Official Journal of the Chartered Tax Institute of Malaysia

tax guardian

Vol.12/No.3/2019/Q3

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ctim
CHARTERED TAX INSTITUTE OF MALAYSIA

RM30.00

WHY WITHHOLDING TAX STILL REMAINS A MYSTERY AFTER MANY DECADES

- Can the IRBM Reinstate a Dissolved Company to Raise Income Tax Assessments?
- Special Voluntary Disclosure Programme – Taxpayer's Perspective
- Business Deductions: Allowance

ISSN 0128-7583
9 770128 758008

CHARTERED TAX INSTITUTE OF MALAYSIA

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

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Tax Guardian

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

INVITATION TO WRITE

The Institute welcomes original contributions which are of interest to tax professionals, lawyers, 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.

Contributions may be sent to:
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FARAH ROSLEY

RENEWAL AND CHANGE

Greetings! A CTIM Council meeting was held immediately after the conclusion of our 2019 Annual General Meeting (AGM) on 22 June 2019 to elect the incoming President and Deputy President for the term 2019/2020. I am pleased to report that I have been elected as the new President with Chow Chee Yen as my Deputy President. I would like to thank the CTIM Council Members for entrusting us with the mandate to take the Institute forward.

At the AGM, Mr. David Lai and Mr. Koong Lin Loong were re-elected to serve a 2nd four-year term in the CTIM Council, and Mr. Chong Mun Yew and Mr. Alan Chung were elected to serve a four-year term in the CTIM Council for the first time. I heartily congratulate them for being successfully appointed to the CTIM Council.

Upon completion of their 2nd four-year term in the CTIM Council, the outgoing President, Ms. Seah Siew Yun and Mr. K. Sandra Segaran have retired from the CTIM Council at the above-mentioned AGM. I would like to express my deepest appreciation and gratitude to them for their years of invaluable and selfless service to the Institute. Ms. Seah was the CTIM President for two continuous terms from 2017/2018 to 2018/2019. In that short period of time, she was instrumental in building up the image and branding of the Institute as well as enhancing the Institute's rapport and engagements with government agencies and new and existing stakeholders. Her leadership, commitment and tireless efforts have been exemplary and enabled CTIM to leap forward during her two years period as President. Mr. Segaran has been a key member of the CTIM Technical Committee on Direct Taxation. He was also the Co-Organising Chairman of the National Tax Conference Joint Committee for 2018/2019 and Chairman of the Examinations and Education Committee from 2016/2017 to

2017/2018, Editorial Committee from 2013/2014 to 2015/2016 and Research Committee from 2011/2012 to 2012/2013. My deepest appreciation to both Ms. Seah and Mr. Segaran for their contribution to CTIM over the past years and my very best wishes to them.

I am pleased to set-out below some of the key happenings which the Institute was involved in, in the preceding quarter:-

2019 Corporate Income Tax Return (Form C)

Ever since the Inland Revenue Board Malaysia's (IRBM) format of the 2019 Corporate Income Tax Return (Form C) was released to the public at the beginning of this year, the Institute has received numerous feedbacks from concerned members particularly on the information required to be disclosed in the 2019 Form C and worksheets in relation to real property company status, controlled or related party transactions and withholding tax, which is more extensive than the Form C in prior years. The Institute has conveyed members' concerns to the IRBM and engaged with the IRBM in a series of meetings and discussions. The IRBM has considered the issues raised and taken action which has been reflected in the recent changes to the 2019 Form C format uploaded in the IRBM's website. Members can still raise their issues on the 2019 Form C format to the Institute by email at *technical@ctim.org.my* as part of the process of continuous improvement.

Guidelines on Application for Stamp Duty Relief

The IRBM has issued Guidelines on Application for Stamp Duty Relief under Sections 15 and 15A of the Stamp Act 1949 in February 2019 which provide clarification on the amendments to Sections 15 and 15A introduced by the Finance Act 2018 with effect from 28 December 2018 onwards. These Guidelines also set-out the IRBM's interpretation on stamp duty relief provisions, some of which have given cause for concern to the Institute and members such as stating that Section 15A does not apply to transfers of business. The Institute has reviewed the Guidelines and submitted feedback/comments on the issues and concerns arising to the IRBM for their consideration. Members will be updated by e-CTIM when the IRBM's responses have been received.

2020 Budget Proposals

As in previous years, the Institute was invited to submit proposals for the 2020 Budget to the Ministry of Finance (MoF) which the Institute has duly done so at the end of May 2019. The proposals are on direct taxation and indirect taxation in the areas of cost of doing business, attracting quality investment and managing the rising cost of living amongst others. The proposals also reflect the Institute's and members' concerns on issues arising from tax developments which need to be addressed or remedied through the amendment of existing tax legislation or introduction of new tax legislation. Members can access the proposals in the "Members Only" section in the Institute's website.

Tax Agent Licence & Post Licensing Issues Seminar

A Tax Agent Licence & Post Licensing Issues Seminar was organised by the CTIM Public Practice Committee and held at the Sheraton Imperial Hotel in Kuala Lumpur on 18 April 2019. The seminar was aimed at encouraging members to apply for the tax agent licence and be informed on post licensing compliance matters. It covered matters such as tax agent licence requirements and procedures, the IRBM's expectations from tax agents, what to expect at the tax agent interview, post licensing issues and immediate action plan to be a licensed tax agent which were presented by speakers from the MoF, IRBM, CTIM and the private sector. The seminar received good response with a turnout of approximately 200 participants.

CPD Events

As you would be aware, this year's National Tax Conference 2019 organised jointly by the IRBM and the Institute will be held from 5 August 2019 to 6 August 2019 at the Kuala Lumpur Convention Centre. The conference theme is on "Economic Prosperity & Taxation" and it will cover contemporary topics such as Economic Prosperity Towards A Resurgent Malaysia, LHDNM's Strategies & Challenges, Navigating Tax Reforms, Digital Economy – Online Transactions, Deductible Expense Under Section 33(1) – To Deduct or Not to Deduct?, Updates of Tax Cases and Round Table Discussion on Current Issues & Concerns. Not only will participants who attend this event obtain 25 CPD points, which can be used for the Section 153 tax agent licence application/renewal, they will also be acquainted with the current and coming tax developments and subject matter experts. Do come and support this major event and sign up for it early.

