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NATIONAL GST CONFERENCE 2015

GST: A Catalyst Towards a Developed Nation

GST ACT 2014 ON BAD DEBT RELIEF

KEBABS, SOURCE AND TAX

MAKING A CASE FOR TAX RELIEF FOR SIBLING CAREGIVERS IN MALAYSIA

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

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contents

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VOL.8/NO.2/2015/Q2
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INVITATION TO WRITE

The Institute welcomes original contributions which are of interest to tax professionals, lawyers, academicians and students. They may cover local or international tax developments. Article contributions should be written in UK English. All articles should be between 2,500 to 3,500 words submitted in a typed single spaced format using font size 10 in Microsoft Word via email.

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

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ARULJOTHI KANAGARETNAM

WORKING CLOSELY WITH THE TAX AUTHORITIES

The Institute has been working closely with the tax authorities these past few months and I am pleased to report to you on the significant events which have taken place as set-out below.

NATIONAL GST CONFERENCE 2015

The Institute collaborated with the Royal Malaysian Customs Department (RMCD) to organise its first National GST Conference (NGC) 2015 at the Sime Darby Convention Centre in Kuala Lumpur on 20 January 2015. Approximately 900 participants attended this event and the venue was filled to overflowing. The Institute would like to thank the RMCD, participants, moderators, speakers and all those involved for their support and contribution in making this event a major success.

The theme of the NGC 2015 was *GST: A Catalyst Towards a Developed Nation*. The speakers included the head of the RMCD's GST division, the head of the Ministry of Domestic Trade, Co-operatives and Consumerism's (MDTCC) Anti-Profiteering Unit, the head of the Real Estate and Housing Developers' Association Malaysia (REHDA) GST taskforce and GST subject matter experts. They presented their views and insights on practical issues prior to the GST implementation on 1 April 2015 as well as post GST implementation issues from 1 April 2015. The finale of the NGC 2015 was a roundtable discussion moderated by our immediate past CTIM President with the RMCD Director-General and the Chief Executive Officer of the Inland Revenue Board of Malaysia (LHDNM) as the panellists. More details on this event can be found in the subsequent pages of this issue of *Tax Guardian*.

In recognition of the importance of GST, the Institute together with the RMCD will be organising the NGC 2016 as a 2-day event in January 2016. Details of this upcoming event will be provided later.

POST 2015 BUDGET DIALOGUE AND RECENT TECHNICAL DEVELOPMENTS

The Institute together with other professional bodies attended a dialogue hosted by the LHDNM to discuss the joint institutes' memorandum on issues arising from the 2015 Budget and 2014 Finance Bill (No. 2) on 4 February 2015. The Institute also took the opportunity to seek clarification from the LHDNM on the gazette orders issued in December 2014 in relation to the deduction for secretarial and tax filing fees and costs relating to training employees for GST implementation. The minutes of the dialogue will be circulated to members when it is made available by the LHDNM.

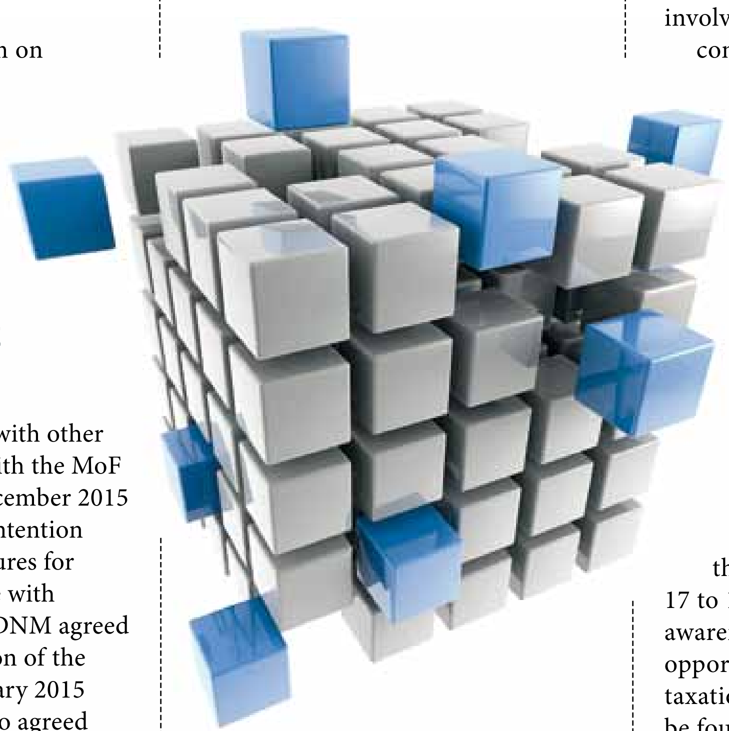
As previously mentioned, the Institute has raised the members' issue with the LHDNM that any person who has qualified for a deduction of statutory audit fees cannot claim the accelerated capital allowance (ACA) on information and communication technology (ICT) for the relevant year of assessment (YA) based on the wording of the gazette order [P.U. (A) 217/2014] issued in July 2014. The LHDNM has indicated that the gazette order is in the process of being amended. The LHDNM also confirmed that pending the issuance of the relevant amendments to the gazette order, a person who qualifies for a deduction of statutory audit fees (but not any other incentives on the asset) can claim the ACA in the same YA as long as the Rules listed in the P.U. (A) 217/2014 have been complied. Members were recently updated on this development via our e-circular.

The Institute recently submitted a memorandum on income tax issues arising from the implementation of GST to the Ministry of Finance (MoF) for their consideration. Members were informed of this submission via e-circular.

RECENT PUBLIC PRACTICE DEVELOPMENT

The Institute together with other professional bodies met with the MoF and the LHDNM on 2 December 2015 to discuss the LHDNM's intention to implement new procedures for tax practitioners to engage with LHDNM officers. The LHDNM agreed to defer the implementation of the new procedure to 1 February 2015 onwards. The LHDNM also agreed that correspondences to the LHDNM could be signed by authorised signatories who are not approved tax agents under Section153 of the Income Tax Act 1967 (ITA) provided their particulars were submitted to the LHDNM by 31 January 2015. Furthermore, Section153 approved tax agents are required to issue a letter (in the format given by the LHDNM) to authorise their staff to engage with LHDNM officers on their behalf. The letter of authorisation must be produced to the LHDNM officers for such engagements. The Institute will work closely with the LHDNM to address ongoing issues which affect tax practitioners as a whole.

The Committee to Strengthen the Accountancy Profession (CSAP) issued a report on strengthening the accountancy profession in Malaysia and invited the public to provide feedback on it. The Institute has submitted its feedback to the CSAP in January 2015 and is requesting for a meeting with the CSAP to discuss its views.



CPD EVENTS

Future GST courses as well as the 6-day GST seminars have been planned for the next few months of 2015. The schedule of courses can be found in our *Tax Guardian* and on our website. Members will also be informed of upcoming courses via our e-Circulars.

The Institute also worked closely with the LHDNM to organise the LHDNM-CTIM Tax Forum 2015 in several major cities throughout Malaysia in March 2015. This year's tax forums focused on *Withholding Tax Procedures & Issues, Correcting the Business Code and Stock Withdrawal under Section 24(2)* of the ITA. Members were notified on the dates and venues for the tax forums via brochures and e-Circulars.

The second CTIM Members' Technical Dialogue for the year 2014/2015 was held on 13 March 2015 at the Renaissance Hotel, Kuala Lumpur. The dialogue was focused mainly on GST issues to cater for members who were involved in preparing for GST which commences on 1 April 2015. The panellists who responded to the members' issues were from the CTIM Technical Committees as well as a senior RMCD officer who was invited by the Institute for this event. Numerous issues were received from members and the event was attended by more than 100 members.

EDUCATION

For the first time, the Institute participated in the Star Education Fair from 17 to 18 January 2015 to increase awareness among the public on the opportunities available in the field of taxation. An article on this event can be found in the subsequent pages of this issue of *Tax Guardian.*

MEMBERSHIP

These past few months have seen more applications for CTIM *membership*. I am pleased to inform you that the current CTIM membership is in excess of 3,260 members.

The Institute continues to grow because of the strong support from its members. The CTIM Council and I wish to express our heartfelt thanks to our members. Together, we will continue to raise the standard for tax practitioners in this country.

Editor's Note

K. SANDRA SEGARAN

GST : HERE IT IS!

Perhaps the most awaited date, 1 April 2015, that marks the tax calendar of every taxpayer no matter the preference, is here as GST is rolled out in full measure in Malaysia. Several years of speculation and preparation preceded this important tax development as Malaysia for known reasons implement a system that replaces the sales and service tax regime with a more efficient multi-staged domestic consumption tax.

With the rapid change in the pace of legislative developments, cooperation and collaboration with the Revenue authorities is the order of the day. Notable examples are the jointly organised and well received inaugural National GST Conference 2015 with the Royal Malaysian Customs Department (RMCD), held at the Sime Darby Convention Centre in Kuala Lumpur on 20 January 2015; LHDNM- CTIM Tax Forum held in and outside Kuala Lumpur; GST Training modules with the RMCD collaboration; Tax Licence issues; Memorandum on Income Tax Issues arising from GST; consultation on IRB's draft public rulings and technical dialogues.

The authorities seem to have revisited representation and authorisation issues relating to the Tax Licence and appeared to have tightened rules in relation to dealing with the IRBM. CTIM has also sought clarifications with continuous engagement with the authorities and dissemination of developments through the widely read e-CTIM.

CTIM's technical team has summarised the proceedings at the NGC which should proof useful for members, especially those from outstation who were not able to attend. While complexities and uncertainties of unravelling new legislation caught the attention of many, the international experience shared by overseas speakers are invaluable not only for the authorities but practitioners and taxpayers alike.

In this issue, Kenneth Yong and Lee Fook Koon examine provisions relating to bad debt claims under the GST provisions. A comparison is made to the Income Tax legislation where

differing thresholds apply. The authors also highlight the differences in the legislation and caution a uniform approach to claims of bad debts. For purposes of GST the modalities are substantially different in view of the input tax credit mechanism. It is to be noted that in the case of supplies, the tax fraction of the unpaid amount is entitled for input tax credit, assuming the customer did not fully settle the invoice within six months from the time of supply (or he has become insolvent before that) and sufficient efforts were made to recover the debt. The tax fractions of subsequent receipts are accounted for as output tax whenever such payments are received. The article also analyses what 'sufficient efforts' mean in line with the legislation and guides and decisions issued by RMCD.

Legal costs to contest protracted tax disputes with the IRBM is a double jeopardy after being hit with additional taxes and penalties for incorrect returns under the self-assessment system. Realising this, the IRBM has introduced a new mechanism to expedite disputes and seek avenues for a quick resolution within the framework of the existing law. In this issue, IRBM contributes an article by Abu Tariq Jamaluddin who has years of experience handling tax disputes at the Special Commissioners of Income Tax and the Courts. The article entitled "Resolution is the Solution" highlights this new department in IRBM which has been entrusted to resolve tax appeals. The idea itself is a brainchild of the CEO and DGIR of LHDN, YBhg Kolonel (K) Tan Sri Datuk Wira Dr. Hj. Mohd Shukor Hj. Mahfar. Central to this mechanism is to ease taxpayers' burden in terms of legal costs and time taken to resolve tax appeals. This mechanism is used for appeals arising from an audit or an investigation. IRBM branches will not review the appeals but forward the same to the Dispute Resolution Department at Cyberjaya. Cases are selected to go through an Appeal Review Panel (ARP) or a Proceeding. The Proceeding enables the taxpayer to present his case with evidence in an informal manner and he may be represented by a tax practitioner or a lawyer if he so wishes. If there is no reasonable prospect of arriving at a settlement or resolution, the appeal will be forwarded to the SCIT for litigation.

The popular topic on Source of income is once again featured with more case precedents in Malaysia. Dr. Nakha Ratnam, our regular contributor examines the Kyros case in the light of other local and foreign precedents.

Mr. Siva Subramanian Nair and Dr. Susela Devi have contributed an article based on a Phd thesis in relation to Tax Relief for Sibling Caregivers of disabled family members. In addition to their study, they have drawn parallels with two neigbouring countries to argue a case for tax relief for sibling caregivers. Their advocation of relief is premised on the fact that the siblings are assisting the government's welfare role and for equitable reasons, they ought to be relieved. Insights from this study reinforce the role of the government (which they argue had delegated the caregiving role to the families), to inculcate accountability in society. The government is indebted to sibling caregivers for their role and has a responsibility to assist them in every way possible. An avenue for discharging this responsibility was seen in the tax system through the offering of tax relief, rebates, incentives and other forms of assistance.

Venkataraman Ganesan shares some insights in the area of Transfer Pricing Development relating to Location Savings which typically arises from MNEs taking advantage and shifting operations to lower tax jurisdictions with a view to availing potential competitive advantages, arising as a result of price differences in the factors of production. This article provides a brief overview related to the dynamics of Location Savings, its progression and impact. Three case precedents involving Sundstrand, Compaq and Baush & Lomb involving USA MNEs outsourcing manufacturing operations in Singapore and Ireland, both low tax jurisdictions show how the pricing mechanism used were not rejected by the USA courts. The writer also shares developments in Asia particularly China and India which have expressed strong views on Location Savings Advantages.

In addition this issue feature the regular columns on local and international technical and case updates, Learning Curve and CTIM news.

CPD EVENTS

A series of events were conducted in the 1st quarter 2015 as follows:

- Half-day Seminar on Transfer Pricing Documentation.
- GST Implication on Employer and Employee Benefits.
- GST for Property Developers - How it Effects Your Business.

The workshop on 'GST Implication on Employer and Employee Benefits was conducted by Zen Chow on 8 January 2015 in Kuala Lumpur. The speaker discussed the overview of GST and the implications that will benefit both the employer and employee.

On 11 February 2015, Fennie Lim conducted a workshop on 'GST for Property Developers - How it Effects Your Business' at CTIM's training room. The workshop covered two key factors as follows:

- Early preparation and planning to identify impact of GST on business activities and how to implement it.
- Allocating sufficient resources to implement GST structure and system.

Mr. SM Thanneermalai conducted a half-day seminar on Transfer Pricing Documentation in Kuching (26 January 2015) and Kuala Lumpur (9 February 2015). The seminar covered the practical issues faced in preparing contemporaneous transfer pricing documentation.

NTC 2014 CHEQUE PRESENTATION

The National Tax Conference 2014 cheque presentation was held on Wednesday, 4 March 2015 at the Menara Hasil, Cyberjaya.

Mr. Aruljothi Kanagaretnam, President of CTIM presented a mock cheque to the Chief Executive Officer of LHDNM, YBhg Kolonel (K) Tan Sri Datuk Wira Dr. Hj. Mohd Shukor Hj. Mahfar in the presence of the Co-Organising Chairman of the NTC 2014 i.e Tuan Haji Adzhar Sulaiman of LHDNM and Ms. Yeo Eng Ping of CTIM. Prior to the presentation, a meeting to discuss the NTC 2015 scheduled from 25 to 26 August 2015 at the Kuala Lumpur Convention Centre was held at the same venue.

DECEMBER 2014 EXAMINATIONS - NEW SYLLABUS

The new syllabus for the CTIM examinations was implemented for the first time in the December 2014 examinations. The syllabus and examination structure was revamped to two levels i.e. intermediate and final levels. The number of subjects offered was reduced from 10 to 8 papers. Students who successfully complete the intermediate level examinations will be awarded the CTIM ***Tax Technician Certificate*** that will enable them to be recognised as qualified tax technicians by potential employers.

STAR EDUCATION FAIR

CTIM participated for the first time in the Star Education Fair organised by the Education Committee held from 17 to 18 January 2015 at KLCC with the aim of bringing awareness of CTIM and the various advantages of having an added qualification in tax to SPM, STPM students, parents and the general public. The Institute maintained a booth that was manned by all Education Committee Members, Secretariat staff and 10 seconded staff of Council and Education Committee Member Ms. Goh Lee Hwa. Approximately 1,000 interested visitors stopped by the booth over the two day event.

CAREER TALKS

A career talk was presented by Council and Education Committee Member, Datuk Harjit Singh at the Sentral College Penang in the last quarter of 2014 to approximately 200 students. He was assisted by Dr. Paul Ang and Ms. Kellee Khoo from CTIM Northern Branch who were also interactively involved with the students during the question and answer session. The Northern Branch was instrumental in organising the Career Talk.

The Education Committee led by its Chairman and Council Member, Mr. Lew Nee Fook visited the Faculty of Accountancy at UiTM Arau, Perlis on 2 March 2015 and presented a Career Talk and a presentation on GST to the Faculty students.

NATIONAL GST CONFERENCE 2015

CTIM Technical Team

The National GST Conference (NGC) 2015 was held at the Sime Darby Convention Centre on 20 January 2015 and was jointly organised by the Chartered Tax Institute of Malaysia (CTIM) and the Royal Malaysian Customs Department (RMCD). This year's theme was – "GST: A Catalyst Towards a Developed Nation", and the sessions covered the practical issues on implementation of GST (prior to 1 April 2015 and post 1 April 2015), the Price Control and Anti-Profiteering Act (PCAPA) and a special roundtable discussion on current issues affecting taxpayers.

SESSION 1: PRACTICAL ISSUES ON IMPLEMENTATION OF GST (PRIOR TO 1 APRIL 2015)

Session 1 was moderated by MA Sivanesan (Deputy Under-Secretary, Tax Division (Indirect Tax & GST), Ministry of Finance Malaysia). The speakers and panellists were YBhg Dato' Subromaniam Tholasy (RMCD Director, the Head of the GST Division of the RMCD), Chris Jenkins (Executive Director, GST, BDO Tax Services Sdn Bhd) and YBhg Dato' Ng Seing Liong (Chairman of GST Task Force, Real Estate and Housing Developers Association Malaysia (REHDA)).

GST IMPLEMENTATION BY THE RMCD

Dato' Subromaniam Tholasy explained that the RMCD had been increasing public awareness on GST and helping the public prepare for GST. GST hand holding programmes had been conducted for more than 40,000 members of the public free of charge. The RMCD's GST portal, *http://gst.customs.gov.my* provided public access to more than 70 GST guides and answers to frequently asked issues (now known as DG's decisions) which covers more than 20 issues and topics. Thousands of queries had been received from the public daily and participants were urged to check the available information first.

The RMCD's GST portal also provides an online facility for businesses to register for GST. There were approximately 50,000 businesses which had not registered for GST. These businesses were urged to register by the RMCD's extended deadline of 28 February 2015 or else

face a fine of at least RM15,000.

He also outlined the steps taken by the RMCD to ensure that GST was implemented effectively including the completion of seven major standard operating procedures and the development of a blueprint to tackle GST fraud.

GST IMPLEMENTATION FROM THE BUSINESS PERSPECTIVE

Chris Jenkins made comparisons with the Australian GST. The RMCD had pumped out more GST information to the public and taken an industry based approach to educate the public on GST. Malaysian businesses tended to be more reliant on GST advisors and the RMCD.

He also highlighted practical issues / barriers to proper GST implementation by businesses. Applying the GST Act for the services industry was expected to be more challenging as it was more readily applicable for the manufacturing industry. There was also a general failure of businesses to take responsibility for managing the GST implementation project which led to improper configuration of the business processes to GST requirements. Other barriers included gambling that GST will go away, implementing GST at the last minute and the lack of prioritisation of GST issues.

PRACTICAL ISSUES ON IMPLEMENTATION OF GST IN THE PROPERTY INDUSTRY

YBhg Dato' Ng Seing Liong highlighted the various GST issues identified by the REHDA GST Task Force which would impact the property industry. The imposition of GST was expected to increase house prices by about 2.6% as the GST incurred would be passed on to consumers. REHDA had proposed for housing priced up to RM500,000 to be accorded the GST zero rating. *(Sivanesan clarified that this proposal was not accepted by the authorities.)*

REHDA had also proposed that the maintenance fees charged by the Joint Management Body and the Management Corporation to the property purchasers be zero-rated instead of standard-rated. *(Sivanesan confirmed that the authorities had decided to exempt the maintenance fees from GST instead of zero-rating it.)*

Other REHDA proposals to the authorities included imposing stamp duty on the sales consideration of real properties exclusive of GST, allowing developers to fix the method of allocation of residual GST input tax credits for mixed developments, etc.

SESSION 2: PRACTICAL ISSUES ON IMPLEMENTATION OF GST (POST 1 APRIL 2015) AND PCAPA

Session 2 was moderated by YBhg Datuk Aziyah Bahauddin (Director, Public Finance, Performance Management & Delivery Unit (PEMANDU)). The speakers and panellists were Koh Soo How (Tax Partner, GST, PricewaterhouseCoopers Services LLP, Singapore), Ng Sue Lynn (Tax Partner, GST, KPMG Tax Services Sdn Bhd) and Guna Selan Marian (Senior Assistant Principal Director, Head of the Anti-Profiteering Unit, Enforcement Division, Ministry of Domestic Trade, Co-Operatives and Consumerism (MDTCC)).

LOOKING BEYOND 1 APRIL 2015

Koh Soo How observed that the Malaysian journey to a GST had

taken 10 years and is part of the global shift from direct tax to indirect tax. Businesses needed to know and manage their GST risks. There were several GST risks such as technical risks in accounting for output and input GST, financial accounting system risks, human risks, legislative risks and business risks. Businesses should be prepared with tools to manage and identify GST risks on a timely basis. Technology tools should be in place to analyse and compare the GST related data with the industry norm, reconcile variances and generate exception reports on duplications and disallowed expenses etc. Businesses needed to transition to an environment where internal controls for GST were integrated with real time monitoring by management. The biggest risk was not recognising that there is a GST risk.

