the CPD events.