Membership

I am pleased to inform that the Institute's membership comprising of fellow members and associate members has reached 3,600 members. This is largely attributable to the hard work of my predecessor, CTIM Council Members and all those involved in encouraging eligible individuals to apply for membership in the Institute. I am most grateful for all their efforts and I look forward to being involved in the continuing growth of our membership in terms of quantity and as well as quality.

The Institute continuously endeavours to stay ahead as the premier body for tax professionals in Malaysia. Towards this purpose and with the support of the CTIM Council, I hope to carry on the good work and high standards which have been put in place by my predecessors. The Council and I would also like to take this opportunity to thank all members and friends of the Institute for your assistance and involvement in the Institute's activities and events, which have contributed significantly to the achievements of the Institute.

Editor'sNote

YEO ENG PING

Its that time of the year where preparations for Budget 2020 themed "Kemakmuran Bersama: Menjana pertumbuhan inklusif yang berkualiti ke arah ekonomi berpendapatan tinggi" are underway, with Budget consultations being called by the Ministry of Finance. CTIM was invited on 27 June 2019, and YB Lim Guan Eng shared on the several key policy directions:-

- To continue fiscal consolidation by reducing the deficit from 3.7% of GDP in 2018 to 3.4% in 2019 and achieve 3% in 2020.
- To increase Malaysia's competitiveness, where current ranking is at 22.
- To continue to encourage foreign direct investments, recognising the trade conflicts externally
- To continue to encourage, develop and adopt technology, innovation and digitalisation

The last few months have also been interesting. At the 34th ASEAN Summit on 22 June 2019 in Bangkok, the Prime Minister Tun Mahathir raised the possibility of taxing e-commerce transactions, given the growth of online business in contrast to traditional "bricks and mortar" businesses. Our tax laws are keeping up and have already seen changes to tax e-commerce, such as the service tax on imported services and expansion of the "royalty" definition in the Income Tax Act 1967 a few years ago. Just recently in June, the Customs issued a Guide on Information Technology Services, which provides examples of IT services that are within the service tax scope and treatment of imported services. These include digital data services delivered through the Internet e.g. ebooks, content, newspapers, journals, media streaming; software support services, as well as training services (as part of consultancy, training or coaching services). Guides on this topic have also been issued by the IRBM including an update in May 2019 to the Guidelines on taxation of electronic commerce transactions (e-CT), issuance of Practice Note No. 1/2018 on the tax treatment of digital advertising provided by a non-resident in March 2018. However, these laws do not as yet cover the full spectrum of issues in the taxation of e-commerce (which may potentially be harmful to the tax base of a country), and like many other countries there are debates on what more needs to be done in terms of taxation policy including introduction of new unilateral taxes. Perhaps once international bodies such as the OECD and the UN have completed their recommendations, expected in 2020, we will see further changes of our tax laws in this area.

Two articles in this edition of the *Tax Guardian* touches on some of the tax issues that will be pertinent as we consider the taxation of certain e-commerce businesses, one is on withholding tax where it includes a discussion on the scope of the Malaysian "royalty" definition, and another on the taxation of intangibles.

Other news includes the introduction of new "earnings stripping rules" which come into effect from 1 July, to limit the deductibility of interest, where the maximum interested allowed as a tax deduction is 20% of the tax-EBITDA. This has been discussed for some time and it appears that a number of suggestions raised at the consultation sessions have been accepted. The Editorial Committee is calling for an article on this, so I will not steal the thunder from the author and stop here.

Its not exactly our usual area of practice, but you may also be interested to know that the Departure Levy Bill 2019 was passed. It proposes to impose a levy on outbound air travellers, to be implemented from 1 September 2019. This is expected to replace the tourism tax (which is a levy of RM10 per room per night at accommodation premises). The rate of departure levy will vary by class and destination of travel ranging from RM8 to RM150, but there are proposed exemptions - for example, for infants, transit passengers, crew, pilgrimage travellers, government agencies.

Finally, before I end this message, a reminder that the IRBM's special voluntary disclosure programme is still ongoing, but will end on 30 September 2019. There are three articles that I hope you will find interesting in this edition – one article provides broad perspectives on the SDVP so far, there is another which discusses the possibility of reinstating a dissolved company, and last but not least an article submitted by the Multinational Branch of the IRBM on common findings in transfer pricing audits.

CPD EVENTS

A series of events were conducted in the 2nd quarter of 2019 as follows:

- Quarterly Tax Updates
- Tax Agent Licence & Post-Licensing Issues
- The Art of Taxation and Staying Relevant in Changing Times
- Half-day Talk on SVDP: Let's Chat
- Employment Tax and Payroll Tax Malaysia

The Institute organised a series of seminars entitled "Quarterly Tax Updates 2019" at all major cities. Various speakers from CTIM Council Members and tax lawyers were invited to speak on "Post-Budget Updates", "Latest Public Rulings, Practice Notes & Guidelines" and "Re-visit of Selected Tax Cases 2018". Ms. Norhaslinda Bukhari, Director of Policy Consultation Division, Tax Policy Department of the Inland Revenue Board Malaysia presented a paper on "Post-Budget Updates – latest issues from the MoF & the IRBM and recent gazette orders" during the seminar in Kuala Lumpur on 24 April 2019. The session was chaired by Ms. Seah Siew Yun, CTIM President.

On 18 April 2019, a seminar on "Tax Agent Licence & Post Licensing Issues" was conducted at the Sheraton Imperial Kuala Lumpur Hotel. The objective of the seminar is to prepare tax practitioners to become a licensed tax agent. In addition, members had the benefit of being informed on post licensing compliance matters. Mr. Zen Chow, Chairman of Public Practice Committee gave an opening speech before other speakers shared their inputs on various subject matters.

A series of workshops on "The Art of Taxation and Staying Relevant in Changing Times" were conducted at all major cities by Ms. Yong Mei Sim. This workshop helped the participants to understand the IRBM's treatment for unexplained extraordinary wealth as well as using the AMLATPUA provisions to tax underground, illegal, corruption, bribery income and criminal activities as well as unexplained transactions and what are the critical tax issues which are often overlooked and how to address these tax issues.