PRACTICAL ISSUES ON IMPLEMENTATION OF GST (POST 1 APRIL 2015)

Ng Sue Lynn stressed that businesses needed to update decisions taken during their GST implementation project and consider GST treatment of new products from now to 1 April 2015.

On 1 April 2015, systems need to be running smoothly to charge GST appropriately and to generate GST compliant tax invoices. Data should be backed up to 31 March 2015 and transitional issues need to be addressed.

Post 1 April 2015, businesses need to monitor the continuous improvement of processes and systems for GST compliance, address GST issues identified during the GST implementation project, etc. Common mistakes in completing the GST return also need to be identified. Businesses are encouraged to have checklists on activities which need to be monitored and to identify the persons responsible for those activities.

Datuk Aziyah urged businesses to have proper systems in place to comply with GST.

PCAPA 2011 WITHIN THE REGIME OF GST

Guna Selan Marian explained that the MDTCC's responsibilities were to formulate and issue guidelines on pricing, monitor prices and enforce action through rules and regulations. The success of GST depends on the enforcement of the anti-profiteering legislation.

The PCAPA 2011 (Amendment) 2014 empowers the Minister to determine the mechanism to counter unreasonably high profiteering. It also prohibits businesses from incorporating recoverable GST or refundable sales tax in the pricing of goods and services.

The PCAP (Mechanism to determine Unreasonably High Profit) (Net Profit Margin) Regulations 2014 specified the mechanism and formulae to determine unreasonably high profits as a result of GST on the premise that there should not be any increment in the net profit margin of any goods or services in the three months period prior to 1 April 2015 compared to the 15-month period from 1 April 2015 with the net profit margin as at 1 January 2015 acting as a benchmark. Businesses should not take the opportunity to increase profit margin on their goods or services as a result of GST.

He also highlighted the MDTCC's focus in profiteering evaluation and several possible implementation issues.

WELCOMING SPEECH BY ARULJOTHI KANAGARETNAM, CTIM PRESIDENT

CTIM President Aruljothi Kanagaretnam welcomed the distinguished guests and participants to the NGC 2015. Aruljothi observed that it was the close cooperation between CTIM and RMCD that had resulted in this first NGC. He thanked all those present for their support in making the NGC 2015 happen. He also thanked the participants and the guest of honour for their presence at this event.

OPENING ADDRESS BY YBHG DATO' SRI KHAZALI HAJI AHMAD, DG OF RMCD

YBhg Dato' Sri Khazali Haji Ahmad said that collaborations between the RMCD and CTIM had been going on since 2011 but it was the first time ever that they had collaborated on a GST conference. The NGC was the best platform to obtain information relating to GST. He encouraged participants to make the most of the conference to ask questions.

KEYNOTE ADDRESS BY GUEST OF HONOUR Y.B. DATO' SERI HAJI AHMAD HUSNI MOHAMAD HANADZLAH, FINANCE MINISTER II

Guest of Honour Y.B. Dato' Seri Haji Ahmad Husni Mohamad Hanadzlah (Finance Minister II) thanked the participants for their efforts to raise the tax revenue. Based on comparisons with VAT/GST implemented in other countries, he was confident that GST could be implemented successfully.

SESSION 3: ROUNDTABLE DISCUSSION ON CURRENT ISSUES AFFECTING TAXPAYERS

Session 3 was moderated by SM Thanneermalai (Co-organising Chairman, Chairman of the CTIM Indirect Tax Committee, CTIM Council Member and Immediate Past-President). The panellists were YBhg Dato' Sri Khazali Hj. Ahmad (DG of RMCD) and YBhg Kolonel (K) Tan Sri Datuk Wira Dr. Hj. Mohd Shukor Hj. Mahfar (Chief Executive Officer (CEO) of Lembaga Hasil Dalam Negeri Malaysia (LHDNM)).

Responding to Thanneermalai's opening question, Dato' Sri Khazali shared that the PM's announcement in the morning had included an increase in the RMCD's tax revenue collection target for 2015 to RM45 billion compared to RM35.2 billion in 2014. Tan Sri Datuk Wira Dr. Mohd Shukor chipped in that the PM had requested him to do something about the tax revenue collections as 2015 was going to be a tough year on government revenues.

Businesses wanted to know when they could get answers to their GST issues. Thanneermalai asked what the RMCD's plan on this matter was. Dato' Sri Khazali revealed that a committee of senior RMCD officers would go through all the queries received. All answers would be published as the DG's decisions. Thanneermalai suggested that the private sector subject matter experts could be involved in the panel or there could be more panels to increase the number of questions answered. He also suggested that clear criteria be given on the 104 provisions in the GST Act which were under the DG's powers so that businesses only need to revert to the DG on exceptional cases. The RMCD would retain the right to audit the businesses. Dato' Sri Khazali agreed that these suggestions were worth considering.

Other matters raised by Thanneermalai for discussion during the session included the LHDNM's strategy to keep the tax revenue collection going in 2015, the recent re-organisation of LHDNM departments, the RMCD and the LHDNM's plans to work together, sales tax refund and how CTIM could work together with the RMCD and the LHDNM to raise the level of compliance and minimise disputes.

(Note: The NGC 2016 will be held on 19 – 20 January 2016.)

GST ACT 2014
ON BAD DEBT RELIEF

Kenneth Yong Voon Ken and Lee Fook Koon

Bad debts are hardly new to businesses. Taxation-wise, bad debts bring with them a set of rules on Income Tax deduction for bad debt relief, rules which have mostly been in place for decades.

In Malaysia, the Goods and Services Tax Act 2014 (the "GST Act") is applied to supply transactions using the "invoice basis" (accrual approach), which by extension, also opens up the possibility of bad debt relief claims for GST purposes.

It should therefore be unsurprising, even natural, for us to 'import' some of our familiarity with bad debt relief under Income Tax rules as a short cut towards understanding GST bad debt relief claims.

While the GST Act, Goods and Services Tax Regulations 2014 ("GST Regulations") and GST Guides prescribe a framework to claim bad debt relief for GST purposes, a Panel Decision issued by the Royal Malaysian Customs Department (RMCD) in late 2014 provided further insights into the actual claim mechanism.

This article describes the GST bad debt relief mechanism in light of the Panel Decision, focusing on the words "sufficient efforts" which is one of the criteria for eligibility of bad debt relief.

GST ACT 2014 ON BAD DEBT RELIEF

Where collection from credit customers are not forthcoming, Section 58(1) (a) and (b) of the GST Act prescribes the following:

> "… any person … may make a claim to the Director-General for a relief for bad debt on the whole or any part of the tax paid by him in respect of the taxable supply if -
>
> (a) the person has not received any payment or part of the payment in respect of the taxable supply from the debtor six months from the date of supply or the debtor has become insolvent before the period of six months has elapsed; and
>
> (b) sufficient efforts have been made by him to recover the debt."

GST REGULATIONS ON PROOF NEEDED

Regulation 73(1)(d) of the GST Regulations further clarifies that a claimant of bad debt relief must hold "records or any other documents showing that sufficient efforts have been made by him to recover the debt."

However, the GST Act and the GST Regulations do not define what constitutes documents showing sufficient efforts.

For this, we turn to the GST Guide on "Tax Invoice and Record Keeping" (version 20-7-2014) for further insights. Para 59 of the Guide states:

"… the taxable person is required to keep additional records to support bad debt relief claims such as:

…

…

(d) records or any other documents showing that sufficient efforts have been taken by the registered person to recover the debt. Sufficient efforts may include:

(i) letters of demand or reminder from company; or

(ii) letter from company's solicitor or legal action taken against the debtor if any; or

(iii) engagement and actions from credit agency if any; or

(iv) bad debt has been written off in the company's account and etc.

It is not compulsory to fulfil all the conditions above. However, merely sending letter of demand to debtors may not be treated as sufficient efforts to recover the debt. Thus, Customs may not qualify the taxable person for bad debt relief."

SUMMARY OF PANEL DECISION

A GST Panel Decision 2014 was issued by the RMCD in October 2014, where the issue of Bad Debt Relief was discussed. In furtherance to this, all references made to "Panel Decision" are specifically targeted at Item 3 of the said Panel Decision 2014, of which the key highlights are:

i) A taxable person may claim bad debt relief subject to the requirements and conditions set forth under Section 58 of the GSTA 2014 …

*ii) The bad debt relief **must be claimed immediately after the expiry of sixth months** from the date of supply.*

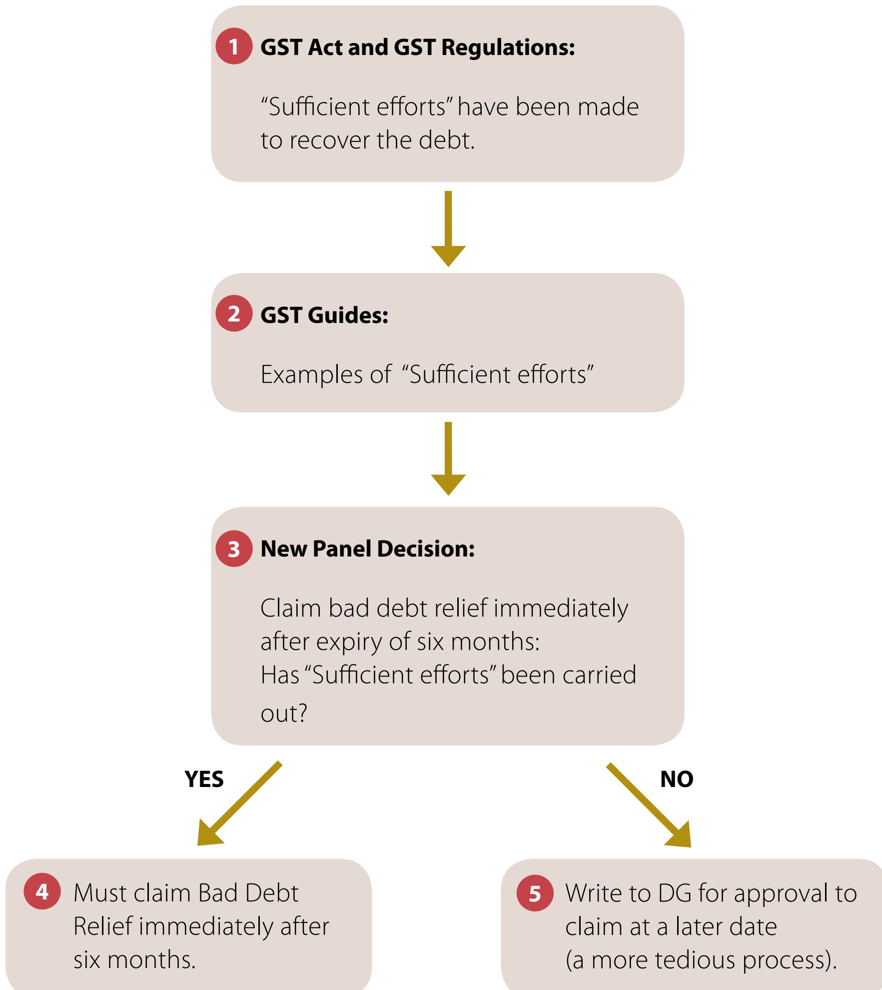
*iii) If the bad debt relief is **not claimed** immediately after the expiry of sixth month, than the taxable person **must apply in writing for the Director-General's (DG) approval** on his intention to claim at such a later date.."*

(Note: emphasis has been added, but wording is reproduced exactly from the said Panel Decision.)

MECHANISM OF CLAIM

As a result of the Panel Decision, the claim mechanism for bad debt relief is now as follows (see **Figure 1**):

Figure 1 Bad Debt Relief



GST Bad Debt Relief claims hinges on "Sufficient Efforts"

(1) The GST Act and GST Regulations require a company to have documentation to prove "sufficient efforts" have been made to recover a debt.

(2) The GST Guide on Tax Invoice and Record Keeping (version 20-7-2014) provides a few examples for "sufficient efforts", one of which is taking legal action against the debtor.

(3) Given that the new six months window under the Panel Decision is a short time frame, "sufficient efforts" must be carried out in the context of a six months time frame.

(4) If "sufficient efforts" are performed, bad debt relief must be claimed immediately upon expiry of six months.

(5) If "sufficient efforts" cannot be performed, then GST-registered businesses follow the more tedious path of writing-in to the RMCD for approval to claim at a later date (presumably when "sufficient efforts" have been carried out).

Following the above, the phrase "sufficient efforts" takes on a new level of significance.

"SUFFICIENT EFFORTS" IN THE GST ACT, GST REGULATIONS AND GST GUIDE

It must be stressed that the GST Act and GST Regulations merely state that companies must hold "records or any other documents showing that sufficient efforts have been made by them to recover the debt".

The GST Act and GST Regulations are silent on exactly what documents are required. Thus, it is for each company to determine what it assesses as the necessary document to prove "sufficient efforts" based on its unique situation and business circumstances.

The GST Guide on 'Tax Invoice and Record Keeping' provides examples of what the RMCD may regard as suitable records for "sufficient efforts".

However, certain items – eg. take legal action – may be onerous and impractical for companies to apply, especially given the very narrow window of six months. Therefore, GST Guides should not be read prescriptively.

DIFFICULTIES WITH THE GST GUIDE

Firstly, the GST Guide on "Tax Invoice and Record Keeping" (version 20-7-2014) itself is not legally authoritative. Guides merely provide insights as to the RMCD's interpretation of the law, but the guides are NOT themselves law. Thus, in applying GST law, we should be guided for sure, but never bound, by GST Guides.

Secondly, the examples in the Guide are NOT exhaustive. Under Para 59(d), consider the phrase "Sufficient efforts **may** include:".

The word used is "may" which clearly indicates that there could be other acceptable items to demonstrate "sufficient efforts" that are not listed out in the Guide since each business has unique circumstances that may be difficult to reduce to a short all-inclusive list.

Thirdly, the Guide itself was issued BEFORE the release of the Panel Decision. This means the Guide was drafted in the context of GST rules and policies prevailing at the time when companies had to "time" their bad debt relief claims. But the Panel Decision has removed this "timing" element as claimants now "must" claim immediately after the expiry of six months.

Thus, when attempting to retrofit 'new' information into 'old' guides, a certain degree of discretion is called for because some 'transitory' inconsistency may arise.

TIME-DIMENSION OF "SUFFICIENT EFFORTS"

Following the GST Act, the conditions to claim GST bad debt relief are [Section 58(1)]:

*(a) the person has not received any payment or part of the payment … from the debtor six months from the date of supply …; **and***

(b) sufficient efforts have been made by him to recover the debt."

The authors opine that in all probability, the words "sufficient efforts" can be benchmarked against the time reference of at least "six months" as clause (a) is linked to clause (b) by the conjunction "and". This suggests a 'time-dimension' to be inherent in interpreting "sufficient efforts".

For instance, before the Panel Decision was introduced, if a GST-registered company were to claim a bad debt relief in say month 15, then records of "sufficient efforts" can be referenced to the circumstances existing as at "month 15" – which then becomes the inherent 'time dimension' of "sufficient efforts".

In light of the new Panel Decision, the standard to be used when defining the word "sufficient efforts" must surely be reinterpreted in a way that allows companies to comply with the RMCD's compulsory six months claim for bad debt relief.

Thus, in defining "sufficient efforts", the 'time-dimension' should be reset to the circumstances existing in "month six". It would be quite unlikely for any business to have taken the debtor to court and obtained a judgement within a short six months window. Therefore, any expectation of "legal action taken against the debtor" should be disregarded as a misplaced example in view of the reduced 'time

dimension' for the words "sufficient efforts".

BAD DEBT RELIEF: GST VERSUS INCOME TAX

In examining claims of GST bad debt relief, it is natural to draw parallels with deductibility of bad debts under the Income Tax Act 1967 as a 'short cut' in interpreting GST practices. However, such comparisons should be approached with caution.

When considering bad debts for income tax deduction purposes, Section 34(2) of the Income Tax Act 1967 makes specific reference to the phrase "the debt is reasonably estimated … to be … irrecoverable".

This should be contrasted with the GST Act as nothing therein states that the debt must be "irrecoverable" before a GST bad debt relief can be claimed. [To avoid disrupting the flow of this discussion, we will ignore the special case where the debtor has become insolvent within six months.]

The test prescribed in Section 58(1) of the GST Act is that "(a) the person has not received any payment or part of the payment … from the debtor six months from the date of supply …" followed by "(b) sufficient efforts have been made … to recover the debt".

Under GST law, there is no requirement to demonstrate that the debt is "irrecoverable", only that it has been outstanding for six months and it is accompanied by sufficient efforts towards recovery (time-referenced to actions that are reasonably expected for a debt of six months). This is arguably a lower qualifying test compared to the high bar of "irrecoverable" set under income tax rules.

Some of the fears, and therefore, the perceived difficulties in achieving "sufficient efforts" spring from our preconceived notions inherited from income tax rules. In interpreting "sufficient efforts" for GST bad debt relief claims, readers should have a clear perspective of the parameters under GST law, and not be deflected by preconceived influences from income tax parallels.

GST LAW: MALAYSIA VERSUS SINGAPORE

As Malaysia's GST law was partly inspired by neighbouring country legislation, it is useful to examine the Singapore-equivalent on bad debt relief which is stipulated in Section 83(1) of the Singapore Goods and Services Tax (General) Regulations (extract shown):

(a) …

(b) …

*(c) a period of **12 months** beginning with the date of supply has elapsed …; and*

(d) the Comptroller is satisfied that

__all reasonable efforts__ have been taken by the person to recover the debt."

Interestingly, Singapore's stipulated 'time-dimension' of "12 months" is longer than Malaysia's six months, and the operative phrase used in the Singapore legislation is "ALL reasonable efforts" which is clearly a much higher qualifying bar.

But more importantly, the word "all" is absent from Malaysia's legislation which merely uses the words "sufficient efforts" without any accompanying adjectives, possibly relaxing the extent of effort required before claiming bad debt relief – an important omission especially in light of the shorter six months 'compulsory' claim policy under the Panel Decision.

RECORDS FOR "SUFFICIENT EFFORT"

With regards to proof needed for bad debt relief claim, the prevailing mood among very senior RMCD officials is that some form of documentation, any form, to prove "sufficient efforts" will normally be acceptable. Verbal examples cited have included official reminder letters sent out to customers chasing for debts, or even an official record (company policy) of a telephone call chasing for collection, as acceptable evidence towards "sufficient efforts" depending on the quantum of the debt in relation to the business circumstances of the claimant.

This was further reinforced at the CTIM National GST Conference held in Kuala Lumpur on 20-1-2015, where Dato' Subromaniam Tholasy - the Director of GST, Royal Malaysian Customs Department - had said:

"Can you imagine the nightmare of tracking later … (if) you want to claim in the 8th month, 10th month, 2nd year, 3rd year, 4th year, 5th year. So we are saying claim it immediately

Under GST law, there is no requirement to demonstrate that the debt is "irrecoverable", only that it has been outstanding for six months and it is accompanied by sufficient efforts towards recovery (time-referenced to actions that are reasonably expected for a debt of six months).

after six months. If you want to claim at a later date, you can but let us know so that we can inform our auditors, so that when they go and audit, that will facilitate you".

The above suggests that the RMCD is holding an accommodative stand to enable GST-registered businesses to comply with the 'compulsorily' six months claim in line with the Panel Decision.

LEGAL SAFEGUARD FOR RMCD

Where companies follow the RMCD's Panel Decision by complying with the "six months bad debt relief claim" in good faith, such "bad debt relief" claims are very unlikely to be challenged by the RMCD during the GST audit - especially if the debts have NOT been collected at the time when the RMCD performs a GST audit.

Furthermore, there is a legal safeguard under Section 58(3) which requires GST-registered businesses to report and repay GST on any subsequent collections from a debtor (for which bad debt relief has already been claimed), thus ensuring no loss of GST revenue to the RMCD.

CONCLUSION

Ironically, we can sometimes learn more about one thing by knowing less about another. This is the case for bad debt relief under GST versus Income Tax where the qualifying criteria for GST is arguably lower than the high bar set by Income Tax Act 1967 (requirement of debt to be "irrecoverable"). In reading GST law, our focus must not be muddled by preconceived influences from analogous income tax treatments, no matter how 'similar' they may appear. Instead, we must relearn the rules of GST with a fresh perspective.

GST rules and practices are undergoing a period of fine-tuning where guides and panel decisions are being released at a frantic pace in view of the approaching GST rollout date. In retrofitting new panel decisions to existing rules, some transitory inconsistencies may be inevitable; which is where an accommodative approach by the RMCD during this educational phase of GST will become crucial – for the taxpayer as well as for the Royal Malaysian Customs Department.

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RESOLUTION IS THE SOLUTION

Abu Tariq Jamaluddin

It is a well-known fact that the court process for tax appeal cases is time consuming and cost burdening to the taxpayer. The minimum period for a case to be resolved, on the assumption that parties decide to litigate the case all the way to the court of appeal ("COA"), would be three to four years. This minimum period may be extended depending on numerous factors, such as the availability of court dates, witnesses and officers in charge. On this premise, the Inland Revenue Board of Malaysia (IRBM) has decided to embark on a new dispute resolution process.

The idea of a new mechanism for the resolution of tax appeals was first announced by the Chief Executive Officer ("CEO") of the IRBM, Kolonel (K) Tan Sri Datuk Wira Dr. Hj. Mohd Shukor Hj. Mahfar in his opening address during the 2013 National Tax Conference. He stressed on the importance of finding the best method to deal with disputes raised by the taxpayer. In pursuit of that, emphasis is to be given on how to reduce the time and cost which the taxpayer has to bear when going through an appeal process.