CTIM organised a special half-day talk on "Special Voluntary Disclosure Programme (SVDP) - Let's Chat on 24 May 2019 at the G Hotel, Penang and 28 May 2019 at the Seri Pacific Hotel, Kuala Lumpur. The talk in Penang was presented by Mr. Arief Putra Mohd Sharipudin, Director, Innovation & Quality Division, Corporate Services Department (IRBM) and chaired by Ms. Kellee Khoo, CTIM Northern Branch Chairman. Ms. Farah Rosley, Deputy President of CTIM chaired the session in Kuala Lumpur whereas the talk was presented by Mr. Syarein Abu Samah, Director, Communication Division, CEO's Office (IRBM). Mr. Chow Chee Yen and Mr. S Saravana Kumar were involved as panel members at both locations. Approximately 100 participants attended the talks.

Ms. Sakaya Johns Rani conducted a workshop on "Employment Tax and Payroll Tax Malaysia in two major venues i.e Johor Bahru on 23 May 2019 and Kuala Lumpur on 18 June 2019. This workshop provided participants the opportunity to gain insights into Employment Tax and payroll blind spots in Monthly Tax Deduction (MTD), and Employer's tax statutory reporting - Form E and Form EA.

27TH ANNUAL GENERAL MEETING OF THE INSTITUTE - COUNCIL MEMBERS

The Chartered Tax Institute of Malaysia (CTIM) held its 27th Annual General Meeting (AGM) on 22 June 2019 at the Sheraton Imperial Hotel Kuala Lumpur. A total of 49 members attended the AGM.

Pursuant to Article 59, Lai Shin Fah @ David Lai and Koong Lin Loong were re-elected to the Council.

Pursuant to Article 57 (ii), the following were elected as new members of the Council:-

1. Alan Chung Ch'ung Yit
2. Chong Mun Yew

The first Council meeting for the 2019/2020 term was held on the same day. Pursuant to Article 63, the Council has elected from amongst the Council Members as listed below for the term 2019/2020, the President and the Deputy President.

President

Farah Rosley
Partner, Ernst & Young Tax Consultants Sdn Bhd

Deputy President

Chow Chee Yen
Tax Advisor, Grant Thornton Malaysia

Council Members

Phan Wai Kuan
Senior Executive Director, PwC Taxation Services Sdn Bhd

Nicholas Anthony Crist
Executive Director, KPMG Tax Services Sdn Bhd

Yeo Eng Ping
Partner, Asean Tax Leader, Ernst & Young Tax Consultants Sdn Bhd

Koong Lin Loong
Chief Executive Officer, Reanda LLKG International

Lai Shin Fah @ David Lai
Tax Executive Director, BDO

Mohd Noor Bin Abu Bakar
Partner, Imran Chartered Accountants

Chow Tuck Him
Head of Tax, YYC Tax Consultants Sdn Bhd

Leow Mui Lee
Managing Director, Axcelasia Taxand Sdn Bhd

Dr. Zulfahmy Bin Ibrahim
Executive Chairman, Zulfahmy & Co

Thenesh Kannaa A/L Kannan @ Renganathan Kannan
Partner, TRATAX

Low Geok Ping
Executive Director, Deloitte Tax Services Sdn Bhd

Soh Lian Seng
Executive Director, KPMG Tax Services Sdn Bhd

Alan Chung Ch'ung Yit
Head of Indirect Tax, Grant Thornton Malaysia

Chong Mun Yew
Executive Director, Crowe KL Tax Sdn Bhd

Farah Rosley *is a Partner in the business tax services practice of Ernst & Young Malaysia. She has more than 21 years of taxation experience. She has been a Council Member of CTIM since 2014 and Deputy President from 2017.*

Chow Chee Yen *is currently the Tax Advisor of Grant Thornton Malaysia. He has more than 28 years of taxation experience. He has been a Council Member of CTIM since year 2016.*

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: JULY - SEPTEMBER 2019

Month /Event	Details				Registration Fee (RM) (excluding service tax)			CPD Points/ Event Code
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
JULY 2019								
Seminar: Managing Large Taxpayers' Issues – practitioners' guide	3 July	9a.m. - 5p.m.	Kuala Lumpur	Various Speakers	450	550	650	8 SE/022
Seminar: Managing Large Taxpayers' Issues – practitioners' guide	10 July	9a.m. - 5p.m	Penang	Various Speakers	450	550	650	8 SE/023
Workshop: The Effects of Digital Tax in Malaysia	16 July	9a.m. - 5p.m	Kuala Lumpur	Sivaram Nagappan	400	550	600	8 WS/030
Seminar: Managing Large Taxpayers' Issues – practitioners' guide	18 July	9a.m. - 5p.m	Johor Bahru	Various Speakers	450	550	650	8 SE/024
AUGUST 2019								
NATIONAL TAX CONFERENCE 2019	5 & 6 Aug	9a.m. - 5p.m.	Kuala Lumpur	Various Speakers	Early Bird **1400** Normal Fee 1600	Early Bird **1500** Normal Fee 1800	Early Bird **1600** Normal Fee 1900	25 NTC/001
Workshop: Public Rulings 2019	27 Aug	9a.m. - 5p.m	Ipoh	Kularaj	350	450	500	8 WS/033
Workshop: Public Rulings 2019	29 Aug	9a.m. - 5p.m	Kuala Lumpur	Kularaj	400	500	600	8 WS/034
Public Holiday ***(Hari Raya Aidiladha: 11 Aug, National Day: 31 Aug)***								
SEPTEMBER 2019								
Seminar: Unravelling Tax Avoidance Issues	4 Sep	9a.m. - 5p.m.	Kuala Lumpur	Various Speakers	450	550	650	8 SE/021
Workshop: The Effects of Digital Tax in Malaysia	5 Sep	9a.m. - 5p.m	Johor Bahru	Sivaram Nagappan	350	450	500	8 WS/031
Workshop: Public Rulings 2019	10 Sep	9a.m. - 5p.m	Melaka	Kularaj	350	450	500	8 WS/035
Seminar: Taxation of Land Transaction	19 Sep	9a.m. - 5p.m	Johor Bahru	Various Speakers	450	550	650	8 SE/018
Seminar: Taxation of Land Transaction	30 Sep	9a.m. - 5p.m	Penang	Various Speakers	450	550	650	8 SE/019
Public Holiday ***(Awal Muharram: 1 Sep, Malaysia Day: 16 Sep)***								

DISCLAIMER : The above 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 and Ms Zaimah at 03-2162 8989 ext 121, 108, 131, 107 and 119 respectively or refer to CTIM's website **www.ctim.org.my** for more information on the CPD events.