The Dispute Resolution Department ("the department") was then established to bring that idea to life, to find ways and to establish methods in providing the taxpayer with a better and more pragmatic platform to resolve a tax appeal. There are many forms of dispute resolution process. Dispute resolution basically means an avenue of settling disputes outside the courtroom. The types of dispute resolution typically are negotiation, conciliation, mediation and arbitration. Some of them are voluntary but some could also be mandatory. While mediation and arbitration are two of the most common forms of dispute resolution, negotiation is almost always attempted first to resolve a dispute. Negotiation allows parties to meet in order to settle a dispute giving more leverage to parties to control the process and the solution.

As a new mechanism to arrive at a settlement of tax disputes, the IRBM has decided to adopt a Dispute Resolution Proceeding which can be construed as a hybrid of the negotiation and mediation process ("the Proceeding"). Nevertheless, whatever name one might call it, the most important element of any dispute resolution is to have the right and the most conducive platform for the process to take place effectively. This article will elaborate on the Proceeding which is available as an alternative for the taxpayer to resort to when an appeal is filed against an assessment.

PROCEDURE OF APPEALS

Section 99 of the Income Tax Act 1967 ("the Act") is the core section with regards to an appeal filed by a taxpayer. It is a provision which allows a taxpayer to appeal against any assessment or additional assessment raised under the Act, by way of a prescribed form ("Form Q"), to the Special Commissioners of Income Tax ("SCIT"). Under this provision the taxpayer has 30 days to file an appeal to the Director-General of Inland Revenue ("DGIR").

Once an appeal against an assessment is filed at any of the branches of the IRBM, the branch is given 30 days to forward the appeal to the department. The 30 day rule applies to an assessment raised after a field audit or an investigation. This is a new internal ruling introduced by the IRBM in line with the establishment of the department. It is pertinent to note that with this new internal ruling the branch is no longer required to review the appeal filed by the taxpayer. All documentations relating to the assessment will be forwarded to the department for consideration. In respect of appeals against other assessments, the branch is given a longer date to resolve the appeal before the case is forwarded to the department. However under Section 101 of the Act, it is still entrenched that the DGIR is given a window of 12 months in total to review an appeal which is filed against an assessment.

In the case of a relief application for error or mistake, the application must be made within five years from the year of assessment in which the return was furnished. The branch will first review the relief application. Once the branch decides not to grant the relief, the taxpayer has six months to request the DGIR to forward the relief application to the SCIT. The request will be forwarded to the department for a final review before the application is sent to the SCIT.

DISPUTE RESOLUTION PROCEEDING

The new mechanism comes into play after the department has received the appeal from the branch. Currently there are two divisions under the department, namely, the Dispute Resolution Division and the Tax Litigation Division. The Dispute Resolution Division deals with cases before the appeal is forwarded to the SCIT. The Tax Litigation Division, on the other hand, will handle all appeals that have been sent to the SCIT and courts. As the focus of this article is on the resolution of an appeal, no further comments will be made in respect of the functions of the Tax Litigation Division.

Once an appeal has reached the department, it will be dealt with either by the Appeal Review Panel ("ARP") or will be processed by way of the Proceeding. The difference between the ARP and the Proceeding is that, the ARP will decide appeals without any active involvement of the taxpayer and the appeal would normally be sent to SCIT without undue delay. In contrast, in the case of the Proceeding, the taxpayer will be invited to present their case to the ARP and will be actively involved in the negotiation process.

The department has identified the types of appeals which will be dealt with by the ARP. The ARP generally deals with appeals where the issues raised in the Form Q are similar with issues in other appeals which are still pending at the SCIT or court. For example, where there is an appeal pending at the Court of Appeal ("COA") on the issue whether guarantee fees are deductible expenses under the Act, any other appeals filed to the DGIR on a similar issue will be referred to the ARP. This approach will ensure consistency in the tax treatment by the DGIR and expediency in disposing an appeal filed by the taxpayer.

The ARP is also sought after to deal with an appeal, if the issue involved has been determined by the SCIT or courts; or where there are clear precedents. In principle the DGIR will process all appeals filed by the taxpayer despite there being a clear decision by the courts on a particular issue. If the taxpayer intends to distinguish an existing decision of the SCIT or courts; or proceed with litigation regardless of that decision, the appeal filed by

taxpayer will be handled by the ARP to expedite the appeal process.

It is also suitable to process an appeal through the ARP if the basis of the appeal is to challenge a public ruling issued by the DGIR. This is so because the ruling made reflects a stand taken by the DGIR and as such any departure from that existing stand will normally require a decision by the SCIT or the courts. Therefore it will be appropriate for the appeal to be disposed of quickly.

There would be three possible outcomes from the ARP process. Firstly the appeal by the taxpayer will be forwarded to the SCIT and inevitably the litigation process would have to commence. Secondly, the ARP could also arrive at a conclusion that the appeal by the taxpayer is to be allowed based on the facts and the applicable law. Thirdly, the ARP may also arrive at a conclusion that the disposal of an appeal would be dealt with more effectively under the Proceeding, where the presence of the taxpayer is instrumental. The taxpayer will then be informed of the next steps in the proceeding.

At this juncture, it should be acknowledged that the Proceeding is a major reform in the appeal procedure. The Proceeding provides the taxpayer with a forum or platform to present their appeal to a separate or specific body or department in the IRBM.

During the Proceeding, parties are able to fully understand the strengths and weaknesses of the appeal. This process hopefully will create room or provide an opportunity for and possibility of settlement between the parties.

The Proceeding basically deals with all appeals which are not under the scope of the ARP. In practice an appeal which is suitable for the Proceeding will usually involve a substantial amount of facts. A clear example of this will be an appeal involving transfer pricing adjustments. For the record, transfer pricing cases have so far gone through the Proceeding.

The Proceeding is also relevant when further clarification is needed on the issues or facts in dispute. Based on that clarification, the panel of the Proceeding will be able, for example, to understand the nature of the business of the taxpayer and the basis or purpose of any payments made or received. The clarification will also help the taxpayer to further substantiate an appeal or a claim. However, failing to provide sufficient explanation could also expose the weaknesses of the taxpayer's case. In such circumstances, the possibility of coming to a resolution of the appeal filed by the taxpayer becomes greater.

More often than not a Form Q usually covers a wide range of issues. The Proceeding may help parties to identify and narrow down the issues in dispute. During the Proceeding perhaps certain issues can be resolved leaving only one or two for litigation. Any resolution of issues is without a doubt beneficial to the parties concerned.

The Proceeding is also beneficial if there is a dispute or disagreement over how facts ought to be considered or construed in coming to a decision. Question of facts such as whether the disposal of land is subject to income tax or real property gains tax would be a good example. In such a case, the facts are usually not disputed. The problem arises because both parties insist that the

facts should be construed in their favour. The department strongly believes that the Proceeding is an appropriate forum to address such a conundrum.

Finally, the Proceeding should be preferred if an appeal would be of little or limited precedent value. Obviously not all tax appeals will result in the creation of a precedent. In such a case, going to court will only result in a decision having limited applicability. On that ground it is worth it, especially for the DGIR, to go through the Proceeding and avoid a ligation process.

THE OBJECTIVES OF THE PROCEEDING.

The main objective of the Proceeding is to resolve disputes as early as possible. It also aims to produce outcomes that are lawful, effective and acceptable to the parties. The settlement reached during the Proceedings shall be in accordance with the provisions of the Act and based on accepted tax principles. There will be no element of bargain on issues in dispute in order to achieve an agreement.

The Proceeding also aims to make IRBM more accessible to the taxpayer especially when there is a dispute. The Proceeding provides a second opportunity for the taxpayer to present their appeal to another forum after discussions with the audit or investigation officers have failed.

The Proceeding also ensures that IRBM uses its resources efficiently. As the litigation process takes a long period of time and a lot of effort to be finally determined, the Proceeding will act as a filter for the DGIR to effectively identify cases with concrete basis, worthy of being upheld and argued in court.

Ultimately the Proceeding would hopefully enhance the level of satisfaction of taxpayers with regards to the handling of tax appeals by the DGIR. This is achieved by ensuring that the Proceeding will provide a conducive environment for the taxpayer even in the midst of a dispute and a difficult situation.

BASIC RULES DURING THE PROCEEDING

There are some basic rules governing the Proceeding which should be followed. The first one is, the matters discussed, documents involved and anything else in connection will remain confidential. The second rule is, matters discussed or offers made are on a without prejudice basis. Both parties are required to observe these rules to ensure efficacy of the proceedings.

In terms of costs, as the proceeding is a choice given to taxpayers, all parties to the Proceeding will bear their own related costs or expenses. For example, the cost of preparation of documents by the taxpayer, any expenses relating to transportation for the taxpayer to get to the venue or the cost of hiring tax agents or lawyers to attend the Proceeding as the taxpayer's representative, will be borne by the taxpayer.

Another crucial element in achieving efficacy of the Proceeding is the time frame for making decisions. The department understands that time is of the essence. Too long a time taken will defeat the purpose of resorting to the Proceeding. The department will therefore take all reasonable efforts to ensure that decisions after a final Proceeding will be given to the taxpayer within one month after the date of the Proceeding. The department will inform the taxpayer or his representative officially in writing.

ROLES OF THE PARTIES

At the Proceeding, the taxpayer or his representatives will need to present the issues and facts of the appeal. It would also be necessary for the taxpayer to elaborate on the grounds of the taxpayer's appeal and to highlight all the relevant documents. As a rule of thumb, it would be prudent to cover as much as possible to help the Proceeding's panel understand the taxpayer's stand on the appeal and for the taxpayer to be transparent. To round that off, the taxpayer may also highlight any relevant cases or applicable laws. The taxpayer may also propose any settlement if desired.

The Proceeding's panel will then analyse those issues, facts and documents as presented by the taxpayer or his representatives. In the final analysis, the Proceeding's panel will evaluate the strengths and weaknesses of the appeal and based on all those finding, the panel will explore any possibility of settlement with regards to the issues raised by the taxpayer.

LEGALITY OF THE PROCEEDING

The introduction of the Proceeding does not require an amendment to the Act. The Proceeding will take place during the review period provided for under Section 101 of the Act. The section allows the DGIR to review an

appeal before it is forwarded to the SCIT.

The power of the DGIR during the review period is clearly stipulated under Section 101 of the Act, among others, the DGIR may require the taxpayer to furnish relevant particulars and information, to produce books of accounts, records and documents that are related to the assessment. The DGIR may summon any person, not necessarily the taxpayer, to provide relevant information that may assist him in carrying out the review. The Act also allows the DGIR to examine any person on oath.

In short, the DGIR is of the view that this new Proceeding is well within the ambit of Section 101 of the Act. Even though the DGIR could summon the taxpayer to give evidence, the Proceeding is intended to be carried out on a voluntary basis. Unless and until a change to the process is really needed, the DGIR will maintain this voluntary basis and negotiation approach in the Proceeding.

Furthermore Section 102 of the Act provides that the appeal will be forwarded to the SCIT if the DGIR is of the opinion that there is no reasonable prospect of coming to an agreement with the taxpayer. It can therefore be safely construed that the Act actually promotes settlement between the parties. It is also provided in Section 101 of the Act that during the review process, the DGIR and the taxpayer may reach an agreement orally or in writing. The effect of the agreement on the assessment appealed against varies as follows -

(a) the assessment will be confirmed where the taxpayer agrees to withdraw the appeal;
(b) the assessment will be reduced where the DGIR partly concedes to the appeal,
(c) the assessment will be increased in accordance with the agreement; or,
(d) the assessment will be discharged in the case where the DGIR agrees with the appeal filed by the taxpayer.

In a nut shell, any settlement or agreement signed between the parties as a result of the Proceeding is indeed within the ambit of Section 101 of the Act.

BENEFITS OF THE PROCEEDING.

When the idea of the Proceeding was mooted by the CEO, he must have foreseen that this new mechanism will indeed be beneficial to both the taxpayer and the IRBM. The benefits are many but these are the most obvious ones.

In terms of the costs involved and the time consumed, it is clear especially if comparison is made with the actual time frame, costs and expenses that parties have to bear if the appeal goes for hearing and onwards to the apex court. This is even more so on the part of the taxpayer because the reality is that professional or consultancy fees can be quite hefty.

The Proceeding will also provide a platform for the taxpayer to be heard, in an informal environment, involving simple procedures, before any decision is made regarding pursuing the appeal in courts. Once the appeal is litigated it would be difficult to have access to these benefits again.

In terms of expertise, the appeal will be processed by a group of officers who have a wealth of experience in handling tax appeals and are able to consider and even gauge how the courts will look at a tax appeal. This aspect of the Proceeding will surely help both the IRBM and the taxpayer to arrive at a reasonable settlement. In fact the Proceeding is also open to lawyers and tax practitioners who have vast experience in taxation.

THE STATISTICS

Since the inception of the department until now, out of 131 Forms Q sent to the department, 38 have been selected for the Proceeding.

From these 38 Forms Q, 25 have achieved settlement, two have been forwarded to the SCIT and 11 more are awaiting decision from the panel of the Proceeding.

Therefore based on these statistics, so far, the department has managed to achieve settlement for 65.7% of the cases that have been selected for the Proceeding. The IRBM is hoping that this percentage will gradually grow.

CONCLUSION

In conclusion, the IRBM would like to invite taxpayers and tax practitioners to support and adopt this new mechanism. This new approach will definitely benefit both the taxpayers and the IRBM. Finally, to encapsulate the matters discussed in this article, let us take in the following oft-quoted words -

"Discourage litigation. Persuade your neighbours to compromise whenever you can. Point out to them how the nominal winner is often a real loser - in fees, expenses, and waste of time…" – Abraham Lincoln

"Justice delayed is justice denied." – William E. Gladstone

Abu Tariq Jamaluddin, *Director, Dispute Resolution Department, Lembaga Hasil Dalam Negeri Malaysia*

MAKING A CASE FOR TAX RELIEF FOR SIBLING CAREGIVERS IN MALAYSIA

Siva Subramanian Nair and Dr. S. Susela Devi

In an attempt to bridge the gap between academic research and practice, we share some insights from academic research to influence practice. We make a case for the provision of tax relief for sibling caregivers in Malaysia by examining the practices in immediate neighbouring countries and drawing insights from a recently completed study on "Accountability, Vedic & Schumacher's Philosophy and Autoethnography: An Advocation for Tax Relief for Sibling Caregivers in Malaysia" (henceforth referred to as "Advocation for Tax Relief").

It is timely for the Malaysian tax authorities to consider tax relief for sibling caregivers, at least, in the interest of harmonising the fiscal policies within the Association of Southeast Asian Nations (ASEAN) in view of the ASEAN Economic Community initiative.

The discussion of this paper is organised in the following manner: The first section draws upon key highlights from the study that advocates a policy initiative to review existing relief granted to individuals. Secondly, current reliefs for disabled persons available in Malaysia are detailed and a comparison is made between two selected countries in the ASEAN regional grouping, namely Singapore and Thailand. Finally the case is made for the provision of tax relief.

INSIGHTS ON NEED FOR "ADVOCATION FOR TAX RELIEF"

Although the concept of accountability is wide, this paper

focuses on the government's accountability to the society and hence, to caregivers. The government's responsibility extends to taking care of persons with disabilities: it is part of their commitment, duty and obligation. Therefore, where a caregiver voluntarily takes care of his or her disabled brother or sister, the government has effectively delegated its duty and responsibility to that caregiver.

The ability of the caregiving sibling to bear the trials and problems associated with the caregiving role and continue with a positive exuberance has, in many cases, been attributed to their religious upbringing and the strength of their faith and belief. This provokes the need to conceptualise accountability from a theological viewpoint as pursued from a Vedic philosophy perspective.

The challenges for the sibling caregiver include paying for medical treatment, transportation, supporting equipment and health supplements required by the disabled sibling. It also shows that sibling caregivers face numerous difficulties, make many sacrifices, and handled a great number of challenges in caring for disabled family members.

We suggest an endowment of tax reliefs for sibling caregivers which would facilitate the discharge of this responsibility. Even if the tax relief does not equal the amount spent on the person with disabilities, it will at least serve as a motivator for them, and as an acknowledgment that the government recognises and cares that the sibling has voluntarily assumed the responsibility of caring for the person with disabilities - a responsibility which is actually that of the government.

Currently, however, the recognition in the form of tax relief is only given to caregivers who are parents or children of the person with the disability. This discrimination must be reconsidered and the government must illustrate its accountability to society by endorsing the move to extend similar tax relief to sibling caregivers as well.

For decades, the Malaysian government has used the tax system to provide financial assistance to persons with special needs including persons with disability. In illustrating its commitment to ease the financial burden of disabled persons, the government has incorporated numerous tax reliefs in its tax legislation, especially in the Income Tax Act 1967 (as amended), hereinafter referred to as "the Act". These are discussed in the next section.

CURRENT TAX RELIEF AND INCENTIVES IN MALAYSIA

Tax reliefs for persons with disability and their caregivers are contained in the Act and it is basically accorded to a taxpayer as a deduction from his total income in ascertaining his chargeable income. In line with its responsibility to and in fulfilling its role of accountability for the well-being of, persons with disability, the Malaysian government has incorporated different types of relief granted for such persons and these are detailed below.

Disabled individual [Section 46(1)(e)]

Currently, a relief of RM9,000 may be claimed by every individual for the basis year (year of assessment). A disabled person, however, can claim an additional RM6,000 and their relief claim would total RM15,000. This additional relief is available to both the husband and the wife in the case of the filing of separate assessments.

Disabled Spouse [Section 47(1)(b) and Section 45A]

An individual can claim spouse relief of RM3,000 in the year of assessment for either a husband (Section 45A) or a wife (Section 47), provided that the couple are living together in the year of assessment. The concept of living together is not a geographical concept but one of intention: they must not be divorced or separated by an order of a court, a deed of separation or a written separation agreement. In addition, a further RM3,500 may be claimed if the spouse is disabled, for a total claim of RM6,500.

Basic Supporting Equipment [Section 46(1)(d)]

A maximum claim of RM5,000 can be made in the year of assessment for the purchase of any necessary basic equipment for use by a disabled individual or his spouse, child or parents.

Disabled Child [Section 48(1)(d) and 48(2)(b)]

The parent of a disabled child may claim child relief of RM5,000 (RM6,000 from YA 2015) as opposed to the relief of only RM1,000 that may be claimed for a normal child. In addition, if the disabled child is receiving full-time instruction at any university, college or other similar educational establishment, or is serving under articles or indentures with a view to qualifying in a trade or profession, the parent is entitled to claim increased relief of RM6,000. This brings the total claim for a disabled child to RM11,000, with effect from year of assessment 2013.

A child is defined as a legitimate child, a step-child of the husband or wife, or an adopted child provided the Director-General is satisfied that the adoption is in accordance with any law (not necessarily Malaysian law). With effect from the year of assessment 1996, a wife living together with her husband and who is assessed separately on her income, may elect in writing to claim child relief. To claim child relief, the child should be unmarried, maintained by the claimant and the child's total income for the year of assessment must not exceed the amount of child relief claimed.

Medical Expenses for Parents [Section 46(1)(c)]

Initially this subsection provided relief only for medical expenses incurred in respect of a parent; but a proposal in the 2011 Budget served to include special needs and carer expenses as well. However, the carer cannot be the individual himself, his spouse or child. Other eligibility requirements specified that the parents should be Malaysian residents, the medical treatment and care services should be provided in Malaysia and the medical practitioner should be registered with the Malaysian Medical Council.

The government's recognition that some individuals had special

needs and required the services of a carer was at least a step forward. It also provides encouragement that the proposal suggested by this study would not fall on deaf ears.

As noted from the above discussion, in Malaysia any tax relief given to caregivers of persons with disabilities is only given to the parents (in the form of a tax relief for a disabled child as detailed above), or to the children as stated in Section 46(1)(c) of the Act which in addition to providing a relief for medical expenses incurred in respect of a parent, provides a relief to a person in respect of special needs and carer expenses for his parents.

The government's recognition that some individuals had special needs and required the services of a carer was at least a step forward. However, no tax relief, credits or incentives are ever given to the siblings of persons with disabilities who, in many cases are required through the bonds of love, affection and family ties, to take care of a disabled sibling in the event of the death or incapacity of the parents or because the disabled person himself remains unmarried due to his disability.

The granting of tax reliefs to persons with disability is basically aimed at easing their financial burden which is generally enhanced due to their disability compared to an able person. This argument of equality and justice for the disabled extends to the caregivers as well, especially when the person with the disabilities has no source of income and all expenses and related costs are borne by the caregiver. Accepting caregiving responsibility whilst also managing their own family obviously results in a heavier financial burden which translates to a lower standard of living. Therefore a tax relief should also be provided to caregivers as compensation for the additional costs borne by them or in sheer recognition of their sacrifices.

Insights from this paper reinforce the role of the government (which had delegated the caregiving role to the families), to inculcate accountability in society. The government is indebted to sibling caregivers for their role and has a responsibility to assist them in every way possible. An avenue for discharging this responsibility was seen in the tax system through the offering of tax relief, rebates, incentives and other forms of assistance.

The finding from this study revealed that the caregiving responsibility has both quantitative

implications in terms of the additional financial burden laid on caregivers and qualitative implications. The respondents concurred that although the qualitative impediments cannot be obliterated through a financial endowment, at the very least it will provide an emotional and psychological reprieve. We share the opinions of siblings caring for persons with disabilities: revealing affirmative opinions that the introduction of tax relief for sibling caregivers would serve to either directly or indirectly alleviate the burden of caregiving.

In the next section we shall look at the tax reliefs available for sibling caregivers in our immediate neighbouring countries of Singapore and Thailand.