WHY WITHHOLDING TAX STILL REMAINS A MYSTERY AFTER MANY DECADES (PART II)

SM Thanneermalai

Part II of this article will focus on the withholding tax issues around royalties, interest and public entertainers, and the relevant legislations are Section 109 and Section 109A together with the supporting legislations dealing with the charging sections, derivation sections and the tax rates which are to be found in Sections 4(a), 4(c), 4(d), Section 15, and Schedule 1 Part II of the Income Tax Act 1967 (ITA).

ROYALTIES

There is a great divide between the interpretation of the definition of "Royalties" in Section 2 of the ITA between the tax professionals / industry and the Inland Revenue Board Malaysia (IRBM).

The IRBM appears to be taking the position that most payments to non-residents involving the use of e-commerce and the Internet medium will fall within the withholding tax provisions. This is a cause of major concern to businesses as the withholding tax is frequently borne by the payer although the intention of the legislation is to tax the non-residents.

There is a failure to realise that in the past, when the medium was different, for example placing an advert on a billboard overseas, would not be regarded as a payment for the use of or the right to use copyrights or any intellectual property, and therefore would not be subject to withholding tax. However, today if the same advert is placed in an Internet platform through a non-resident provider of the platform, it appears that the IRBM takes the view that the payment would be subject to withholding tax under the royalty provisions on the basis that the business is allowed to use the software supporting the platform.

This doesn't make sense. The only thing that is different from the past and the present is that the medium has changed from a billboard to the Internet medium. How does this change the tax treatment?

The royalty relating to broadcasting, satellites, radiofrequency spectrums, and other visual images or sounds will not be dealt with in this article as it is very focused to certain specialist industries and will not affect general businesses.

USE OF, OR THE RIGHT TO USE

The key words under contention in Section 2(1) dealing with "Royalty" relating to the common business transactions are:

a) the use of, or the right to use in respect of, any copyrights, software, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks and other like property or rights.
b) The use of, or the right to use, know-how or information concerning technical, industrial, commercial or scientific knowledge, experience or skill.

Licensing is basically the right to use an intellectual property that is owned by someone else, whereby the licensor gives permission to the licensee under an agreement, while royalties are the payments for the use of that intellectual property.

Withholding tax on royalties will only apply if the Malaysian resident is making a payment to the non-resident for using the copyrights / software.

Some common examples of payments made to non-residents businesses are:

i) Payments for online advertising on Facebook / Google
ii) Payments for use of online payment systems such as Paypal
iii) Payments to online trading platforms such as Lazada / Ebay
iv) Payments to cloud computing service providers such as Amazon
v) Payments for subscriptions to content aggregators such as Bloomberg / CCH

The key question here is "Is the payment made for the use of or right to use the copyrights, software, and etc.?"

The IRBM has issued an updated guideline on taxation on electronic commerce transactions on 13 May 2019. The positions taken in the examples mentioned in the guideline bring most payments made to non-residents for electronic commerce transactions within the royalty or services withholding tax provisions. However, our observation of the tax treatment adopted in the examples is that the IRBM appears to be swaying towards taxing most of these payments under the royalty withholding tax provisions. In Example 3, where a company uses a non-resident social media company's platform to create an advertising campaign, the IRBM states the payments made for the use of the platform are subject to WHT under the royalty provisions.

This may not be a correct interpretation of the law. One has to ask the question "Is the copyrights or any intellectual property surrounding the platform being used by the resident taxpayer?" The answer would be negative. The user does not use the copyrights but merely places its advert onto the platform using the Internet. The platform has been setup and the user doesn't have right to exploit the copyrights and this will be clearly evident in the contract agreement between the user and the non-resident service provider. The platform also may allow you to choose the timing of your advertising, target audience, etc. and this is a service provided by the non-resident and any payments thereon should not be subject to withholding tax if the services are provided outside of Malaysia.

Although our legislation has included the word "software" into Section 2(1), any payments for the use of software would still be equivalent to a licensing payment, because anyone who owns the software, is legally the owner of the copyrights relating to the software. Adding the word "software" to the legislation doesn't appear to make any difference to the coverage.

Copyrights and software are not defined in the ITA. Guidance has to be found in Sections 7 and 3 of the Copyrights Act 1987.

Sections 7(1) of the Copyright Act 1987 provides—

"Subject to this section, the following works shall be eligible for copyright:

(a) literary works;

(b) musical works;
(c) artistic works;
(d) films;
(e) sound recordings; and
(f) broadcasts."

Section 3 of the Copyright Act 1987 defines "literary works" to include:

(a) novels, stories, books, pamphlets, manuscripts, poetical works and other writings;
(b) plays, dramas, stage directions, film scenarios, broadcasting scripts, choreographic works and pantomimes;
(c) treatises, histories, biographies, essays and articles;
(d) encyclopedias, dictionaries and other works of reference;
(e) letters, reports and memoranda;
(f) lectures, addresses, sermons and other works of the same nature;
(g) tables or compilations, whether or not expressed in words, figures or symbols and whether or not in a visible form; and
(h) computer programmes,..."

Section 13(1) of the Copyright Act 1987 states that copyright in a literary, musical or artistic work, a film, or a sound recording or a derivative work shall be the exclusive right to control in Malaysia—

The reproduction in any material form;

- The communication to the public;
- The performance, showing or playing to the public;
- The distribution of copies to the public by sale or other transfer of ownership; and
- The commercial rental to the public, of the whole work or a substantial part thereof, either in its original or derivative form

Payments for the use of the copyrights will only arise if the user is paying for the above purposes. Unless there is exploitation or use of the copyrights in the above circumstances, it would appear that any payments made to the non-resident would fall outside the provisions of "royalty" in the ITA.

Recently the Minister of Finance through the Income Tax (Exemption) (No. 4) Order 2019 has exempted non-residents from paying income tax and Section 109 withholding tax in respect of any income derived in Malaysia from payments received for shrink-wrapped software, site-licenses, downloadable software or software bundled with any hardware by an end user who is an individual resident in Malaysia so long as the end user uses the software for personal usage only. However, from this exemption order, it is clear that the authorities take the view that payments for software made by businesses (whether individual or corporate) will attract withholding tax under Section 109 of the ITA.