TAX RELIEF FOR HANDICAPPED SIBLINGS IN SINGAPORE

Singapore's acknowledgement of the contributions made by siblings of persons with disabilities is evident from the enactment of Section 39(2)(j) in the Singapore Income Tax Act. The Inland Revenue Authority of Singapore states on its website that handicapped brother/sister relief is a relief to provide recognition for individuals supporting their handicapped siblings.

Eligibility to claim

Eligibility to claim the relief is extended to any person who has supported his or her (or even their spouse's) physically or mentally handicapped brothers/sisters who are living in Singapore. The Authority also explains that a claim will be denied in the event that another person has claimed any other reliefs on the same sibling. The following provides a lucid example:

If your father claimed 'handicapped child relief' for your handicapped brother, you and your sibling cannot claim this relief on the same handicapped brother.

Conditions governing the claim

The disabled sibling should have lived with the claimant in the same household in the previous year or if not, the claimant must have incurred S$2,000 or more in supporting the disabled sibling in the previous year.

Prior to 2010, an additional condition was that the disabled sibling should not have an annual income exceeding S$2,000 in the previous year, where income included all forms of taxable income (e.g., trade, employment and rental), tax exempt income (e.g., bank interest, dividends and pension) and foreign-sourced income (regardless of whether it had been remitted to Singapore). However, Singapore's Minister of Finance stated in the 2010 Budget speech that for handicapped-dependant-related reliefs, the income threshold condition will be removed in recognition of the extra resources and attention needed in providing care to the disabled. Hence taxpayers will be able to claim the reliefs regardless of the income of the handicapped dependant.

The quantum claimable

Earlier, the caregiving brother or sister was able to claim S$3,500 for each handicapped brother/sister. However, if the same handicapped sibling is supported by more than one person the relief of S$3,500 is shared by all the relevant caregivers.

However, the 2014 Budget announced an increase in the handicapped sibling relief of S$2,000 with effect from YA 2015 bringing the relief to S$5,500.

TAX RELIEF FOR HANDICAPPED SIBLINGS IN THAILAND

Section 47 of the Revenue Code of Thailand sets out the tax deductible items for personal income tax calculation purposes. This section basically provides for personal tax relief.

In 2009, the Thailand Revenue Code Amendment Act No. 37, B.E. 2552 (2009) added an additional item to the list of items under Section 47 which would allow taxpayers who actually support qualifying disabled persons to take an allowance.

Eligibility to claim

Eligibility to claim relief is extended to any person who is taking care of a disabled or incapacitated family member or care of a disabled or an incapacitated person other than a family member.

The quantum claimable

The claimable amount is Thai Bhat 60,000 in respect of each disabled person when calculating his/her net taxable personal income.

Therefore the granting of a tax relief for sibling caregivers of persons with disabilities is not novel as demonstrated by the examples of Singapore and Thailand. What about tax policies in other countries?

THE TAX POLICY ELSEWHERE

In Hong Kong, a taxpayer can claim dependent brother or dependent sister allowance if the spouse maintains an unmarried brother or sister any time during the year of assessment. Australian taxpayers are entitled to the dependant (invalid and carer) tax offset if they maintain certain dependants who are genuinely unable to work because of their invalidity or carer obligations whilst in Luxembourg taxpayers may claim a tax allowance for the maintenance and education costs of close relatives such as a sibling, niece or nephew for whom the taxpayer is responsible.

Sometimes the tax relief is an indirect form of financial assistance to the caregiver, aiming to encourage family caregivers. In Canada, caregivers may be eligible to financial support through the federal tax system which offers assistance to unpaid caregivers such as the Caregiver Tax Credit, the Eligible Dependent Tax Credit, and the Infirm Dependent Tax whereas the United States has a Dependent Care Tax Credit for working caregivers. The home carer tax credit may be claimed by a couple where one spouse or partner (cares for one or more dependent persons) in Ireland.

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CONCLUSION

This article promotes policy initiatives to introduce tax relief for sibling caregivers in Malaysia. It is critical that research findings are shared in a layman language to reach the practitioners and policy-makers. It is hoped that there will be concerted effort to convince the relevant authorities and the government in general, to abate the caregiver's financial burden, recognise their service, provide a form of compensation for their sacrifices, as well as give due recognition for voluntarily undertaking the responsibility of the government.

Kebabs, Source and Tax

Dr. Nakha Ratnam Somasundaram

IN THE CASE OF *KETUA PENGARAH HASIL DALAM NEGERI V KYROS INTERNATIONAL SDN BHD*[1] THE ISSUE OF SOURCE AND INCOME TAX EXEMPTION WAS HIGHLIGHTED. THIS ARTICLE TAKES A BRIEF LOOK AT ISSUES RELATING TO SOURCE OF INCOME AND EXEMPTION UNDER PARA 28 OF SCHEDULE 6 OF THE INCOME TAX ACT 1967 (AS AMENDED)[ITA].[2]

INTRODUCTION

In Malaysia, the charge to income tax is set out in Section 3 thus:

Subject to and in accordance with this Act, a tax to be known as income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia.

This is a fundamental principle of the Malaysian tax system based on the territorial scope– a person sought to be charged to tax could be taxed only if there is income arising from a Malaysian source – and in this context, the resident status of the person sought to be taxed is irrelevant.[3] Furthermore, if the person has income from a source outside Malaysia, it would be brought to charge only if it is remitted to, and received in Malaysia. Such income, of course, if remitted to and received in Malaysia would be exempted from income tax under para 28 Schedule 6.

But this kind of exemption does not apply across the board. For example, under Section 3B tax shall not be charged on income in respect of an offshore business activity carried on by an offshore company, other than an offshore company which has made an election under Section 3A of the Labuan Offshore Business Activity Tax Act 1990.

On the other hand, under Section 54(1), income of a resident company carrying on the business of banking, insurance, transporting passengers or cargo by sea or air is liable to tax in Malaysia, whether income from such activities are remitted or not (i.e. it is taxed on a world scope).

With effect from the year of assessment 2004, para 28 Schedule 6 applies to all persons (excluding persons carrying on the business of banking, insurance etc. mentioned above) in respect of income derived from outside Malaysia and remitted to and received in Malaysia.

INCOME

Central to the charging section is the concept of income. Obviously, the ITA intends to tax only income – and therefore by implication receipts of a capital nature are not to be taxed. However, the ITA does not define what 'income' is and that leads to a host of problems and questions (with no answers of course!), and one invariably has to resort to case laws for a guidance to determine what constitutes income.

The courts have admitted on several occasions that the word 'income' is a difficult word and it is not a simple matter to define it. For example in *Kamakshya Narain Singh v CIT* [11 ITR 513] Lord Wright remarked as follows:

'Income, it is true, is a word difficult and perhaps impossible to define in any precise general formula…the multiplicity of forms which the word 'income' may assume is beyond enumeration.'

The words used in the ITA, for example in Section 4, is 'gains or profits' and it is generally accepted that the word 'income' is a more generic term than profit or gains – and interestingly, these two elements need not be present in income before it could be taxed.

Thus, in *CIT v Shaw Wallace* (6TC 178), Sir George Lowndes likened income to the fruit of a tree or the crop in a field, being essentially the produce of something which is spoken of loosely as 'capital'.

And in the case of *Mersey Docks & Harbour Board v Lucas* [2 TC 25] the word 'gains' was treated as equivalent to 'profits'.

Generally, the courts tend to associate a receipt with the source, and whether the source is from a fixed capital, or circulating capital. A receipt associated with a fixed capital is usually taken to be of a capital nature, while that connected with a circulating capital is taken to be of a revenue nature.

For example, in *Golden Horseshoe (New) Ltd v Thurgood* (18 TC 280), Lord Justice Romer held that:

'changes in his (i.e. the taxpayer's) floating or circulating capital must be taken into consideration in ascertaining his annual gains and profits…'

ACCRUED, DERIVED OR RECEIVED

In Section 3, only '…*the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia'* would be charged to Malaysian income tax (with the income received in Malaysia from outside Malaysia being exempted under para 28 Schedule 6). Consequently, the words 'accrued', 'derived', and 'received' are the key words in relation to liability to Malaysian income tax.

The words 'accrued', 'derived' or 'received in Malaysia from outside Malaysia ' are not defined in the ITA, and again, assistance need to be sought from decided case laws.

While dictionary meanings like 'accrue' means *'to fall as a natural growth or to come by way of an accession'* or that 'derive' means '*to draw, fetch or to obtain or receive from a source*' are of limited use, for the courts tend to treat them as synonymous[4]. For example, in *Commissioner of Taxation (NSW) v Kirk* [(1980) AC 588] it was held that:

'their Lordship attach no special meaning to the word 'derived' which they treat as synonymous with 'arising or accruing'.

This approach was followed in the cases of *CIT v Lovell and Christmas Ltd* [(1908) AC 46] and *CIT v Eastern Extension Telegraph Co* [(1906) AC 526] where the term 'accruing' was held to be similar in meaning to 'derived'.

Dr. Veerinderjeet Singh, a leading tax expert in the country, is of the view that the terms 'accruing in', 'arising in', and 'derived from' should denote the same meaning when dealing with the location in which, or from where the income arises, accrues, or is derived.[5]

Nevertheless, there are subtle differences. The word 'accrue', particularly in the context of interest income, denotes an income coming in passively (for example the interest on a bank fixed deposit')[6] while the word 'derive' connotes an active involvement in obtaining the income (e.g. the exercise of an employment or the carrying on of a business activity).

The word 'accrue' incorporates four essential elements as follows:[7]

(a) The element of time to enable the income to be related to the relevant year of assessment ;
(b) The element of place which will determine where the income will be taxed;
(c) The element of source in respect of the income and how it arises; and
(d) The element of the person[8] who is entitled to the income and accordingly chargeable to tax on such income.

The issue of whether an income is accrued or derived in Malaysia is given a semblance of certainty by the relevant classes of income under Section 4 being treated specifically in respect of its derivation under the various other related sections.[9]

Thus, business income under Section 4(a) is deemed to be derived from Malaysia in relation to Section 12 which provides as follows:

12. *(1) Where for the purposes of this Act it is necessary to ascertain any gross income of a person derived from Malaysia from a business of his, then—*

(a) subject to subsection (2), so much of the gross income from the business as is not attributable to operations of the business carried on outside Malaysia shall be deemed to be derived from Malaysia;

(b) notwithstanding paragraph (a), if the business consists wholly or partly of the manufacturing, growing, mining, producing or harvesting in Malaysia of any article, product, produce or other thing—

(i) the gross income from any sale of the article, product, produce or other thing taking place outside Malaysia in the course of carrying on the business; or

(ii) where the article, product, produce or other thing is exported in the course of carrying on the business and subparagraph (i) does not apply, an amount equal to the market value of the article, produce, product or other thing at the time of its export,

shall be deemed to be gross income of that person derived from Malaysia from the business.'

One would note the phrase '*shall be deemed to be gross income of that person derived from Malaysia*' used in the section. This has significant legal implications as it apparently requires one to make a distinction as between business income attributable to Malaysia and one that is not attributable to Malaysia. The word 'deemed' now imposes an artificial construction[10] – and so gross income that is not attributable to operations of business carried on outside Malaysia would be deemed to be derived from Malaysia.

Essentially Section 12 extends the scope of charge in terms of jurisdiction for business income. But such overreaching provisions brings along its own set of derivation determination problems not fully answered by that section.[11]

SOURCE

This brings us to the issue of source. As the Malaysian tax is territory based, the determination of the source of the income becomes critical. Whether this word '*source*' is to be given a legal meaning, a technical meaning or just an ordinary meaning needs to be carefully examined in the context of where is the originating source of the income.

In the New Zealand case of *N.V. Philips Gloeilampenfabreiken* [(1954) 10ATD 435], it was held that 'derived'

means more than just received – one needs to look at the source or origin rather than the fund or place from which the income was taken. In other words, one needs to look at the originating source.

Legal meaning and ordinary meaning gets mixed up in the case of *Nathan v FC of T* [(1918) 25 CLR] where it was held that the word 'source' meant not a legal concept but something a practical man would regard as the real source of income; but the judge *Isaacs J.* in that case went on to say that legal concept must enter into the question when one considers to whom a given source belongs – and such matter is matter of fact.

And so, using the 'matter of fact approach', in the South African case of *CIR v Black* [21 SATC 200] the source of income was taken to be where the dominant, main, substantial and the real cause of the accrual of the income is.

In another South African case, *CIR v Lever Brothers & Unilever Ltd* [(1946) 14 SATC 1] *Watermeyer CJ.*, explained that the source of receipt received as income is not the quarter whence they come, but the originating cause of their being received as income, arising from the work the taxpayer does to earn the income – and it could be plain simple employment or even the employment of property, or capital.

The reverse concept was expressed persuasively by *Latham CJ.*, in the case of *United Aircraft Corporation* [(1943) 7 ATD 31] where his Lordship said that a person, who neither owns anything in a country, nor does, nor has done anything in that country, cannot derive income from that country.

Another important case that dealt with the issue of source in some detail was the Privy Council case of *Hang Seng Bank Ltd* [(1991) 1 AC 306]. The House of Lords indicated that to determine where the source of income is, one needs to look to see what the taxpayer has done to earn the profits in question. If he has rendered service, it will be derived from where the service was rendered. If it was a manufacturing activity, then the income will be derived from that profit making activity. In addition, if it was obtained by the exploitation of property or assets, the profit will have arisen in, or derived from, the place where that property was let. In the case where money was lent, it will be derived where the money was lent.

Thus, in essence, for Malaysian tax purposes, Section 3 being principally a territorial law, if the originating source of income is not within the territorial jurisdiction of Malaysia, then such income would be outside the scope of charge. And even if such income from a source outside Malaysia is remitted to Malaysia and received in Malaysia, it would be exempted.

It sounds so simple. But it is not so simple.[12]

Some relevant recent cases where the source of income was a central issue are examined here.

AJE SDN BHD V KPHDN [(2001) MSTC 3357][13]

A Malaysian bus company operated various bus routes in Malaysia including one that ended in Johor Bahru and then continued into Singapore with permission from the Singapore authorities. Condition for that permission included that tickets sold for journeys *from* Singapore into Malaysia are sold in Singapore. The income from the sale of bus tickets in Singapore, and the related cost were recorded separately and reflected as such in the accounts.

However, return journeys from Malaysia to Singapore were treated as Malaysian derived income.

The IRB treated both the income from the sale of tickets in Singapore and in Malaysia as Malaysian sourced income under Section 12(1)(a).

AJE Sdn Bhd however contended that the bus tickets sold in Singapore were contracts for carriage concluded in Singapore and accordingly sourced in Singapore – and not liable to Malaysian income tax.

The Special Commissioners of Income Tax decided in favour of the taxpayer and the Revenue appealed to the High Court. The High Court dismissed the appeal and found that the source is where the recipient has to do something or provide a service in order to receive the income. In this case, the service provided was the carriage and the acts were the sale of tickets in Singapore – which was the basis for the conclusion of a contract for the provision of the service.

Some supporting case laws applied in arriving at a decision in AJE Sdn Bhd was the Hong Kong *Hang Seng* case and the *Tariff Reinsurance Ltd v* the *Commissioners of Taxes* [(1938) 59 CLR 194].

In *Tariff Reinsurance*, an Australian case, it was held that the place where the contract was entered into between the parties was to be regarded as the sole source of income, and therefore the location of the income will be where that contract was entered into.

Subsequent to this decision, the Double Tax Agreement signed with Singapore incorporated some provisions under which for example profit from the operation of buses by a Malaysian company will be taxed only in Malaysia.[14]

CH SDN BHD V KETUA PENGARAH HASIL DALAM NEGERI [(2010) MSTC 10-003]

CH Sdn Bhd (the taxpayer) carried on the business of manufacturing and exporting latex and synthetic gloves. Allegiance Healthcare Holding BV ("Allegiance Netherlands") was a Dutch company and both the taxpayer and Allegiance Netherlands were part of the Cardinal-Allegiance Group of companies.

Allegiance Netherlands functioned as a financing entity for the group, including expediting movement of loans wherever needed within the group. This arrangement avoided the long bureaucratic process involved when using third party bankers. The central treasury function within the Cardinal-Allegiance Group enabled entities with surplus funds to invest the same by way of loans to Allegiance Netherlands, which were repayable with commercially competitive interest rates.

The taxpayer and Allegiance Netherlands entered into several credit agreements under which CH Sdn Bhd made advances to Allegiance Netherlands during the years of assessment 1999 to 2005. In consideration of the loans granted to Allegiance Netherlands, the taxpayer received interest payments.

The taxpayer's share of the invested surplus funds consisted of profits from its business activity carried on in Malaysia.

The Revenue charged the interest to tax on the basis that the true source, or the "originating source" for the respondent's interest income, was the funds provided for the loans - which were garnered from the carrying on of the taxpayer's business

in Malaysia.

The taxpayer appealed to the Special Commissioners of Income Tax (SCIT) submitting that it was the loan that it made to Allegiance Netherlands pursuant to the agreements entered into in the Netherlands that produced the income in the form of interest.

The main issue for determination by the SCIT was whether interest income paid to the taxpayer by Allegiance Healthcare BV during the years of assessment 1999 to 2005 was derived from outside Malaysia, and whether it was tax-exempt in Malaysia.[15]

The SCIT allowed the appeal by the taxpayer. The Inland Revenue Board appealed to the High Court, which dismissed the case. The Court of Appeal too upheld the decision.

KYROS INTERNATIONAL SDN BHD V KETUA PENGARAH HASIL DALAM NEGERI [(2013) MSTC 30-056]

Kyros International Sdn Bhd's (Kyros) principle activity was fast food chain operation and investment holding. The fast food operation was, however, transferred to KYROS Kebab Sdn. Bhd. but the propriety rights were held by Kyros itself, and thus there was a separation between the operations, from the holding of rights, and trademarks in these two separate entities.

Kyros has substantial reputation and goodwill in the business of operating kebab fast food chain. It supports the franchisee in the operations by giving various services including operating system audit and business development advice.

Kyros entered into franchise agreement with parties in several countries including Pakistan, Indonesia, and Singapore under which a Master Franchise Agreement and a Non-exclusive Unit Franchise Agreement were signed.

Under the Master Franchise Agreement, three payments were made, namely, franchise fee, a royalty, and a business development fee. Under the Unit Franchise Agreement, the franchisee will pay a franchise fee and a monthly royalty worked out at 5% of the gross turnover.

The arrangement segregated the royalty payment from the franchise fees, which essentially refers to payments made for the services provided by Kyros to the franchisees.

The issue was whether the franchise fees received by Kyros are income received from outside Malaysia, and if such income is remitted to Malaysia, should it be exempted under para 28 of Schedule 6 of the ITA.

The SCIT found that the execution or operations of business took place outside Malaysia, and held that all activities in respect of the agreement entered between Kyros and the foreign franchisees accordingly took place outside Malaysia. The SCIT relied on the Privy Council case of *CIR v. Hang Seng Bank Ltd* to find the franchise fees to be akin to letting property (in this case the franchise) and concluded that the franchise fees are to be treated as income received from outside Malaysia, and accordingly exempted from income tax under para 28 of Schedule 6 when received in Malaysia.

The IRB appealed and the High Court overturned the SCIT's decision. On further appeal to the Court of Appeal, the decision was given in favour of Kyros.

Again, the Court of Appeal relied on the case of *Hang Seng where it was held that "profit will have arisen in or derived from the place where the property was let, the money was lent".* [16]

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[1] *(2013) MSTC 30-056*

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

[3] *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').*

[4] *The Concise Oxford Dictionary 12th Ed, Oxford University Press*

[5] *Veerinder on Taxation, 2nd Ed., CCH 2011, p 264*

[6] *In Colquloun v Brooke (2 TC 490) for example, it was held that 'accrue' meant only a right to receive, and as such must be legally constituted. However one needs to take note of Section 27 where interest is treated on a 'received basis' for taxing purposes, and when received, it is attributable to the period for which it is receivable.*

[7] *See Veerinder on Taxation, 2nd Ed. CCH 2011, p. 264-265*

[8] *Under Section 2, 'person' includes a company, a body of persons and a*

CONCLUSION

The issue of what is income for income tax purposes is as old as tax law itself and its meaning is still evolving. Add to this, the issue of source, which becomes critical because of the territorial tax base and the jurisdiction of the relevant tax authorities. This can be further complicated by e-commerce.[17] As a result, tax laws seem to be getting more and more complex and difficult to understand.

And so, no wonder that even the man who revolutionised theoretical physics with his simple $E= MC^2$ formula found income tax to be the hardest things to understand.[18]

To get out of the tax gravity, one could consider writing to the IRB, just like what Charles M. Schultz did:[19]

Dear IRS,

I am writing to you to cancel my subscription. Please remove my name from your mailing list.

~Charles M. Schultz (Snoopy)

But then, you have e-filing, another strange force beyond space and time!

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corporation sole; and 'company' in turn is defined to mean a body corporate and includes anybody of persons established with a separate legal identity by or under the laws of a territory outside Malaysia; exercised in Malaysia').

[9] For example, the derivation of employment is set out in Section 13, the derivation of interest and royalty in Section 14 and the special classes of income in Section 15A.

[10] Artificial construction can take several forms. Example: place of derivation (e.g. Section 15), chargeability of a person, the year of taxability, and even the amount of income derived (e.g. Section 54(3) states that the shipping income of a non-resident operator is deemed to be 5% of the gross earnings from the outward shipments from Malaysia).

[11] See footnote 10. [8] See Veerinder on Taxation, 2nd Ed. CCH 2011, p. 264-265

[12] See Vodafone International (Holdings) B.V. v Union of India and Another (311 ITR 46).

[13] See 'Ticket to Tax', Dr. Nakha Ratnam Somasundaram, Tax Nasional, p 31-33 Vol 14/2005/Q2

[14] Under clause 4 of Article 8 of the Double Tax Agreement signed between Malaysia and Singapore on 5 October 2005 to be effective from 1 January 2007, profits derived by an enterprise of a Contracting State from the operation of road vehicles in international traffic for the carriage of passengers shall be taxable only in that State.

[15] The relevant applicable law is Section 3 of the Act, Income Tax (Exemption) (No 48) Order 1997 and para 28 of Sch 6 of the Act.

[16] Other cases relied on was (i) Commissioner of Inland Revenue (N.Z.) v N.V. Philips' Gloeilampenfabrieken [1995] N.Z.L.R. 868; (ii) Ch Pte Ltd v Comptroller of Income Tax (1988) 1 MSTC 7,022; and (iii) Commissioner of Inland Revenue v Orion Caribbean Limited (in vol liq) [1997] HKRC 90-089

[17] See E-commerce and Tax Chaos, Dr. Nakha Ratnam Somasundaram, Tax Guardian, Vol. 7/No. 2/2014/Q2

[18] Dr. Albert Einstein is quoted to have said so, according to Leo Mattersdorf who was his close friend, and also his tax agent. Source: http://quoteinvestigator.com/2011/03/07/einstein-income-taxes/. Retrieved 4 May 2014

[19] Charles M. Schultz is the author of the famous cartoon, 'Peanuts'.
Source: http://www.quotegarden.com/taxes.html. Retrieved 4 May 2014

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LOCATION SAVINGS IN TRANSFER PRICING

THE DYNAMICS AND DEVELOPMENTS

Venkataraman Ganesan

"If you don't drive your business, you will be driven out of business"
– B.C.Forbes, founder of Forbes

"Location Savings", for want of an established definition, and in its most common parlance in the context of Transfer Pricing, refers to the net cost savings realised by a Multinational Enterprise ("MNE") predominantly as a consequence of relocating some of its operations from a "high cost" jurisdiction to a "low cost" jurisdiction, with a view to availing potential competitive advantages, arising as a result of price differences in the factors of production.

This article provides a brief overview related to the dynamics of location savings, its progression and impact. While Section A deals with the emergence of the location Savings concept, Section B sets out the Organisation of Economic Co-operation and Development ("OECD") view on the subject. Section C elucidates the concept of quantifying and attributing location savings, while Section D lays down a bird's eye view of three landmark Court Rulings involving location savings. Section E traces the rapid ascendancy of the concept of location savings in the Asian hemisphere concluding with a few key takeaways.

OPERATION BOOTSTRAP AND THE EMERGENCE OF LOCATION SAVINGS

The emergence of the concept of location savings in the context of transfer pricing may be traced to the emergence of "Operation Bootstrap" in the United States of America ("USA" or "US"), five decades ago. Operation Bootstrap represented a joint development between the USA and Puerto Rico governments with an enshrined objective of enhancing economic development and facilitating employment in Puerto Rico. While the US minimum wage applied to all US possessions, the rate of wages for any given type of labour were lower in the possessions than in the US, thereby clearly demonstrating the existence of location savings. Recognising the existence of such savings, the US Treasury released Revenue Procedure 63-10[1], elucidating that a manufacturing affiliate of the US, located in a possession ought to receive an arm's length compensation representing the same price that an independent manufacturer would attract for manufacturing the same product. Thus the Revenue Procedure aimed for the employ of the Comparable Uncontrolled Price ("CUP") Method, to establish transfer prices between the US entity and the manufacturer situated in a US possession.

In US Transfer Pricing Regulations[2] as prevalent currently, the concept of Location Savings is addressed in the following manner:

"If an uncontrolled taxpayer operates in a different geographic market than the controlled taxpayer, adjustments may be necessary to account for significant differences in costs attributable to the geographic markets. These adjustments must be based on the effect such differences would have on the consideration charged or paid in the controlled transaction given the relative competitive positions of buyers and sellers in each market. Thus, for example, the fact that the total costs of operating in a controlled manufacturer's geographic market are less than the total costs of operating in other markets ordinarily justifies higher profits to the manufacturer only if the cost differences would increase the profits of comparable uncontrolled manufacturers operating at arm's length, given the competitive positions of buyers and sellers in that market".

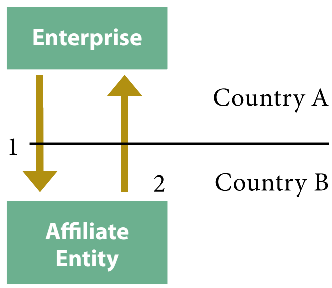
LOCATION SAVINGS AND OECD[3]

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter "Guidelines") contain a brief discussion of location savings in the context of the examination of the transfer pricing aspects of business restructurings.

The Guidelines by way of illustration provides the following two illustrations dealing with location savings

Illustration 1

A manufacturer of branded apparel operating in a high cost jurisdiction decides to relocate the production operations to an affiliate incorporated in a low cost jurisdiction.



Step 1

The enterprise in Country A decides to shut down its manufacturing operations on account of high costs of manufacturing and relocates the production function to an affiliate company in Country B, where there are competitive advantages vis-à-vis labour costs; The entity in Country A retains the rights on the brand name and continues designing the clothes

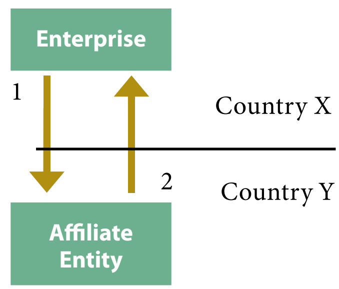
Step 2

The enterprise in Country B is characterised as a contract manufacturer manufacturing the finished goods for exclusive sale to the entity in Country A; Country B does not employ any substantial or non-routine intangible;

The Guidelines in the aforementioned example also assume that the lower labour costs of the affiliate in Country B will allow significant location savings. The Guidelines also propound that since the manufacturing activity is highly competitive, and also since Country A is a contract manufacturer assuming no material risks and not possessing any intangibles, the parent has the option realistically available to use either the affiliate or a third party. Hence, all or most of the location savings would be attributed to the entity in Country A.

Illustration 2

An entity in Country X is engaged in the business of providing specialised engineering services to independent clients. Country X charges a fee to its independent clients based on a fixed hourly rate that compares with the hourly rate charged by competitors for similar services in the same market.



Step 1

The enterprise in Country X establishes a subsidiary in Country Y where it hires equally qualified engineers for substantially lower wages, and subcontracts a large part of its engineering work to its subsidiary in Country Y; The Group derives material location savings as a result of this arrangement; The clients in Country X are not aware of the sub-contracting arrangement and continue to directly interact with Country X.

Step 2

The enterprise in Country Y

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[1] *Revenue Procedure .63-10, 1969-1. CB 490*

[2] *Section 482 regulations 1.482-1(d)(4)(ii)(C)*

[3] *Paragraphs 9.148-9.153 The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, ("OECD Guidelines, 2010)*

represents the sole entity capable of rendering such specialised engineering services

In the event, the subsidiary in Country B is the only one capable of providing the required quality standards (or has some locally developed intangibles) then a split of the profits is likely. Hence a Profit Split Method ("PSM") might represent the most feasible outcome to determine the beneficiaries of the location savings accruing to the Group.

STEPS IN QUANTIFYING LOCATION SAVINGS

The following broad steps may be employed in order to ascertain the existence of location savings and quantifying the same:

1. Evaluate the existence of Location Savings Advantages ("LSAs")

The starting point involves the ascertaining of LSAs. This takes the form of calculating the net cost savings. Some classical examples of cost savings would inter alia include, lower labour costs, reduced raw material costs, cheap availability of real estate, easy access to capital thereby resulting in decreased costs of financing etc. These costs savings should then be subtracted by off-setting disadvantages (if any), such as costs of conducting a business, high transportation costs as a result of an inefficient supply chain infrastructure, quality control issues as a result of a technically incapable work force etc.

After balancing all the cost savings against the corresponding cost 'dissavings', the net LSAs (if the savings exceed the dissavings), may be arrived at.

2. Identify Location Rents

Two quintessential factors encouraging the existence of Location Rents are:

- Ascertainable and quantifiable location specific advantages; and
- Such location savings advantages NOT being passed on to the end user or ultimate consumer

It needs to be mentioned that depending upon the facts and circumstances surrounding a particular case, there might be no location rents even assuming LSAs clearly exist[4]. The quantification of location rents may warrant different type of analyses, depending on the uniqueness of the case in hand and the various commercial and economic factors surrounding the business operations.

3. Apportionment of Location Rents

Whist apportioning the Location Rents, a critical aspect to be considered would be the presence or absence of bargaining power attributable to one or both of the transacting entities. This bargaining position to a great extent is dependent upon the contributions made by each party to the transaction/(s) in question, and more importantly is influenced by how each party perceives the contribution of the other.

An important facet to be considered is the potential of the bargaining power to shift. An entity enjoying a unique bargaining position might find such a position to be in constant flux depending upon geographical factors, economic exigencies or even political instability. To wrap it up, the notion of cost arbitrage has to be weighed against the realistic and feasible option of outsourcing the activities to an independent unrelated third-party. This is dependent upon the complexity of the services transferred/proposed to be transferred offshore and the possible existence of proprietary data.

Some of the more popular alternatives available to apportion the location rents are as follows:

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[4] *Paragraph 5.3.3.4.9 of the United Nations Transfer Pricing Manual for Developing Countries(UN TP Manual)*

- *Profit Split Analysis*

A Contribution Profit Split Method (subject to the availability and reliability of adequate and relevant data) may be employed to determine the share attributable to each party to the transaction under consideration depending upon the respective contributions made. Such an analysis involves ascertaining the access to location specific advantages.

- *50:50 Rule*

Often times, data inadequacy and paucity of market based information would preclude the employ of a Contribution Profit Split Method. Subject to the non-applicability of other realistically alternative methods, locations savings could be split equally amongst the transacting entities under the assumption that the contributions made by each of the said entities have been equally valuable.

- *Comparable Uncontrolled Price/Comparable Uncontrolled Transaction Method*

Use of CUP/CUT data represents the most direct method of allocating location savings to the parties contributing to the concerned transaction/(s). It consists in assessing the price to be charged by the LSA subsidiary to its parent by reference to the price charged by independent suppliers under similar circumstances. Judicial rulings have also looked at this approach in a favourable vein, as would be evidenced in the succeeding paragraphs.

- *Transactional Net Margin Method*

The lack of CUP/CUT data would force an MNE to fall back upon and resort to the adoption of the Transactional Net Margin Method ("TNMM") for the purpose of determining the sharing of location savings. A classic disadvantage of using TNMM would be the non-availability of adequate comparable companies, especially if the transaction/(s) under consideration is/ (are) unique in nature. This difficulty might not only impair the comparability analysis, but might also render the whole exercise, futile.

- *Shapley Value*

The Shapley Value, named in honour of Lloyd Shapley, who introduced it in 1953, is a solution concept in cooperative game theory.[5] To each cooperative game it assigns a unique distribution (among the players) of a total surplus generated by the coalition of all players. The Shapley Value is characterised by a collection of desirable properties.

To apply the Shapley Value concept, it is necessary, first, to identify the players in the game (i.e., the entities that can choose whether to interact). Second, it must be possible to determine the value associated with each prospective set of players if they interact. The basic idea of the Shapley Value is an incremental benefit concept. A player's value is to be determined from the value the player contributes to the other players. The crux of the Shapley Value is the concept of incremental. A player's value is to be determined from the value added by the player to the other players.

[5] *Sergiu Hart, Shapley Value, The New Palgrave: Game Theory, J. Eatwell, M. Milgate and P. Newman (Editors), Norton, pp. 210–216, 1989.*

With respect to location savings, in the event both players interact, the location savings would be realised, whilst no value would be created if both players refrain from interaction. If one player interacts and the other does not, the location savings less the costs of establishing an identical entity to the other player would be realised. Based on this analysis, the Shapley Value can be used to split the location savings.

JUDICIAL PRECEDENTS

The following paragraphs provide a brief overview of three seminal Rulings on location savings. Since the notion of location savings is only beginning to gain rapid ground and ascendancy in Asia, these decisions are in the context of the United States Transfer Pricing Regulations:

A. The Sundstrand Corporation Case[6]

Sundstrand Corporation ("Sundstrand", or SunCo") a company incorporated in the US, was engaged in the business of manufacturing components for power transmission, heat and fluid handling, and advanced technology. As part of its advanced technology business, SunCo, manufactured aviation components. One of such aviation components was the constant speed drives ("CSD").

Looking to expand its manufacturing operations, SunCo established a subsidiary in Singapore – SunPac. Singapore was chosen as a location with an objective of exploiting the potential cost efficiencies expected to realise on account of low costs associated with labour. SunPac was incorporated to primarily manufacture CSD spares. SunPac was characterised as a fully risk assuming manufacturing entity and a licensee of SunCo. SunPac paid a royalty to SunCo for the utilisation of manufacturing/product technology. However interestingly, although characterised as a full-fledged manufacturing entity from a transfer pricing perspective, SunPac exclusively sold the manufactured products to SunCo. In an ensuing trial, SunCo indicated that the group's intention was to have SunPac sell directly to independent unrelated third party customers. The intercompany transfer prices ensured that all location savings were left in Singapore as accruing to SunPac.

As a result of a transfer pricing audit, the US Internal Revenue Service ("IRS") challenged the aforementioned structure as well as the characterisation of SunPac. According to the Revenue authorities SunPac represented a "Contract Manufacturer" or a mere "machine shop" whose only customer was the parent entity. The IRS also deemed the Cost Plus Method to determine the arm's length rate of return to SunPac. While the IRS also contended that there existed no location savings that could be attributable to SunPac, SunCo provided substantial evidence to demonstrate the presence of location savings.

The Court, in its Ruling determined that since SunPac was operating under a license from SunCo, it could not be characterised as a Contract Manufacturer. The Court also agreed to the argument propounded by SunCo with respect to location savings. The Court ruled that SunPac should be the beneficiary of any component of location savings as the licensing arrangement with SunCo bestowed upon SunPac a "monopolistic status" with respect to the manufacture and sale of CSD spare parts. Such a monopolistic position would logically lead SunPac to determine the transfer prices in such a manner so as to cause all location savings to reside within the territorial boundaries of Singapore. This case law demonstrated that location savings could not only be

[6] *Sundstrand Corp v Commissioner, 96 T.C.M. (CCH) 226(1991)*

evidenced as to its existence, but the very concept was also amenable for a concrete quantification for the purposes of ascertaining the entitlement to benefits amongst the involved parties.

B. The Compaq Computer Corporation Case[7]

Compaq Computer Corporation ("Compaq", or CompCo") was in the business of designing, manufacturing and selling personal computers ("PCs"). Compco manufactured central processing units ("CPUs"), at various subsidiaries spread across the globe and also on a need basis, procured component parts from some of its sub-contractors.

CompCo set up Compaq Asia ("CompAsia") an Asian subsidiary in Singapore for manufacturing the electronic circuitry within the CPUs. This circuitry is popularly known as PCA. CompaqAsia was provided with the requisite equipment and production processes by CompCo for facilitating the production of PCAs by CompAsia. Although the technology transferred by CompCo to CompAsia could not be categorised as falling within the realms of 'proprietary technology', CompAsia was the only manufacturer of PCAs in Asia possessing the relevant ability and resources to meet the quality standards stringently set out by CompCo globally. This aspect lent a distinct attribute to the functioning of CompAsia and granted it a unique market standing.

A Cost Plus approach was adopted by CompCo for the determination of transfer prices between CompCo and CompAsia. Such a methodology led to all location savings residing with or accruing to CompAsia. Upon conducting an audit, the US IRS while also employing the Cost Plus formula, denied CompAsia the sole benefit of location savings and also reduced the profit element from the mark-ups agreed upon between the two transacting entities. Challenging the contention of the tax administration, CompCo obtained Comparable Uncontrolled Prices ("CUPs") from similar PCAs purchased from unrelated subcontractors, most of which were located in the United States: The CUPs adjusted by CompCo fully supported the prices actually charged by CompAsia and implicitly placed the benefit of the location savings in CompAsia.

The Court accepted the CUP analysis submitted by CompCo and desisted from making any adjustments towards location savings. The judgement of the Court was based on the fact that since all subcontractors (including CompAsia), were selling to cater to the needs of the market in the US, the relevant geographic market constituted the US market, thereby obviating the need to undertake adjustments for eliminating geographic differences.

C. The Bausch & Lomb Case[8]

Bausch & Lomb ("B&L") along with its subsidiaries was engaged in the business of manufacturing, marketing and selling of soft contact lenses and affiliated products. B&L incorporated a subsidiary in Ireland, B&L Ireland ("BLI") with a view to availing certain tax benefits that was accorded under the Irish Tax regime. B&L licensed the technology for the manufacture of lenses to BLI in addition to licensing some of its trademarks in relation to the sale of such lenses by BLI. A consideration by way of royalty was paid by BLI to B&L in respect of the aforementioned technology transfer. The lenses manufactured by BLI were sold to B&L at a price of US$7.50 per lens. Even though B&L purchased a significant quantity of such lenses from BLI, the former was not committed to procure all the lenses that were manufactured by BLI. BLI also sold the lenses to third parties outside the US for US$7.50.

The IRS challenging the aforementioned arrangement argued that BLI ought to have been characterised as a contract manufacturer, earning a routine rate of return commensurate with the functions performed, assets deployed and risks assumed. The IRS also contended that B&L, in the IRS's view, would not have licensed its technology or Intellectual Property to an unrelated supplier instead of hiring that supplier to manufacture

7 Compaq Computer Corporation and Subsidiaries v Commissioner, 99-00 T.C.M. Docket No.24238-96

8 Bausch & Lomb, Inc. v Commissioner, 92 T.C.M 525,581 (1989)

the lenses thereby earning the residual profit itself.

The Tax Court as well as the Second Circuit rejected the stance adopted by the IRS. The form and substance of the transaction clearly placed the risk of the manufacturing operations on BLI. Hence, BLI earned the profits from this activity. The comparable uncontrolled sale price for the lenses to third parties was crucial to this conclusion.

LOCATION SAVINGS – AN ASIAN PERSPECTIVE

With a burgeoning consumer base, ever increasing trade liberalisation coupled with clear economic advantages such as cheap and surplus labour, many MNEs from across the globe have made a beeline for India and China. So it comes as no great surprise that location savings has been gaining prominence in these two jurisdictions.

China's stance on Location Savings

The State Administration of Taxation ("SAT") has articulated its views on location savings. As per the SAT, foreign companies should be in a position to enjoy the fruits in the form of a higher profit margin due to either location savings or market premiums on account of the lower costs and enhanced selling prices in China.

India's view on Location Savings

Indian authorities have tended to take an aggressive approach when it comes to location savings. This is amply evident from the submissions made by India in the United Nations Transfer Pricing Manual, relevant extracts from which are as reproduced herein below:

"It has also been noticed that India provides the following Location Specific Advantages (LSAs) to MNEs in addition to location savings:

- *Highly specialised and skilled manpower and knowledge;*
- *Access and proximity to growing local/regional markets;*
- *Large customer base with increased spending capacity;*
- *Superior information networks;*
- *Superior distribution networks;*
- *Incentives; and*
- *Market premium"*[9]

However such extremely aggressive positions have been contested by the taxpayer and tempered by the Courts.

In a recently concluded case, the Mumbai Bench of the Income Tax Appellate Tribunal[10] held that location savings arising from a low cost base would not be subject to tax. The Tribunal reasoned that no additional tax liability could be claimed by the tax authorities from competitive industries under the garb of location savings. One of the key rationale influencing the final decision of the Tribunal (in its view) was the fact that the taxpayer operated in a competitive market and was precluded from enjoying exclusive access to factors that may have resulted in LSAs. Consequently, there was no super-profit accruing to the taxpayer vis-à-vis its competitors.

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[9] *Paragraph 10.4.7.4 of the United Nations Practical Manual on Transfer Pricing*

[10] *Watson Pharma Pvt Ltd v DCIT 8(3), Mumbai, ITA No. 1423 & 1565 / Mum/2014; 9 January 2014*

CONCLUSION

With ever reducing cost of and easy access to technologies, and availability of finance coupled with a shift in the balance of power from the Western hemisphere to the Eastern half of the world, location savings has the potential of creating a material impact upon the manner in which the business operations of an MNE is structured. With the ensuing OECD initiative on Base Erosion Profit Shifting ("BEPS"), location savings in the realm of transfer pricing will certainly cease to be a peripheral spectre. Astute planning and assiduous documentation might be the most appropriate way forward for an MNE boasting operations spanning territorial borders, for, while hindsight may be 20:20 vision, delayed clarity might mean definite disaster.

The author is an Associate Director with the Transfer Pricing practice of Deloitte Touche Tohmatsu Tax Services Sdn Bhd. The views postulated in this article solely represent the views of the author and may not be construed to represent either the views or the position that might be taken by Deloitte Touche Tohmatsu Tax Services Sdn Bhd upon this subject.

This column only covers selected developments from countries identified by the CTIM and relates to the period 16 November 2014 to 15 February 2015.

CHINA (PEOPLE'S REP.)

Rules on business restructuring relaxed

The MoF and SAT jointly issued a notice on 25 December 2014 (Cai Shui [2014] No. 109) on the changes to an earlier notice (Cai Shui [2009] No. 59) which deals with business restructuring. The notice retroactively applies from 1 January 2014 and is summarised below.