Guidance from Singapore and Australian tax authorities

Both countries' tax legislation also contains the words "use of, or the right to use" when dealing with the issue of royalties. Unlike Malaysia, they do not separately categorise software.

i) Singapore

Singapore has adopted a rights-based approach when dealing with payments for software, information and digitised goods. The rights-based approach draws the distinction between the transfer of a copyright right and the transfer of a copyrighted article from the owner to the payer.

A transaction involves a copyright right if the payer is allowed to commercially exploit the copyright. The term "commercially exploit" means able to:

a) Reproduce, modify or adapt and distribute the software, information and digitised goods; or
b) Prepare derivative works based on the copyrighted software programme, information or digitised goods for distribution

Payment for software or digitalised goods that do not involve the transfer of the copyrights embedded in the goods will be considered as payments for copyrighted articles and are not subjected to withholding tax.

If a person purchases software for personal use or for use within the business operations, the payment he makes is a payment for a copyrighted article, and thus it is not a royalty payment (withholding tax is therefore not applicable).

Payments for the use or the right to use information such as subscriptions to *Bloomberg, Reuters, LexisNexis*, etc. is not royalty because such information is only used to support the business just like any other asset and the usage of the information is limited both qualitatively and quantitatively. Such payments are considered as payments for copyrighted articles and not subject to withholding tax.

ii) Australia

In Paragraph 16 of Taxation Ruling IT 2660, the concept of payment for royalties "for the use of, or the right to use" covers all forms of exploitation of a right or property short of outright sale of the right or property. As to copyright, a payment for the right to produce, reproduce or exploit a work or other subject matter in which copyright subsists will be a payment for the use of the copyright, whether or not the right is actually used by the person paying the royalty.

It appears that unless the user exploits the copyrights, royalty is not payable. Exploitation here generally means commercial exploitation of the intellectual property rather than personal use or use within a business.

In Taxation Ruling 93/12, payments for any licence for the simple use of computer software (i.e. where the end-user acquires only the right to run the programme, whether on a single computer only or on the licensee's computer network, and does not acquire the rights to use the copyright in the programme) are not royalties.

Paragraph 26 of Taxation Ruling 93/12 states that if the end user is just granted licence to use shrink wrap software, where neither copyright of the programme nor property in the tangible carrying media (such as a disk) is transferred to the end user, the payments made thereon are not treated as royalty since the copyrights remain the property of the developer.

Both Australia and Singapore take a wider view on this matter. Payments for the use of software programmes downloaded via the Internet or purchased through tangible forms (such as discs or magnetic tapes) do not appear to attract withholding tax on the grounds they are not royalty payments if they are used for personal use or used in the business operations without commercially exploiting the software.

Alienation of property

Paragraph (h) of the royalty definition in Section 2(1) includes

payments for the alienation of any property, know-how or information mentioned in paragraph (a), (b) or (c) of the definition.

This is a paragraph that can cause concerns when Malaysian residents pay non-residents for the acquisition of intellectual property such as film rights, software, etc.

Alienation means the transfer or disposal of a property. Any sums paid in relation to alienation of intellectual property covered within the royalty definition has to be income of the non-resident for the royalty withholding tax provisions to apply.

Malaysia only taxes income. If the alienation of property is regarded from a Malaysian tax perspective as capital to the non-resident recipient, then Malaysia does not have the right to tax the non-resident and consequently, the money received by the non-resident from the alienation of property will not be subject to withholding tax.

INTEREST

Generally, from a withholding tax point of view, there are very few problems with interest payments. The area that sometimes causes a concern is the definition of interest. In order for interest to be arise, there must be a debt.

Interest is not defined in the ITA, while "Debt" is defined in Section 23(a) as a reference to a debt in a liquidated sum (whether or not due or due and payable). Unless the payment is defined as interest, withholding tax will not be applicable. However, one should distinguish interest from other forms of payments such as discounts, premiums, etc. which take into account an element of interest in arriving at such payments are not subject to withholding tax as the Section 109 specifically refers to interest.

The definition of interest can be wide. Paragraph 18 of the Commentary on Article 11 of the OECD Model states that the term "interest" designates, in general, income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in profits.

It is important to look at the underlying instrument before one can determine whether the payment is interest or a distribution of the share of the profits. This is applicable when dealing with the different types of bonds. The OECD in Paragraph 18 from the same commentary states bonds and debentures in particular, which carry a right to participate in the debtor's profits are nonetheless regarded as loans if the contract by its general character clearly evidences a loan at interest.

Paragraph 19 further states that interest on participating bonds should not normally be considered as a dividend, and neither should interest on convertible bonds until such time as the bonds are actually converted into shares. However, the interest on such bonds should be considered as a dividend if the loan effectively shares the risks run by the debtor company.

Careful evaluation of the payments relating to debt claims or hybrid debt claims should be done before a decision is made whether to pay withholding tax or not.

PUBLIC ENTERTAINER

The key issue here is whether a person who provides a service that can fall within the definition of public entertainer in Section 2(1) can also be simultaneously caught within Section 109B as providing services.

The overlap could cause a problem. Public Ruling No. 6 / 2017 - Withholding Tax on Income of a Non-Resident Public Entertainer makes it clear in its examples that if the person is speaking at a public event and is exercising his professional vocation, he falls within Section 109A withholding tax provisions as a public entertainer.

However, if the speaker was speaking to a closed door audience from one organisation, the non-resident will be subject to withholding tax provided the service is rendered in Malaysia.