Acquisition by shares

Pursuant to Para 2, Article 6 of Cai Shui [2009] No. 59, acquisition by shares may be eligible for the special tax treatment of business restructuring and, therefore, no capital gains need to be realised for income tax purposes if certain requirements are met. One of the requirements is that the shares acquired account for more than 75% of the total shares of the acquired enterprise. This percentage has been reduced to 50%.

Acquisition by assets

Pursuant to paragraph 3 of Article 6 of notice Cai Shui [2009] No. 59, the acquisition by assets may be eligible for the special tax treatment of business restructuring and, therefore, no capital gains need to be realised for income tax purposes if certain requirements are met. One of the requirements is that the assets acquired account for more than 75% of the total assets of the acquired enterprise. This percentage has been reduced to 50%.

Transfer of shares and assets between group companies

The transfer of shares or assets between a resident parent and its wholly owned resident subsidiaries or between resident companies under 100% common control is eligible for the special tax treatment and, as a result, no capital gains need to be realised and the original tax base of the transferred shares or assets will be retained for the purposes of determining the values and depreciation, provided:

- the transaction has a reasonable commercial purpose and its primary purpose is not the reduction, exemption or deferral of taxes;
- the original substantive business operations related to the transferred shares and assets remain the same in the 12 consecutive months after the transfer; and
- the transferor and transferee have not recognised any gain on the transaction in their books for accounting purposes.

Taxation of investment by using non-monetary assets

The MoF and SAT jointly issued a notice on 31 December 2014 (Cai Shui [2014] No. 116) regarding the tax treatment of investments using non-monetary assets. The notice retroactively applies from 1 January 2014 and is summarised below.

The term "non-monetary assets" means any assets which are not cash, bank deposits, notes receivable or bonds. "Investment using non-monetary assets" is limited to situations in which a new enterprise is established or an investment is made in an existing enterprise.

The gains on the transfer of non-monetary assets used for the investment can be spread over a maximum of five years and included in the taxable income of the relevant tax year for the purposes of enterprise income tax.

The value of the shares acquired by contributing non-monetary assets must be set at the fair market value of the non-monetary assets plus the imputed gain of each year (if the gains are taxable over five years).

In cases where the investor disposes of the acquired shares or withdraws the investment within five years, the remainder of the gains which have been taxed must be included in the taxable income of the tax year in which the disposal of shares or the withdrawal of investment takes place, and taxed accordingly. This also applies to situations in which the investor is liquidated. In determining the value of the acquired shares, the new tax base of the shares (the original fair market value plus the realised gains) must be taken into account.

Enterprises that make investments by using non-monetary assets and that satisfy the requirements for the special tax treatment referred to in the notice Cai Shui [2009] No. 59 may elect to apply the special tax treatment.

Unsettled issues prior to the issuance date of this notice can be settled according to the rules of this notice.

HONG KONG

Amended Stamp Duty Bill 2014 gazetted

On 5 December 2014, the amended Stamp Duty Bill 2014 was gazetted by the Hong Kong Inland Revenue Department.

The revised bill seeks to implement the waiver of stamp duty payable on the transfer of shares or units of exchange traded funds as proposed in the 2014-15 Budget.

The bill will be submitted to the Hong Kong Legislative Council on 17 December 2014.

Extension of profits tax exemption to private equity funds proposed

The Financial Secretary of Hong Kong submitted a discussion paper to the Legislative Council Panel on Financial Affairs on 5 January 2015 concerning the extension of profits tax exemption to private equity funds. As a commitment of the 2013-2014 Budget announced by the Financial Secretary, the proposal aims to extend profits tax exemption to transactions conducted by offshore private equity funds in respect of eligible overseas portfolio companies and to further strengthen Hong Kong's status as a premier international asset management centre.

INDIA

Union Cabinet approves Goods and Services Tax Bill

On 17 December 2014, the Cabinet Committee on Economic Affairs approved the Goods and Services Tax (GST) Bill. The GST Bill will be tabled in the ongoing winter session of Parliament.

The GST Bill was first introduced in 2011 by the government and was approved with various recommendations by the Standing Committee on Finance on 7 August 2013.

Central Board of Direct Taxes notifies rules on income distributed by business trusts

On 19 January 2015, the Central Board of Direct Taxes (CBDT) notified via Notification No. 03/2015/F No/142/10/2014-TPL, dated 19 January 2015, rules to be followed by any person responsible for making payment of the income distributed on behalf of a business trust (BT) to a unit holder. As per the rules:

- the statement of income (SOI) distributed by a BT to its unit holder (UH) shall be furnished to the Principal Commissioner (PC) or the Commissioner of Income Tax (CIT), within whose jurisdiction the principal office of the BT is situated by 30 November of the financial year following the previous year during which such income is distributed;
- the above would be applicable provided the SOI shall also be furnished to the UH by 30 June of the financial year following the previous year during which the income is distributed;
- the SOI should be furnished to the PC or the CIT in Form No. 64A, duly verified by an accountant and should be furnished electronically under digital signature;
- the SOI should be furnished to the UH in Form No. 64B, duly verified by the person distributing the income on behalf of the BT; and
- the Director-General of Income Tax (Systems) shall specify the procedure for filing Form No. 64A and shall also be responsible for evolving and implementing appropriate security, archival, and retrieval policies in relation to the statements so furnished.

The Income Tax Rules 1962 will be amended with the insertion of rule 12CA after rule 12C, incorporating the above. The above amendments in the Income Tax Rules 1962 will be effective on the date of their publication in the official Gazette of India.

SINGAPORE

Revised transfer pricing guidelines

On 6 January 2015, the Inland Revenue Authority of Singapore (IRAS) issued revised transfer pricing (TP) guidelines. The revised e-Tax Guide consolidates the following e-Tax Guides published previously on:

- TP guidelines published on 23 February 2006;
- TP consultation published on 30 July 2008;
- supplementary administrative guidance on advance pricing arrangements published on 20 October 2008; and
- TP guidelines for related party loans and related party services published on 23 February 2009.

The 2015 TP guidelines are generally in line with the OECD Transfer Pricing Guidelines (2010) as well as some relevant areas of the Base Erosion and Profit Shifting (BEPS) initiative.

This e-Tax Guide contains the following main parts:

Part I – Transfer pricing principles and fundamentals

Part I provides guidance on the arm's length principle and transfer pricing documentation requirements.

(a) **Arm's length principle**
IRAS generally follows the OECD Guidelines, endorsing the arm's length principle as the standard to guide transfer pricing. The 2015 e-Tax Guide provides more guidance on the application of the arm's length principle, including on the recommended three-step approach to apply the arm's length principle in related party transactions.

(b) **TP documentation**
The section on TP documentation has been updated to provide more comprehensive guidance on TP documentation. IRAS requires contemporaneous TP documentation to be maintained by taxpayers. For ease of compliance, IRAS will also accept as contemporaneous TP documentation any documentation prepared at any time no later than the time of completing and filing the tax return for the financial year in which the transaction takes place.

The TP documentation is to be organised at both group and entity level. A monetary threshold (SGD15 million for four specific categories of related party transactions and SGD1 million for all other categories) is set for the preparation of TP documentation. In addition, TP documentation will not be required in the following circumstances:

- where the taxpayer transacts with a related party in Singapore and such local transactions (excluding related party loans) are subject to the same Singapore tax rates for both parties;
- where a related domestic loan (as defined) is provided between the taxpayer and a related party in Singapore and the lender is not in the business of borrowing and lending;
- where the taxpayer applies the 5% cost mark-up for routine services in relation to the related party transactions concerned; and
- where the related party transactions are covered by an agreement under an APA (an annual compliance report is still required).
- The TP guidelines set out various compliance matters relating to TP documentation, including the following:
- the date of creation or update of each document must be stated in the document;
- TP documentation is not required to be submitted when taxpayers file their tax returns, but must be submitted within 30 days upon request by IRAS; and
- TP documentation should be reviewed periodically.

Part II – Transfer pricing administration

The section on TP Consultation (TPC) has been updated to include a flowchart of the TPC process, and the "outdated" TP Questionnaire has been removed.

(a) **MAP and APA processes**
The TP guidelines also provide detailed step-by-step procedures for the mutual agreement procedure (MAP) and advance pricing agreement (APA) processes. Samples of documents such as the letter of authority and an APA are available in the annexes, as well as the minimum information required for pre-filing meetings and guidance on the annual compliance report for APA purposes.

Part III – Other issues

(a) **TP adjustments**
Part III includes a section on IRAS' position on the various types of adjustments relating to TP, which can be summarised as follows:

- Year-end adjustments: IRAS will accept year-end adjustments when the following conditions are met:
- TP analyses and contemporaneous TP documentation to establish the arm's length prices are in place;
- year-end adjustments are made symmetrically in the accounts of the affected related parties to avoid double taxation or double non-taxation; and
- adjustments are made before tax returns are filed.
- If the conditions are not met, IRAS will tax upward adjustments while not allowing downward adjustments.
- Compensating adjustments: these are adjustments made when the taxpayers' actual results differ from the agreed arm's length prices provided in the APA with IRAS. IRAS will tax upward adjustments and allow downward adjustments based on the terms provided in the APA.
- Self-initiated retrospective adjustments: these arise when taxpayers conduct a review of their past transfer prices due to subsequent changes in circumstances. IRAS will tax upward adjustments and allow downward adjustments. However, IRAS will not allow any retrospective downward adjustments in the absence of contemporaneous TP documentation to support the adjustments.
- Corresponding adjustments arising from transfer pricing adjustment by tax authorities: IRAS will only consider making corresponding adjustments to eliminate double taxation when there is a tax treaty in place and taxpayers have applied for the MAP provided in the tax treaty and such application is accepted by IRAS and the foreign tax authority. IRAS' position for corresponding adjustments is to tax upward adjustments and allow downward adjustments based on the MAP in the tax treaty.

(b) **Related party services**
IRAS has updated this section to provide clearer guidance on the application of the arm's length principle to related party services. This section includes:

- the use of the "benefits test" to determine whether related party services have been provided;
- detailed guidance on the application of the arm's length principle;
- administrative practices for routine support services; and
- a flowchart that summarises the application of the arm's length principle to related party services.

(c) **Related party loans**
IRAS provides further guidance in this section as follows:

- The application of the arm's length principle to related domestic and cross-border loans;
- details of the three-step approach to determine the arm's length interest charges for related party loans;
- illustration of the CUP method

as the preferred method for determining the arm's length pricing;

- guidelines for comparability adjustments where CUPs are available but not entirely comparable to the tested related party loan; and
- steps to determine the arm's length rate when an appropriate CUP is not available.

(d) Attribution of profit to permanent establishment

- The 2015 e-Tax Guide has a new section on IRAS' position regarding the attribution of profits to a permanent establishment (PE). No further attribution of profits to a PE is required when the following conditions are met:
- the taxpayer receives an arm's length remuneration from its foreign related party that is commensurate with the functions performed, assets used and risks assumed by the taxpayer;
- the remuneration paid by the foreign related party to the taxpayer is supported by adequate TP documentation to demonstrate compliance with the arm's length principle; and
- the foreign related party does not perform any functions, use any assets or assume any risks in Singapore, other than those arising from the activities carried out by the taxpayer.

THAILAND

Cabinet approves inheritance tax

On 18 November 2014, the Cabinet approved a bill introducing inheritance tax. According to the bill, the inheritance tax would apply as follows:

- pre-mortem inheritance: 5% if the value of the asset exceeds THB10 million (see Note); or

- post-mortem inheritance: 10% if the value of the asset exceeds THB50 million.

The bill will now be forwarded to the National Legislative Assembly for deliberation and approval.

Note. *Where the gifted asset is in the form of real estate, it is the giver that will be accountable for the tax.*

VIETNAM

Law No. 71 – CIT, PIT and other amendments

On 26 November 2014, the National Assembly (NA) approved legislation amending a number of tax laws. The official legislation (Law No. 71/2014/QH13) was subsequently issued and is summarised below.

Corporate income tax

- The 15% cap on deductible advertising and promotion expenses for CIT purposes has been removed.
- New investment projects that manufacture supportive industrial products which have been prioritised by the Ministry of Finance (MoF) are entitled to:

(i) 10% tax rate for 15 years;
(ii) tax exemption for four years; and
(iii) 50% tax reduction for nine years.

This incentive applies in particular to high-tech products and products that support the textile, footwear, IT and automotive industries.

- Large-scale manufacturing projects are also entitled to the tax incentives (i) to (iii) if the investment capital is at least VND12 trillion; the projects use certified technology; and the capital disbursement is within five years of the licensing date.
- From 1 January 2016, the preferential tax rate for investment projects located in areas with difficult socio–economic conditions will reduce from 20% to 17%.
- Qualifying companies would be able to select the most favourable and appropriate tax incentives based on those available at the date of licence as well as any new/amended incentives subsequently introduced.

Personal income tax

- Income from business activities will no longer be taxed according to the progressive PIT rates if the annual revenue exceeds VND100 million. Instead, the income, which may now also be finalised separately from employment income, will be taxed at the following flat rates:

Business activity	Rate (%)
leasing	5.0
insurance/multi-level marketing/lottery agent	5.0
supply/distribution of goods	0.5
services, construction without materials	2.0
production, transportation, services associated with goods, construction with materials	1.5
other business activities	1.0

be taxed at the deemed rates (i.e. at gross) of 0.1% and 2% respectively. The option to pay PIT on the net profit is no longer available.

- Income of Vietnamese vessel crew members working for foreign shipping companies or Vietnamese international transportation companies will be exempt from PIT.

Tax administration

The "higher" interest rate of 0.07% per day on tax overdue for more than 90 days is abolished. However, the penalty of 0.05% per day from the payment due date remains.

Tax exemption for global sovereign bonds

On 1 November 2014, the government issued Resolution No. 78/NQ-CP exempting income from government (i.e. sovereign) bonds issued in 2014 on the global market from both corporate and personal income tax.

Decree 91 and Circular 151

The MoF issued Decree 91/2014/ND-CP (Decree No. 91) on 1 October 2014 amending current decrees on corporate income tax, personal income tax, value added tax, and tax administration. Circular 151/2014/TT-BTC was subsequently issued on 10 October 2014 to provide guidance on the implementation of Decree 91.

The key points of both Decree No. 91 and Circular No. 151, which took effect from 15 November 2014, are summarised below.

Corporate income tax (CIT)

- The tax exemption period for income from science research and technology development has increased from one year to three years. The tax exemption period for income from the sale of products manufactured by technology new to Vietnam has also increased, from one year to fie years.
- For a first investment project which indicated involvement of multiple stages, the profit derived from subsequent phases will remain under the same CIT incentive programme as the first stage. This treatment is effective from 1 January 2014.
- The list of industrial zones (IZs) subject to CIT incentives has been expanded to include those IZs located within the urban districts which are newly developed from 1 January 2009.
- Welfare expenditure for staff and/or family members of staff are deductible but capped at the average monthly salary and must be accompanied by supporting documents.
- Provisional quarterly CIT returns are no longer required to be filed but taxpayers are still required to estimate and make quarterly CIT payments.
- Decree 91 and Circular 151 also include provisions on existing incentives for expansion investment projects, export ratio and additional machinery and equipment purchase.

- Personal income tax (PIT)
- Accommodation benefits from an employer to employees working in IZs, economic zones, or in regions with difficult socio-economic conditions are exempt from PIT.
- Value added tax
- The sale of guaranteed assets for settlement of a guaranteed loan is VAT exempt.
- Enterprises with prior year annual revenue below VND50 billion (compared to VND20 million previously) can file a VAT return on a quarterly basis.

New Law on Investment 2014 and Law on Enterprises 2014

The National Assembly of Vietnam passed the new Law on Investment 2014 (LOI) and Law on Enterprise 2014 (LOE) on 26 November 2014. The new laws aim to create a clear, open and transparent environment for investors. Some of the important key points of these two laws are highlighted below.

Law of Investment 2014

- The list of prohibited and non-

prohibited business activities has been updated. The list consists of 6 prohibited business lines and 267 conditional business lines. Generally, investors will be permitted to carry out investment activities which are not prohibited by law. For conditional sectors, the conditions of the investment will be detailed in laws, ordinances, decrees and/or international treaties to which Vietnam is a member. All investment conditions from various previously issued legal documents which are contrary to this law will be abolished from 1 July 2016.

- The following projects will also be entitled to investment incentives:
- investment projects with an investment capital of VND6,000 billion or more, disbursed within three years from the date of issuance of the Investment Registration Certificates or Investment In-Principle Approvals;
- investment projects in rural areas which employ 500 employees or more; and
- high-tech enterprises and scientific and technology enterprises/organisations.
- A new system was introduced to classify entities with foreign capital into different concepts and groups.
- A corporation with foreign owned capital shall be treated as a "foreign investor" if it has:

(i) a foreign investor that holds 51% or more of its charter capital or, in the case of a partnership, the majority of unlimited liability partner(s) are foreign individuals;

(ii) a corporation(s) as per (i) above holding 51% or more of its charter capital; or

(iii) a foreign investor(s) and a corporation(s) as per (i) above jointly holding 51% or more of its charter capital.

- A corporation with foreign owned capital which does not fall under any of the above categories will be treated as a "local investor".
- Investment procedures applied to investment activities for the establishment of corporations are as follows:
- the investment procedures will be separated from the corporation registration procedures; and
- prior to registering a corporation in Vietnam, foreign investors must have investment projects and obtained the relevant approvals and/or certificates from various related bodies. Additionally, foreign investors must also obtain the Enterprise Registration Certificate (ERC).

Law of Enterprise 2014

- The enterprise registration procedures are now simplified. The Enterprise Registration Certificate (ERC) now only includes the name of the company, head office, details of the company's legal representative, details of the members of a limited liability company (LLC) or a partnership company, and its charter capital.
- Enterprises will be allowed to decide the form, contents and number of corporate seals/stamps to be used. However, they will have to lodge the relevant specimens with the business registration authority.
- The roles and duties of the legal representatives of the enterprises are clearly defined.
- Enterprises are required to notify the business registration authority within five days on changes in respect of information of their managerial persons (including members of the board of directors), controllers and/or directors/general directors.
- For foreign investors, payments for the purchase, sale and transfer of share of capital contribution and dividend distribution must be made via capital accounts opened at a bank in Vietnam (except for payments in kind).

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

The technical updates published here are summarised from selected government gazette notifications published between 16 November 2014 and 15 February 2015 including Public Rulings and guidelines issued by the Inland Revenue Board (IRB), the Royal Malaysian Customs Department and other regulatory authorities.

INCOME TAX

Finance (No. 2) Act 2014

Finance (No. 2) Act 2014, incorporating changes proposed in the 2015 Budget, was gazetted on 30 December 2014. The Act adopts all the changes proposed in the Finance Bill (No. 2) 2014.

Income Tax (Deduction for Cost Relating to Training for Employees for the Implementation of Goods and Services Tax) Rules 2014

Income Tax (Deduction for Cost Relating to Training for Employees for the Implementation of Goods and Services Tax) Rules 2014 [P.U.(A) 334], gazetted on 17 December 2014, provide a deduction to a qualifying person on the expenditure incurred in training its employees under an accounting or information and communication technology (ICT) training programme which is conducted in Malaysia for the purposes of the implementation of the Goods and Services Tax Act 2014 (GSTA), as verified by the Director-General of Customs and Excise. As the expense is wholly and exclusively incurred in the production of gross income, this training expense should already qualify for a (single) deduction under Section 33(1) of the Income Tax Act 1967 (ITA). The Rules thus effectively provide a qualifying person with a double deduction on the training costs and have effect for the year of assessment (YA) 2014 and YA 2015.

Income Tax (Deduction for Expenses in relation to Secretarial Fee and Tax Filing Fee) Rules 2014

Income Tax (Deduction for Expenses in relation to Secretarial Fee and Tax Filing Fee) Rules 2014 [P.U.(A) 336], gazetted on 17 December 2014, provide the following deduction to a resident person who has incurred and paid the following fees in the basis period for that YA:

a) Secretarial fee charged in respect of services provided by a company secretary registered under the Companies Act 1965, to comply with the statutory requirements under the Companies Act 1965. The Rules take effect from YA 2015 onwards and the total amount of deduction allowed is capped at RM5,000 per YA.
b) Tax filing fee charged by a tax agent approved under the ITA or the GSTA in respect of services provided for the:
    i) Preparation and submission of income tax returns in the prescribed form for the purposes of Sections 77, 77A, 77B, 83 and 86 of the ITA; and
    ii) Preparation and submission of forms prescribed for purposes of the estimate of tax payable under Section 107C of the ITA or a return in the prescribed form for purposes of Section 41 of the GSTA

For the tax filing fee, the Rules take effect from either YA 2015 or YA 2016 depending on whether the service provided is for i) or ii) as indicated above. For the former services, i.e. services provided for the preparation and submission of income tax returns in the prescribed form, the Rules take effect from YA 2016 onwards. For the latter services, i.e. services provided for the preparation and submission of the estimate of tax payable under the ITA or a GST return, the Rules take effect from YA 2015 onwards. The total deduction allowed is capped at RM10,000 per YA.

Income Tax (Deduction from Remuneration) (Amendment) (No. 2) Rules 2014

Income Tax (Deduction from

Remuneration) (Amendment) (No. 2) Rules 2014 [P.U.(A) 362], gazetted on 31 December 2014, take effect from 1 January 2015 and amend the Income Tax (Deduction from Remuneration) Rules 1994. The Rules provide that the employer must determine and make monthly tax deductions (MTD) from the employees' salaries based on either the schedule or the computerised calculation method.

Public Ruling No. 1/2013: Deductions for Promotion of Exports (minor amendment)

Paragraph 6.2.1(c)(i) of Public Ruling (PR) No. 1/2013: Deductions for Promotion of Exports, issued on 4 February 2013, was amended by the IRB on 29 December 2014. The amendment was made to clarify that payments made to non-resident marketing consultants are only subject to withholding tax if the services are performed in Malaysia.