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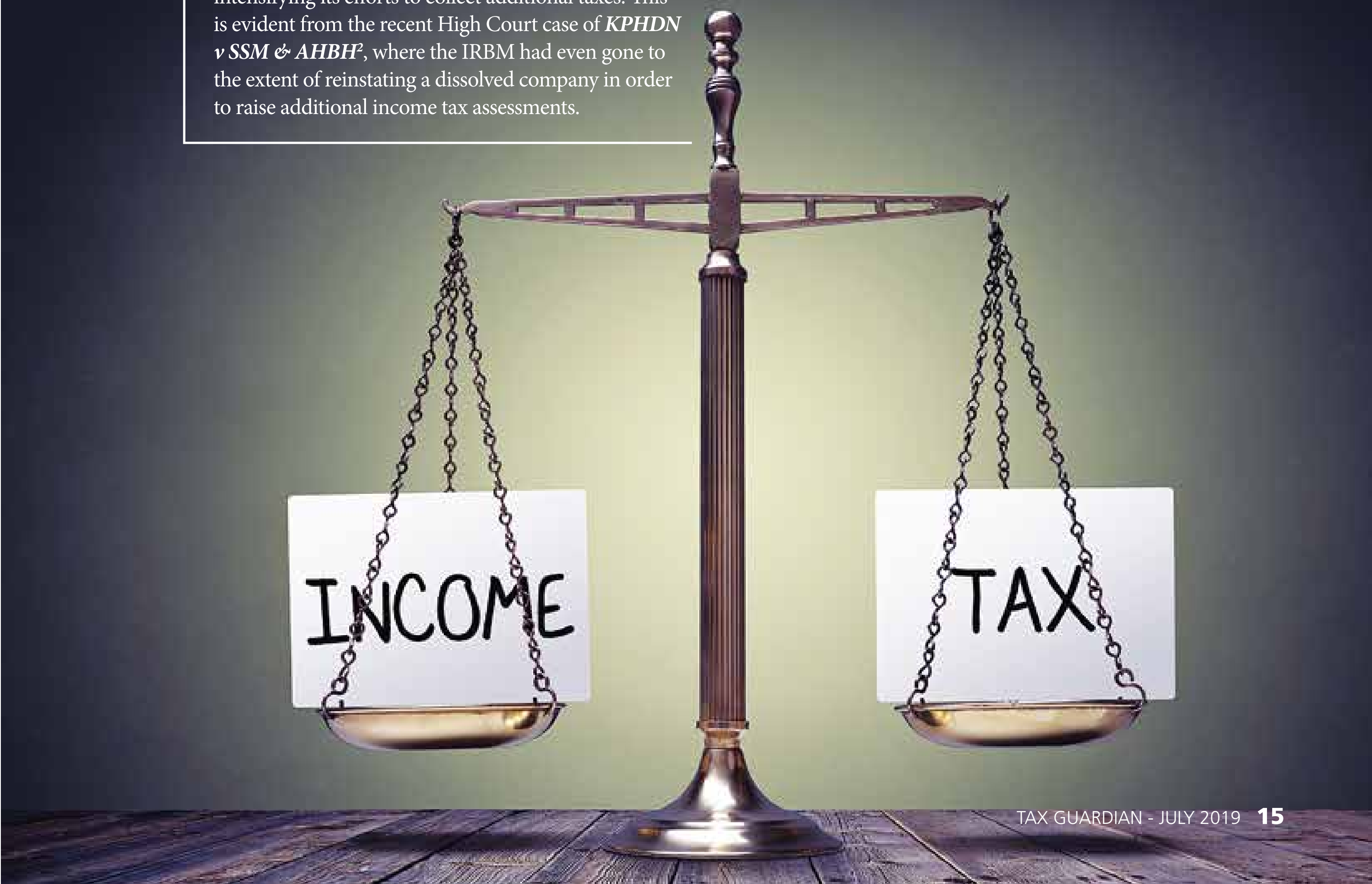
CAN THE IRBM REINSTATE A DISSOLVED COMPANY TO

RAISE INCOME TAX ASSESSMENTS?

S. Saravana Kumar & Tan Iyan Xin

With a target to collect more than RM150 billion worth of direct taxes in 2019[1], the Inland Revenue Board Malaysia (IRBM) seems to have been intensifying its efforts to collect additional taxes. This is evident from the recent High Court case of ***KPHDN v SSM & AHBH***[2], where the IRBM had even gone to the extent of reinstating a dissolved company in order to raise additional income tax assessments.



CAN THE IRBM RAISE ASSESSMENTS AGAINST DISSOLVED COMPANIES?

The legal position in relation to a dissolved company is clear. A company ceases to exist for any purpose upon its dissolution[3]. Therefore, an action or proceeding brought against a dissolved company cannot be sustained and will be nullified[4]. In an income tax context, this means that the IRBM has no basis to raise an income tax assessment against a dissolved company, given that it cannot raise and enforce an assessment against an entity that does not exist.

Nevertheless, Section 535(1) of the Companies Act 2016[5] ("CA 2016") allows an interested party like the IRBM to make an application to the High Court to reinstate a dissolved company. Once the company has been reinstated, the IRBM may raise assessments against such a company and enforce it as if the company has never been dissolved.

In order to raise an additional tax assessment in the *AHBH* case, the IRBM filed an application to the High Court to reinstate a company that had been dissolved. However, the IRBM's application was dismissed by the High Court on the ground that the Court has no power to make an order declaring the dissolution of a company void after two years from the date of the dissolution of the company.

BACKGROUND FACTS

Section 535(1) CA 2016 reads:

> *Where a company has been dissolved, the* ***Court may, at any time within two years after the date of dissolution, on an application*** *of the liquidator of the company or of any other person who appears to the Court to be interested,* ***make an order upon such terms as the Court thinks fit declaring the dissolution to have been void****, and such proceedings may be taken as might have been taken if the company had not been dissolved.[emphasis added].*

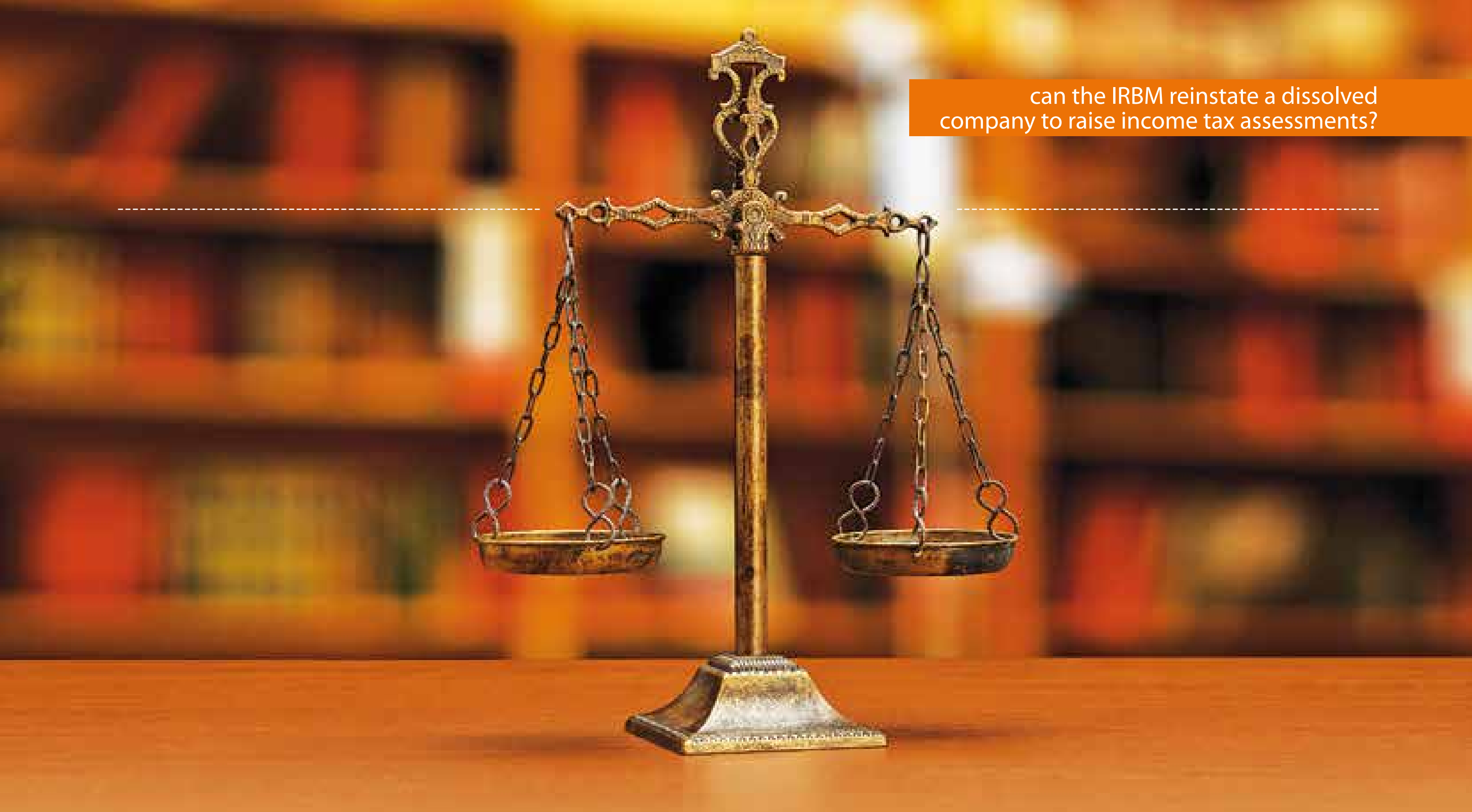
The company in question, MHB was dissolved in 2016. In 2018, the IRBM filed an application under Section 535(1) for the High Court to declare the dissolution of MHB void. The application was filed just within two years from the date of the dissolution of MHB. However, by the time the matter was fixed for trial, the two year period from the date of the dissolution of MHB had lapsed.

On this basis, *AHBH*, the former liquidator of MHB, raised a preliminary objection that the Court has no power to make an order under Section 535(1) declaring the dissolution of a company void beyond two years after the date of dissolution of the company. The main issue arose as to whether the two-year time limit in Section 535(1) refers to the period within which the application has to be made or the period within which the Court declares the dissolution void.

AHBH'S CONTENTION

AHBH contended that the two-year time limit refers to the period within which the Court declares the dissolution of the company void. Since the two-year time limit had lapsed when the matter was fixed for trial, *AHBH* submitted that the Court has no power to declare the dissolution of the company void. In supporting this contention, *AHBH* put forward the following arguments.

Firstly, Section 535(1) provides that ***"the Court may***, at any time ***within two years*** after the date of dissolution … ***make an order*** … declaring the dissolution to have been void". A plain reading of the wording makes it clear that the two-year time limit refers to the period within which the Court declares the dissolution void, not to the period within which the application is to be made to the Court. It is a trite law of statutory interpretation that where the wording of the provision is clear and unambiguous, such provisions should be given their plain, natural and ordinary meaning[6]. Since the ordinary meaning of the Section 535(1) is found, it is the Court's duty



to obey the language of the provision in accordance with settled rules of construction[7].

Secondly, Section 535(1) does not expressly stipulate that the Court may extend the two-year time limit to declare the dissolution of a company void. This is in contrast with other provisions in CA 2016, where power to extend time has been expressly legislated for[8]. Where different words are used in different parts of the same statute, there is a presumption that a different meaning and effect is intended[9]. Therefore, it is presumed that the Parliament does not intend to confer power to the Court to extend the two-year time limit under Section 535(1). This argument is also consistent with Section 45 of the Interpretation Acts 1948 & 1967 ("IA 1948 & 1967")[10], which provides that the Court has the power to extend time even upon expiry of the time period stipulated, if power is given to the Court to extend time in the written law itself.

It is worth noting that Section 582(4) of the CA 2016 allows the Court to *"extend or abridge any time for doing any act or taking any proceeding allowed… by this Act… as the justice of the case may require…"* [11]. In response to this, *AHBH* contended that Section 582(4) is not relevant to the present matter. Reference was made to the Court of Appeal's decision in ***Dinesh Kanavaji Kanawagi & Anor v Virgin Properties Sdn Bhd & Anor***[12] where it was held that the power given to the Court under Section 355 of the Companies Act 1965 (equivalent to Section 582 of the CA 2016) relates to any omission, defect or irregularity in the management or administration of a company. Since the Court's power to declare the dissolution of a company void under Section 535(1)

> ***AHBH*** **contended that the two-year time limit refers to the period within which the Court declares the dissolution of the company void. Since the two-year time limit had lapsed when the matter was fixed for trial,** ***AHBH*** **submitted that the Court has no power to declare the dissolution of the company void.**

[1] *"IRBM to raise income tax collection target to above RM150b in 2019" (The Edge Markets, 1 March 2019) <https://www.theedgemarkets.com/article/irb-raise-income-tax-collection-target-above-rm150b-2019> accessed 29 May 2019.*

[2] *The liquidator in this case, AHBH was successfully represented by the authors together with Datuk DP Naban, Senior Partner at the Tax, SST & Customs Practice of Lee Hishammuddin Allen & Gledhill.*