Public Ruling No. 7/2014 – Unit Trust Funds Part II – Taxation of Unit Trusts

PR No. 7/2014 published on 4 November 2014 provides guidance on the taxation of unit trust funds and property trusts other than a real estate investment trust or property trust fund regulated by the Securities Commission. The new PR replaces PR No. 6/2013 published on 23 May 2013.

Public Ruling No. 8/2014 – Basis Period of a Company, Limited Liability Partnership, Trust Body and Co-operative Society

PR No. 8/2014 – Basis period of a company, limited liability partnership, trust body and co-operative society, which was published on 1 December 2014, provides guidance on the determination of basis periods upon commencement of operations and also when the said entities subsequently change their accounting periods (after commencement of operations). The PR replaces PR No. 5/2001 and 7/2001 that were issued on 30 April 2001.

Public Ruling No. 9/2014: Private Retirement Scheme

PR No. 9/2014: Private Retirement Scheme, which was published on 24 December 2014, provides guidance on the tax treatment of private retirement scheme (PRS) contributions by an individual and employers, and the income of the PRS fund.

Public Ruling No. 10/2014: Special Allowances for Small Value Assets

PR No. 10/2014: Special Allowances for Small Value Assets, which was published on 31 December 2014, explains the treatment of special allowances provided for purchase of small value assets. The new PR replaces the PR No. 1/2008 issued on 27 March 2008.

Public Ruling No. 11/2014: Forest Allowances and Expenses Relating to Timber Extraction

PR No. 11/2014: Forest Allowances and Expenses Relating to Timber Extraction, which was published on 31 December 2014, explains the type of capital expenditure that qualifies for forest allowances, the computation of forest allowances, the computation of forest charges on permanent cessation of the business of timber extraction and subsequent disposal of the forest, and the tax treatment in relation to logging expenses.

Public Ruling No. 12/2014: Qualifying Plant and Machinery for Claiming Capital Allowances

PR No. 12/2014: Qualifying Plant and Machinery for Claiming Capital Allowances, which was published on 31 December 2014, explains whether an asset is qualifying plant and machinery for the purpose of claiming capital allowances in determining the statutory income of a business. The new PR replaces PR No. 2/2001 dated 18 January 2001.

Public Ruling No. 1/2015: Club, Association or Similar Institution

Public Ruling (PR) No. 1/2015: Club, Association or Similar Institution, which was published on 12 January 2015, explains the taxation of a club, association or similar institution which is established and controlled by its members. The new PR replaces PR No. 5/2012 issued on 25 June 2012.

◆◆ 2015 Income Tax Return Filing Programme

The IRB has recently made available on its website, the 2015 income tax return filing programme (ITRF). Where a grace period is given, submissions shall be deemed to be received within the stipulated due date if received within the grace period. Settlement of balance of tax payable under Section 103(1) also applies to the grace periods. Where the ITRF/ balance of tax payable is not furnished within the grace period, penalty can be imposed based on the due date i.e. the original due date.

PETROLEUM INCOME TAX

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

Petroleum (Income Tax) (Accelerated Capital Allowances) (PETRONAS Marginal Field) Rules 2014 [P.U.(A) 304] gazetted on 13 November 2014, provide accelerated capital allowances on qualifying plant expenditure incurred by Petroliam Nasional Berhad (PETRONAS) from YA 2010 to YA 2024 for the purpose of carrying out petroleum operations in a PETRONAS marginal field. The allowances are granted in the form of an initial allowance of 25% and annual allowances of 15%. The Rules are deemed to have come into operation on 30 November 2010.

Petroleum (Income Tax) (Exemption) Order 2014

◆◆ Petroleum (Income Tax) (Exemption) Order 2014 [P.U.(A) 305] gazetted on 13 November 2014, exempts a portion of PETRONAS' chargeable income from the marginal field (determined in accordance with a formula) resulting in a reduction of the effective tax rate from 38% to 25%. The Order is deemed to have come into operation on 30 November 2010.

◆◆ Petroleum (Income Tax) (PETRONAS Marginal Field) Regulations 2014

Petroleum (Income Tax) (PETRONAS Marginal Field) Regulations 2014 [P.U.(A) 317] gazetted on 25 November 2014 set out the tax treatment for PETRONAS when carrying out operations in a PETRONAS marginal field. The Regulations are deemed to have come into operation on 30 November 2010.

STAMP DUTY

◆◆ Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) (No. 4) Order 2014

Loans Guarantee (Bodies Corporate) (Remission of Tax and Stamp Duty) (No. 4) Order 2014 [P.U.(A) 297] was gazetted on 10 November 2014 and came into operation on 17 December 2014. The Order provides that any tax payable under the ITA on the money payable in respect of the Commodity Murabahah Term Financing-I Facility Agreement of up to RM2,500,000,000 guaranteed by the Government of Malaysia shall be remitted in full. Also remitted is any stamp duty payable under the Stamp Act 1949 in relation to the Facility Agreement issued by Maybank Islamic Bank Berhad and Perbadanan Tabung Pendidikan Tinggi Nasional.

◆◆ Stamp Duty (Remission) Order 2014. Stamp Duty (Remission) (No. 2) Order 2014

Stamp Duty (Remission) Order 2014 [P.U.(A) 360] and Stamp Duty (Remission) (No. 2) Order 2014 [P.U,(A) 361], gazetted on 31 December 2014, came into effect on 1 January 2015 and provide a 50% stamp duty remission on the stamp duty chargeable on a loan agreement and instrument of transfer for the purchase of the first residential property costing not more than RM500,000 by a Malaysian citizen, where the sale and

purchase agreement is executed between 1 January 2015 and 31 December 2016.

CUSTOMS AND EXCISE DUTIES

Customs (Provisional Safeguards Duties) Order 2014 Safeguards Act 2006 and Customs Act 1967 [P.U. (A) 327/2014]

The Order provides for the provisional safeguards duties to be levied and paid by the importers in respect of the goods specified in columns (2) and (3) of the First Schedule, exported from the countries specified in column (4) of the First Schedule into Malaysia, at the rates specified in column (5) of the First Schedule. This Order has effect for the period from 14 December 2014 to 1 July 2015.

The provisional safeguards duties levied under this Order shall be guaranteed by a security of an amount equal to the amount of the duties levied. The classification of goods specified in the First Schedule shall comply with the Rules of Interpretation in the Customs Duties Order 2012 [P.U. (A) 275/2012]. The imposition of the provisional safeguards duties under this Order is without prejudice to the imposition and collection of import duties, sales tax (14 December 2014 to 31 March 2015) and Goods and Services Tax (from 1 April 2015 to 1 July 2015).

Customs (Amendment) (No.5) Regulations 2014 Customs Act 1967 [P.U. (A) 312/2014]

The Regulations provide for an amendment in Part l of the Second Schedule within the Customs Regulations 1977 [P.U. (A) 162/1977] and are deemed to have come into operation on 19 November 2014.

The 2014 amendment substitutes the Form Customs No. 22 appearing in Part 1 of the Second Schedule within the Customs Regulations 1977 [P.U. (A) 162/1977 under the heading 'Forms' with a new Form.

Please refer to P.U. (A) 162/1977 and P.U. (A) 312/2014.

Customs (Prohibition of Exports) (Amendment) Order 2015 Customs Act 1967 [P.U. (A) 8/2015]

The Order provides for an amendment in Part I of the Third Schedule of the Customs (Prohibition of Exports) Order 2012 [P.U. (A) 491/2012] and is deemed to have come into operation on 2 February 2015.

The Order provides a substitution of the words "That the export is accompanied by the CC and DD Certificate issued by or on behalf of the Director-General of the Malaysian Rubber Board" with the words "That the export is accompanied by the licence to pack rubber and licence to export rubber issued by or on behalf of the Director-General of the Malaysian Rubber Board" in relation to item 38 under the heading "Manner of Export" within Part I of the Second Schedule.

The Order also provides a substitution of the words "That the export is accompanied by the EE Certificate or a letter of exemption issued by or on behalf of the Director-General of the Malaysian Rubber Board" with the words "That the export is accompanied by the licence to export rubber gloves or a letter of exemption issued by or on behalf of the Director-General of the Malaysian Rubber Board" in relation to item 39 of the same heading as above.

Please refer to P.U. (A) 491/2012 and P.U. (A) 8/2015.

Customs (Prohibition of Imports) (Amendment) Order 2015. Customs Act 1967 [P.U. (A) 9/2015]

The Order provides for an amendment in Part l and Part ll of the Second Schedule of the Customs (Prohibition of Imports) Order 2012 [P.U. (A) 490/2012] and is deemed to have come into operation on 2 February 2015.

The Customs (Prohibition of Imports) (Amendment) Order 2015 provides an amendment by inserting item 10 and the particulars relating to it after item 9 within Part l of the Second Schedule and a deletion of item 19 and the particulars relating to it within Part ll of the Second Schedule.

Please refer to P.U. (A) 490/2012 and P.U. (A) 9/2015.

Customs (Prohibition of Exports) (Amendment) (No. 2) Order 2015. Customs Act 1967 [P.U. (A) 10/2015]

The Order provides for an amendment in the Second Schedule of the Customs (Prohibition of Exports) Order 2012 [P.U. (A) 491/2012] and is deemed to have come into operation on 2 February 2015.

The Customs (Prohibition of Exports) (Amendment) (No. 2) Order 2015 provides a substitution of the words "Ministry of International Trade and Industry" with the words "Ministry of Domestic Trade, Co-operatives and Consumerism", in relation to item 11 in column (5) under the heading "Ministry/ Department/Statutory Body Issuing Licence" within the Second Schedule.

Please refer to P.U. (A) 491/2012 and P.U. (A) 10/2015.

Customs (Prohibition of Imports) (Amendment) (No. 2) Order 2015. Customs Act 1967 [P.U. (A) 11/2015

The Order provides for an amendment in Part ll of the Fourth Schedule of the Customs (Prohibition of Imports) Order 2012 [P.U. (A) 490/2012] and is deemed to have come into operation on 1 March 2015.

The Customs (Prohibition of Imports) (Amendment) (No. 2) Order 2015 provides an amendment by inserting item 11 and the particulars relating to it after item 10 within Part ll of the Fourth Schedule.

Please refer to P.U. (A) 490/2012 and P.U. (A) 11/2015.

Customs (Prohibition of Imports) (Amendment) (No. 3) Order 2015. Customs Act 1967 [P.U. (A) 12/2015

The Order provides for an amendment in Part ll of the Second Schedule of the Customs (Prohibition of Imports) Order 2012 [P.U. (A) 490/2012] and is deemed to have come into operation on 2 February 2015.

The Customs (Prohibition of Exports) (Amendment) (No. 3) Order 2015 provides a substitution of the words "Ministry of International Trade and Industry" with the words "Ministry of Domestic Trade, Co-operatives and Consumerism", in relation to item 2 in column (5) under the heading "Ministry/Department/Statutory Body Issuing Licence" within Part ll of the Second Schedule.

Please refer to P.U. (A) 490/2012 and P.U. (A) 12/2015.

Excise (Amendment) (No. 2) Regulations 2014. Excise Regulations 1977 [P.U. (A) 322/2014]

The Regulations provide for amendments within the Excise Regulations 1977 [P.U. (A) 161/1977], which are referred to as the "principal Regulations" in these Regulations and are deemed to have come into operation on 15 December 2014.

The Excise (Amendment) (No. 2) Regulations 2014 provide an amendment by inserting Part XD and the particulars relating to it after Part XC. The Regulations further provide further amendments in Part ll of the First Schedule of the principal Regulations by inserting item 6, item 7 and the particulars relating to them respectively, and by inserting form JKED No. 6 after form JKED No. 5.

Please refer to P.U (A) 161/1977 and P.U. (A) 322/2014 for details.

GOODS AND SERVICES TAX

Updates on Industry Guides

i. Healthcare Services (revised as at 19 November 2014)
ii. Event Management Industry (as at 23 November 2014)
iii. Bereavement Care Services Industry (revised as at 24 November 2014)
iv. Pre-tertiary Education (revised as at 17 December 2014)
v. Societies and Similar Organisations (revised as at 18 December 2014)
vi. Legal Practitioners (revised as at 3 January 2015)
vii. Agents (revised as at 23 January 2015)

Updates on Specific Guides

i. Partial Exemption (revised as at 21 November 2014)
ii. Designated Area (revised as at 21 December 2014)

Other Updates

i. Frequently Asked Issues 3/2014 uploaded on GST Portal (29 December 2014)
ii. Frequently Asked Issues 4/2014 uploaded on GST Portal (2 January 2015)
iii. List of Sundry Goods uploaded on GST Portal (15 January 2015)
iv. Shopper's Guide released on KPDNKK Portal (http://ebook.kpdnkk.gov.my/ebook/PANDUAN_HARGA_PENGGUNA_-_ZON_TENGAH/index.html)
v. DG's Decision 01 2015 uploaded on GST Portal (6 February 2015)

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

CASE

KETUA PENGARAH HASIL DALAM NEGERI V OKA CONCRETE INDUSTRIES SDN BHD(KUALA LUMPUR HIGH COURT(2015) MSTC 30-091)

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 its own, and also disallowed the reinvestment allowance claims made by the taxpayer on the Disputed Items.

The Special Commissioners of Income Tax ("SCIT") allowed the taxpayer's appeal. Aggrieved by the decision, the Revenue appealed to the High Court.

ISSUES

The main issues before the High Court were as follows:

(a) Whether the following items claimed by the taxpayer qualify for reinvestment allowance:

Factory:

(i) Fencing
(ii) Maintenance parts storage area
(iii) Office
(iv) Bridge
(v) Road
(vi) "Pile shoe" fabrication yard

Plant and machinery:

(i) Mixer trucks
(ii) Batching plant
(iii) Cranes
(iv) Tipper lorries
(v) Compressor
(vi) Weigh bridge

(collectively referred to as "Disputed Items")

(b) 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 the Disputed Items.

(a) Capital allowance

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

(i) 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 Income Tax Act 1967 ("ITA"); and

(ii) 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:

(i) 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;

(ii) 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;

(iii) The subsidiary's labour was at all material times under the taxpayer's instruction and supervision;

(iv) 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…*"

Upon a full evaluation of the SCIT's findings, the High Court agreed with the taxpayer's counsel's contention "that the law only requires the mixer trucks and batching plant to be used for the purposes of the appellant's business. The law does not require the appellant to physically operate the mixer trucks and batching plant". The High Court added that there is no room for the Revenue to read in the additional requirement that the mixer trucks and batching plant cannot be operated by a contract labourer on behalf of the respondent. As long as the taxpayer had incurred capital expenditure on the mixer trucks and batching plant, remained the owner of the items and used the items for the purposes of its business of manufacturing pre-cast concrete, the taxpayer is entitled to claim capital allowance. The High Court also took the view that the Revenue has no authority to dictate how the taxpayer should conduct its business. The taxpayer is at its own liberty to conduct his business with all available means to make good profits. The High Court observed that the Revenue failed to note that the labour contractors used all the respondent's plant and machinery including mixer trucks and batching plant in the taxpayer's factory in Batu Gajah for the preparation of ready mix concrete. The labour contractors were at all material times under the taxpayer's instruction and supervision. The products are made in accordance with the taxpayer's specification. Thus, instead of the taxpayer employing the labour directly, for better management, the labour in regard to the making of ready mixed concrete for the business of the taxpayer is supplied by labour contractors.

(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 & Transformer Manufacturer Sdn Bhd* (2012) MSTC 30-039**, 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. Further, the Court of Appeal had recently affirmed the High Court's decision in *Success Electronics* (supra), which had *inter alia* decided as follows:-

"(a) The word 'factory' was not defined for the purpose of this reinvestment allowance … In the absence of such express definition to the word 'factory', the word should then be given its ordinary meaning.
(b) A factory is a building that is used to manufacture goods which may contain areas for production and non-production.
(c) The imposition of the condition "production area" based on internal ruling or guidelines of the respondent are without any legal authority and therefore had no force of law.
(d) The respondent is not entitled to reduce or to disallow the reinvestment allowance claimed under Schedule 7A of the Act based on its own internal ruling or guidelines.
(e) The functionality of the claimed items in the overall context of the manufacturing process ought to be taken as a valid factor to be considered in giving the appropriate meaning to the word 'factory'.
(f) If the Parliament had intended for the word 'factory' to be narrowly interpreted to mean as was submitted by the respondent, then an express definition, different from the one provided for the term factory in Schedule 2, ought to have been so provided in Schedule 7A."

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.

The High Court agreed with the SCIT's ruling and commented that if Parliament had intended reinvestment allowance to be restricted only to "production area", then Parliament would have surely specified this clearly in Schedule 7A. As an example, the High Court referred to the House of Lords' decision in As an example, the High Court referred to the House of Lords' decision in ***Saxone Lilley & Skinner (Holdings) Ltd vCommissioner of Inland Revenue* [1967] 44 TC 122** where the United Kingdom tax authority's attempt to impose an additional condition in determining the taxpayer's eligibility for industrial building allowance was rejected by. The following passage by Lord Reid in Saxone Lilley (supra) was quoted with approval by the High Court:

" The Crown's main argument was that 'in use for the purposes of a trade' or of a part of a trade means wholly or mainly in use for such purposes. But that involves writing in words which are not there, and I can see nothing in the context to make that necessary. Moreover, it requires no feat of imagination in a draftsman to see that cases may arise where the same building or the same part of it is being

used for two purposes, and if it were intended to exclude such cases I would expect that to he made clear ... "

The Revenue's appeal was dismissed with costs. The Revenue has appealed to the Court of Appeal.

CASE

KETUA PENGARAH HASIL DALAM NEGERI V METACORP DEVELOPMENT SDN BHD (FEDERAL COURT, CIVIL APPEAL NO. 08(F) – 371 – 2011(W) THE HIGH COURT DECISION IS REPORTED AT (2011) MSTC 30-024)

FACTS

This matter originated as a judicial review application at the High Court by the taxpayer seeking for:

(a) A Declaration that the Respondent is bound by and shall give effect to the decisions of the Supreme Court in ***Lower Perak Co-operative Housing Society Berhad v Ketua Pengarah Hasil Dalam Negeri [1994] 3 CLJ 541 and the Court of Appeal in Ketua Pengarah Hasil Dalam Negeri v Penang Realty Sdn Bhd [2006] 2 CLJ 835***, which held that gains arising from the compensation for compulsory acquisition of land are not subject to income tax as the element of compulsion vitiates the intention to trade;

(b) A Declaration that the Decision Impact Statement issued by the Respondent has no legal effect and cannot override the Courts' decisions in *Lower Perak* and *Penang Realty*;

(c) A Declaration that in the event there is a conflict between the Decision Impact Statement and Courts' decisions in *Lower Perak* and *Penang Realty*, the Courts' decisions shall prevail over the Decision Impact Statement by virtue of being part of Malaysian laws; and

(d) An Order of Certiorari to remove into this Honourable court for the purpose of it being quashed the decision of Respondent to raise notices of additional assessment dated 9.12.2009 for the years of assessment 2004 and 2005 against the Applicant as the Respondent had acted *ultra vires* and without any factual or legal basis in raising the said notices.

The taxpayer was a property developer. In 1994, the taxpayer purchased two parcels of land in Mukim Ayer Keroh, Melaka. On two different occasions, one on 31.10.2003, and another on 26.10.2004, the State Government of Malacca issued notices of award and offered compensation pursuant to Section 16 of the Land Acquisition Act 1960 to compulsorily acquire the taxpayer's land. The taxpayer received the compensation but did not subject the compensation to income tax. The Revenue issued notice of additional assessment with penalty for years of assessment 2004 and 2005. The taxpayer did not appeal against the assessment to the Special Commissioners of Income Tax in accordance with Section 99 of the Income Tax Act 1967. Instead, the taxpayer filed for a judicial review and had obtained leave from the High Court on 6.1.2010.

ISSUE

Whether the gains arising from the compulsory land acquisition were subject to income tax?

DECISION

The main issue of contention was whether or not the gains arising from the compensation for compulsory

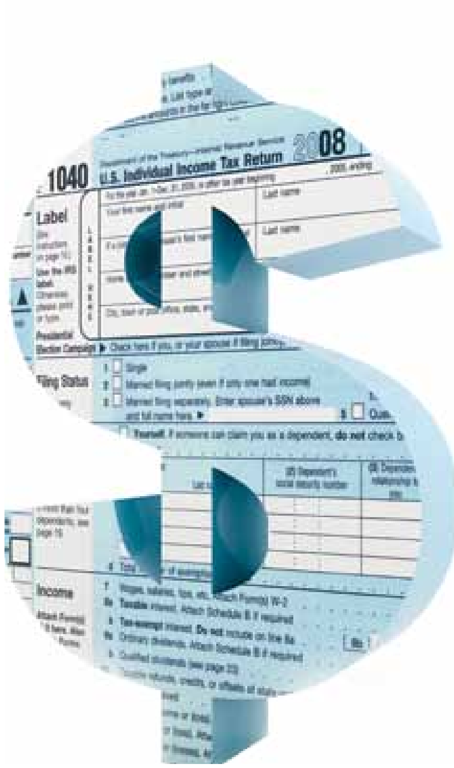
acquisition of the taxpayer's land were subject to income tax under the law. The contention of the taxpayer was based on the decision of the Court of Appeal in *Penang Realty* (supra) which held that the compulsory acquisition of land could not constitute a sale taking the position that profits derived from the compensation paid to the taxpayer on account of compulsory acquisition of the land was not profit that arises from taxpayer's business. The superior Courts in *Penang Realty* (supra) and *Lower Perak* (supra) had held that compensation for compulsory acquisition of land was not subject to income tax. The principle established in those two cases was based on the premise that the element of compulsion vitiates the intention to trade. The general law and the law on income tax, requires that a sale must be consensual. It must be based on one's own free will. Thus, since gains derived from compensation paid to the taxpayer were on the account of compulsory acquisition, it was not profit arising out of the taxpayer's business activity.

For this reason the taxpayer submitted, the Revenue's decision which was based on the Decision Impact Statement **("DIS")** was clearly without any legal authority. The DIS was defective and the Revenue in issuing and relying on the DIS had acted *ultra vires.* It also attracted a constitutional issue under Article 96 of the Federal Constitution which provides that *"no tax or rate shall be levied by or for the purposes of the Federation except by or under the authority of federal law"*. The DIS had no legal effect and cannot override the decisions of the superior courts. Since the DIS was not issued pursuant to any power given by law, it had no force of law relying on the decision in ***Multi-Purpose Holdings Berhad v Ketua Pengarah Hasil Dalam Negeri [2006] 1 CLJ 1121 and Ho Kok Cheong Sdn Bhd & Anor v Lim Kay Tiong & Ors [1979] 2 MLJ 224.***

The High Court added that matters of tax involve inter alia, balancing the need of the government to realise the taxes and the need of the taxpayer to be protected against arbitrary or incorrect assessment brought about by fallible officers who have to fulfil the collection of a certain publicly declared targeted amount of taxes and whose assessment may be influenced by the target to be achieved rather than the correctness of the assessment.

According to the High Court, upon examining the decision of the Court of Appeal in *Penang Realty*, it was clear that the facts of that case were relevant to the present case. The following are the salient principles enunciated by the High Court:

(a) The Court of Appeal's decision in *Penang Realty* is clear whereby compensation from compulsory acquisition is not liable to tax. The Case of ***F. Housing v Director-General of Inland Revenue [1976] 2 MLJ 183*** was distinguishable because the taxpayer in F Housing knew fully well that land in question was to be acquired by the government even before they were purchased. They then took steps to develop the land and convinced the Collector that the market value of the land had increased at the point of acquisition. Eventually after the award of compensation was made the company was wound up. On the given facts of that case it was held that the compensation in that case should be treated as income and therefore attracted taxable gain.



(b) The Court of Appeal in *Penang Realty* followed the Supreme Court in *Lower Perak Co-Operative Housing Society Berhad*. It applied the principle enunciated by the Supreme Court in *Lower Perak* that the compulsory acquisition cannot constitute sale because of the element of compulsion, which vitiates the intention of trade.

(c) It was common ground that the land in question was stock-in-trade and that it was compulsorily acquired. To constitute gross income a third element is required that the stock-in-trade must be compulsorily acquired in ***the course of carrying on a business.*** Even applying Section 24(1)(a) it was clear that it must be read conjunctively.

(d) The failure of the Revenue to follow the decision of the Superior Courts in *Penang Realty* as well as *Lower Perak* renders its decision defective. These two cases are binding authorities on the Respondent, being an arm of the executive. Also based on doctrine of *stare decisis* the High Court is also bound by the decisions of the superior court. Since the Revenue's decision was not based on the legal authorities of the Superior Courts such decision is in excess of its authority.

The decision of the High Court was unanimously affirmed by the Court of Appeal. The Revenue's application for leave to appeal to the Federal Court was unanimously dismissed by the Federal Court.

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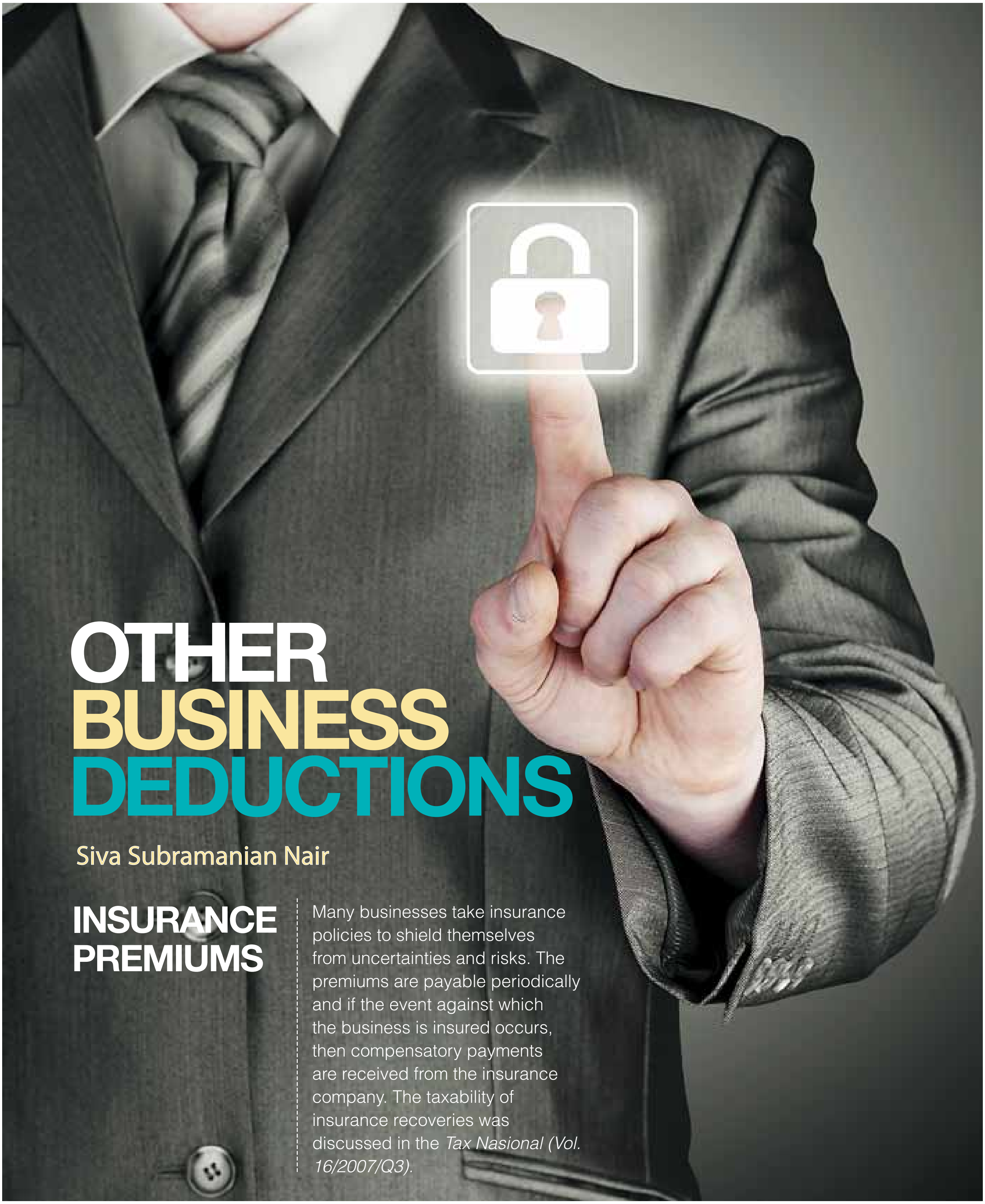

OTHER BUSINESS DEDUCTIONS

Siva Subramanian Nair

INSURANCE PREMIUMS

Many businesses take insurance policies to shield themselves from uncertainties and risks. The premiums are payable periodically and if the event against which the business is insured occurs, then compensatory payments are received from the insurance company. The taxability of insurance recoveries was discussed in the *Tax Nasional (Vol. 16/2007/Q3)*.

In that article it is evident that the general rule in determining whether insurance recoveries are taxable was whether the premium in respect of that policy was deductible; i.e. where the premiums are deductible then any recoveries would be taxable and *vice versa* because Section 22(2)(a) of Income Tax Act 1967 (as amended) states that

"….the gross income of a person from a source of his for the basis period for a year of assessment shall include any sums receivable or deemed to be have been received for that basis period in relation to that source of income by way of insurance, …where such sums are in respect of the kind of outgoings and expenses deductible in ascertaining the adjusted income of that person from that source…":

This article will discuss the deductibility of insurance premiums.

STAFF INSURANCE POLICIES

It is common for a company to take an insurance policy on the life of its staff. The tax treatment for this can be in different varying scenarios.

Company is the beneficiary

An insurance premium relating to group insurance policies or other policies taken by the company where the company is the beneficiary (i.e. the company receives the insurance compensation upon the demise of the staff), will be deductible in ascertaining the adjusted income of the company.

Sometimes, the sums recovered from the insurance company is given to the family of the deceased as a token of condolence but the expense in respect of this gesture will not qualify as a deduction as it is not incurred in the production of income. The consolation is that the amount received is also not taxable for the family.

Family / next-of-kin of the staff is the beneficiary

In these cases the family or any person nominated by the staff receives the insurance compensation upon the demise of the staff but the premiums paid will still be deductible as staff costs. However, the insurance premium paid by the company will be reflected as a perquisite received by the staff and be taxed as part of his employment income.

To provide funds to pay gratuity / retirement benefits etc.

Sometimes companies do not create an internal provision for gratuity or other retirement benefits payable to the staff upon cessation of employment. Instead they take an insurance policy whereby premiums are paid on a regular basis and when any staff is about to resign, the insurance company will pay the policy-holding company the sum required to settle the retirement benefits of that staff. This is illustrated in **Figure 1**.

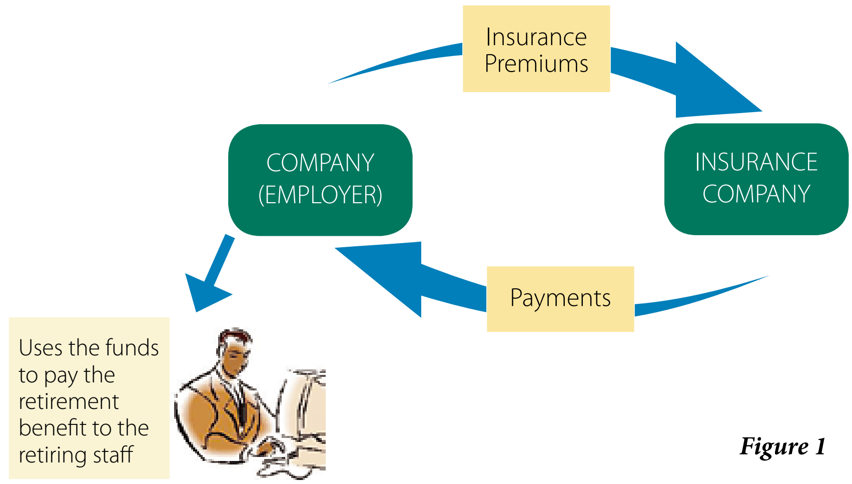

Figure 1

In these cases, the premiums paid by the employer is not deductible and accordingly any amounts recovered are not taxable. However, the amounts paid by the employer to the staff as retirement benefits qualifies as a legitimate staff cost which will rank for a deduction in arriving at the adjusted income of the employer.

Key-man insurance policies

The tax implications of a key-man insurance policy is explained in Public Ruling No: 2/2003 which was issued on 30 December 2003.

What is a key-man policy?

The ruling describes a "key-man" or "key-person" insurance as a policy taken on the life of an employee or a director who is a "key" person to cover the risk of loss of business income which arises due to the death, critical illness, sickness, accident or injury of that key-man or key-person. The right to the insurance proceeds of a "key-man" insurance must remain with the employer or company and the proceeds must not be payable to the "key-person" or his family.

Deductibility of premiums paid

The ruling explains that generally, a premium paid on an insurance, which is intended wholly and exclusively to recover moneys that would replace a loss of profits on the happening of the event insured against, would be allowable as a deduction against the gross income of a business. Therefore, premiums in relations to key-man policies should be deductible.

However, the premium on the policy is allowable only if the insurance has no element of investment and the insurance is taken on the life of a "key-person" whose absence would result in a reduction in the profits of the employer or the company.

Which policies qualify?

Policies that have no element of investment are term life and accident policies. These policies expire at the end of the insured period and there is no return on the premium paid if the insured person lives or is not injured.

A whole life policy and an endowment policy have elements of investment and are therefore regarded as capital assets of a company. Both policies have cash values that can be redeemed after being in force for several years. For an endowment policy there is a lump sum payable upon maturity of the policy. The premium payable on a whole life or an endowment policy is not allowable in arriving at the adjusted income from a business of a company

The above is summarised in **Figure 2** below.

OTHER INSURANCE POLICIES

The general rule is that where the insurance premiums paid related to revenue or trading activities then it would rank for a deduction whereas if it is a capital-based transaction then it is not allowable. Therefore, a transaction which can give rise to or create a trading loss for the company will be of a revenue nature and in consequence any insurance premiums paid to avert such a loss will be deductible in arriving at the adjusted income of the company. Most of the cases relating to insurance dealt with the issue on the taxability of the insurance recoveries but as we have seen earlier the taxability of the recovery occurs when the premiums are deductible, therefore, we can use these cases to illustrate which transactions are revenue in nature and which are capital.

Generally trading or revenue activities include loss of profits, repairs to business premises, defalcation by employees and theft or pilferage of trading stock. In ***J. Gliksten & Sons Ltd v Green 14 TC 364***, a company carrying on a business as timber merchants insured its timber against destruction by fire. Since the timber constitutes its stocks therefore, the insurance premiums were deductible.

Examples of capital transactions would include those involving investments or fixed assets. In ***Crabb v Blue Star Line, Ltd. 19 TC 482***, a company purchased ships and insured for the payment of fixed daily sums if delivery of the ships was delayed. Delivery was in fact delayed. It was held that the premium and recoveries under the policies were of a capital nature because the insurance was incidental to the acquisition of the ships which were fixed assets.

INSURANCE PREMIUMS QUALIFYING FOR DOUBLE DEDUCTIONS

Insurance premiums paid for the import of cargo and also export of cargo insured with any insurance company incorporated in Malaysia qualifies for a double deduction provided that the premium is allowable under Section 33 of Income Tax Act 1967. However, this incentive is only valid until 2015 by virtue of Income Tax (Deductions of Insurance Premiums for Importers) (Revocation) Rules 2012 and Income Tax (Deductions of Insurance Premiums for Exporters) (Revocation) Rules 2012 both of which shall have effect from the year of assessment 2016.

Premium paid on export credit insurance taken with a company approved by the Minister of Finance i.e. Malaysia Export Credit Insurance Berhad also qualifies for a double deduction but the premium must be allowable under Section 33 of Income Tax Act 1967

Now let us look at some examination questions relating to deductibility of insurance premiums paid. Most questions in **Tax II Question 1** based on preparing a tax computation for a company will contain insurance premiums paid. We shall look at two recent sittings.

TAX II J14 QUESTION 1

Note 9 Freight and insurance premium:

TAX II D13 QUESTION 1

Note 5 Insurance comprises:

i. Export credit insurance premium of RM10,000 paid to Malaysian Export Credit

KEY-MAN POLICIES	WHOLE LIFE	ACCIDENT
Deductibility of premiums	Not deductible	Deductible
Taxability of recoveries	Not taxable	Taxable

Figure 2

Insurance Berhad.

ii. During the year, the company purchased a key-man endowment policy on the life of the Marketing Director and paid a premium of RM4,000 for the first year. The company is the beneficiary of the policy and would receive RM250,000 and any bonus declared, at the end of 15 years or upon the death of the Marketing Director, whichever is earlier.

The company also purchased another key-man term policy on the life of the Managing Director for an annual premium of RM6,000.

For 6 marks, a theoretical question was posed in ***Tax II D07 Question 5(A)***

Arjun Sdn Bhd took a "key-man" life insurance policy on the lives of the following employees;

i. the Technical Director, paying a premium of RM6,000 per annum on a whole life policy, and

ii. (ii) the Marketing Director, paying a premium of RM8,000 per annum on an accident policy.

In 2007, Arjun Sdn Bhd received a compensation of RM1 million and RM1.25 million in respect of the Technical Director and Marketing Director respectively upon their untimely demise in a fatal accident.

Required: Discuss with reasons the taxability of the compensation and deductibility of the premiums paid for year of assessment 2007.

Solution

The sum of RM1 million received by the company is not taxable whereas the RM 1.25 million received is taxable. This follows from the fact that the premium of RM 6, 000 is not deductible but the RM 8,000 is deductible.

As per Public Ruling No. 2/2003, policies such as accident or term policies, have no element of investment and expire at the end of the insured period with no return on the premium paid if the insured person lives or is not injured.

However, a whole life or endowment policy have elements of investment and are therefore regarded as capital assets of a company. Both policies have cash values that can be redeemed after being in force for several years.

This marks the end of our discussion on the deductibility of insurance premiums paid.

PARTICULAR	RM'000	SOLUTION
Insurance premium paid to a Malaysian insurance company for the export of cargo to foreign destinations.	210	Double deduction
Key-man insurance policies premiums paid during the year (Note 1 has already stated that [the company] has purchased key-man endowment policies on its directors)	26	Not deductible
Insurance paid to foreign shipping and other carriers for the Axxel's export	299	Allowable

Note 9 Freight and insurance premium

SOLUTION (TAX COMPUTATION COMMENCING WTH PBT)	
Export credit insurance – double deduction	Less10,000
Key-man endowment policy	Add 4,000
Key-man term policy	No adjustment needed

Note 5 Insurance comprises:

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CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: April – June 2015

Month /Event	Details				Registration Fee (RM) (excluding GST)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
APRIL 2015								
Workshop: Submitting Your First GST Return Correctly	6 Apr	9a.m. – 5p.m.	Kuala Lumpur	Thenesh Kannaa	400	450	500	8 WS/009
Workshop: Understanding the Legal and Practical Aspects of Withholding Taxes	9 Apr	9a.m. – 5p.m.	CTIM Training Room	Kularaj	300	350	400	8 WS/005
Seminar: Analysis of Recent Tax Cases 2014 & Understanding Processes	13 Apr	9a.m. – 5p.m.	Penang	Abu Tariq & Saravana Kumar	420	470	520	8 SE/006
Seminar: Analysis of Recent Tax Cases 2014 & Understanding Processes	16 Apr	9a.m. – 5p.m.	Johor Bahru	Abu Tariq & Saravana Kumar	420	470	520	8 SE/007
Workshop: Understanding the Legal and Practical Aspects of Capital Allowances	20 Apr	9a.m. – 5p.m.	CTIM Training Room	Kularaj	300	350	400	8 WS/006
Seminar: Analysis of Recent Tax Cases 2014 & Understanding Processes	21 Apr	9a.m. - 5p.m.	Kuching	Abu Tariq & Saravana Kumar	420	470	520	8 SE/008
Workshop: Accounting for GST	22 Apr	9a.m. - 5p.m.	Kuala Lumpur	Zen Chow	400	450	500	8 WS/011
Seminar: Analysis of Recent Tax Cases 2014 & Understanding Processes	23 Apr	9a.m. - 5p.m.	Kota Kinabalu	Abu Tariq & Saravana Kumar	420	470	520	8 SE/009
MAY 2015								
Seminar: To be confirmed	7 May	9a.m. - 5p.m.	Kuala Lumpur	Various Speakers	450	500	550	8 SE/010
Workshop: Understanding the Legal and Practical Aspects of Tax Audits and Investigations	14 May	9a.m. - 5p.m.	CTIM Training Room	Kularaj	300	350	400	8 WS/007
Training Course for the GST Tax Agent *(6-day)* GST Examination Day *(subject to RMCD confirmation)*	9, 10, 11, 16, 17 & 18 May 30 May	9a.m. - 5p.m.	Kuala Lumpur	Royal Malaysian Customs Dept.	2,200 *(fee for 6 days course)*	2,700 *(fee for 6 days course)*	3,000 *(fee for 6 days course)*	JV/009
Public Holiday ***(Labour day: 1 May)***								
JUNE 2015								
Seminar: Getting Ready for GST Audits	8 June	9a.m. - 5p.m.	Kuala Lumpur	Thenesh Kannaa & Renganathan	450	500	550	8 WS/010
Workshop: Understanding the Legal and Practical Aspects on Deductibility of Expenses Based on Public Rulings *(with relevant Budget 2015 updates)*	24-25 June	9a.m. - 5p.m.	Kuala Lumpur	Kularaj	600	700	800	16 WS/008
Public Holiday ***(DYMM Agong's Birthday: 6 Jun)***								

DISCLAIMER : The above registration fees are subjected to 6% GST. The information is correct and accurate at the time of printing. CTIM reserves the right to change the speaker (s)/date (s), venue and/or cancel the events if there is insufficient number of participants. A minimum of 3 days notice will be given.

ENQUIRIES : Please call Ms Yus, Mr Jason, Ms Jas, Ms Ramya or Ms Ally at 03-2162 8989 ext 121, 108, 131, 119 and 123 respectively or refer to CTIM's website **www.ctim.org.my** for more information on the CPD events.

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PREMIER TAX EVENT OF THE YEAR

NATIONAL TAX CONFERENCE 2015

25 & 26 AUGUST 2015 | KUALA LUMPUR CONVENTION CENTRE

PARTNERING STAKEHOLDERS in a Challenging Environment

The Lembaga Hasil Dalam Negeri Malaysia (LHDNM) and the Chartered Tax Institute of Malaysia (CTIM) will be co-hosting the National Tax Conference for the 15th successive year on 25 - 26 August 2015 at the Kuala Lumpur Convention Centre, Kuala Lumpur.

This conference will provide a good platform for interaction and building mutual understanding amongst key players in the tax arena; taxpayers, tax practitioners, tax administrators and tax policy makers.

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

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