[3] *Dayabest Sdn Bhd & Anor v Unified Corridor Sdn Bhd & Ors (2017) MJLU 855*

[4] *Joddrell v Rochdale Metal Units (2012) EWCA Civ 1035*

[5] *Act 777, s535(1)*

[6] *Andrew Lee Siew Ling v United Overseas Bank (M) Sdn Bhd [2013] 1 CLJ 24; Tenaga Nasional Bhd v Pearl Island Resort Development Sdn Bhd [2017] 9 CLJ 185*

[7] *Pemungut Hasil Tanah, Kota Tinggi v United Malayan Banking Corpn Sdn Bhd [1981] 2 MLJ 264*

[8] *e.g. See Act 777, s143; s361*

[9] *Manokaram a/l Subramaniam v Ranjid Kaur a/p Nata Singh [2008] 6 CLJ 209*

[10] *Act 388, s45*

[11] *Act 777, s582(4)*

[12] *[2016] 4 CLJ 492, para 18*

does not concern the management or administration of a company, the Court's power to abridge time under Section 582 is inapplicable here.

THE LAW IN OTHER COMMONWEALTH JURISDICTIONS

Reference was made to corresponding company law provisions in other commonwealth jurisdictions such as Hong Kong and the United Kingdom ("UK"). In these jurisdictions, amendments had been made to the relevant company law provisions to either remove the time limit for applications to restore a company or to expressly stipulate that the time limit applies to the time within which applications to restore have to be made.

In Hong Kong, Section 290 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Chapter 32) ("Cap 32") was the provision which allowed the Courts to declare the dissolution of a company void.[13] The wording of this provision was originally almost identical to the wording in Section 535(1) CA 2016. In 1997, this provision was amended to expressly allow the Court to extend the two-year time limit to declare the dissolution of a company void. Subsequently, when Cap 32 was repealed and replaced by the new Companies Ordinance ("Cap. 622"), the corresponding provision on restoration of dissolved companies was amended to extend the two-year time limit to twenty years[14]. More importantly, the new provision also expressly stipulates that the time limit applies to the date on which the application to restore a company is made, not the date on which the order to restore is made by the court.

Meanwhile, in the UK, prior to the enactment of the Companies Act 2006, the relevant provisions on the restoration of dissolved companies contained exactly the same wording as Section 535(1) of the CA 2016[15]. However, in enacting Companies Act 2006, the UK Parliament has, amongst others, removed the stipulation of the two-year time limit within which an order for restoration should be made[16].

The development of the legislation on restoration of dissolved companies in these two jurisdictions shows that the legislature in these jurisdictions have recognised the limiting nature of the original wording in the old provisions - all of which are identical or almost identical to Section 535(1) of the CA 2016. In contrast, our Parliament in repealing the Companies Act 1965 and enacting the CA 2016 had merely adopted the wording of Section 307 of Companies Act 1965[17](the preceding provision for Section 535(1) of the CA 2016) in its entirety, even though it could have amended or removed the two- year time limit in Section 535(1) should it have intended to do so. Following this, *AHBH* submitted that our Parliament must have intended to limit the Court's power to declare the dissolution of a company void only within two years after the dissolution of the company.

HIGH COURT'S RULING

The High Court accepted *AHBH*'s arguments and held that it has no jurisdiction to make an order declaring the dissolution of a company void after two years from the date of the dissolution. In doing so, the High Court has also distinguished two Malaysian cases relied on by the IRBM. The IRBM cited ***Carlson White (M) Sdn Bhd v Mutiara Metropolis Sdn Bhd***[18] and ***Mohd Bakri Mohd Noor v Ketua Pengarah Insolvensi Bagi Aset Dan Liabiliti Syarikat Taba Silver Sdn Bhd***[19] as authorities for the proposition that the Court has

the jurisdiction to make an order under Section 535(1) as long as the application was made within two years from the two-year time limit. However, the High Court held that these two cases were not applicable as these decisions have not, amongst others, considered the arguments raised by *AHBH* in the present case.

Further, it was held that the IRBM cannot rely on Order 1A[20] and Order 92 Rule 4[21] of the Rules of Courts 2012 to argue that the Court has an inherent power to make any order as may be necessary to prevent injustice. The Court's inherent power may be invoked to waive any irregularity and mere technical non-compliance with the rules of Court. However, the issue in the present matter concerns the jurisdiction of the Court. While the Court may invoke its inherent power to waive an irregularity, it may not invoke its inherent power to extend its own jurisdiction.

OUR COMMENTS

KPHDN v SSM & AHBH is an interesting case as it raises a question of construction of Section 535(1), which has never been raised before. While there are previous Malaysian and UK case law[22] relating to this section, these cases have merely reiterated the position that applications for the Court to declare the dissolution of a company void have to be made within two years from the date of the dissolution of a company. The issue of whether the order by the Court declaring the dissolution of a company void has to also be made within the two-year time limit has never been considered in these cases.

Some quarters may argue that the limiting nature of Section 535(1) may be abused and may result in unfairness. In particular, parties might deliberately delay Court proceedings so that by the time trial is fixed, the two-year time limit is up and the Court no longer has the power to restore the dissolved company. However, as argued by *AHBH* in this case, it is the duty of the Court to adopt the ordinary meaning of Section 535(1) according its plain reading, even if the result might be thought to be inconvenient, impolite or improbable. To extend the two-year time limit stipulated in Section 535(1) would be to usurp the legislative function of Parliament. Therefore, unless and until Parliament amends Section 535(1), the correct position seems to be that held by the High Court in ***KPHDN v SSM & AHBH***, i.e. that the Court, at the stage of making the order, does not have the power to declare the dissolution of a company void after the expiry of two years from the date of its dissolution.

Finally, this case is a stark reminder to taxpayers that the IRBM is intensifying its effort to collect additional taxes including attempting to reinstate a company which had been wound up in accordance to the due process of the law. Accordingly, there is an urgent need for taxpayers, liquidators and former directors to be mindful of this and seek proper legal consultation to preserve their rights.

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[13] Companies (Winding Up and Miscellaneous Provisions) Ordinance (Chapter 32), s290
[14] New Companies Ordinance (Chapter 622), s765
[15] Companies Act 1985 (United Kingdom), s651; Companies Act 1948, s352; Companies (Consolidation) Act 1908, s223
[16] Companies Act 2006 (United Kingdom), s1031
[17] Act 125, s307
[18] [1999] 3 CLJ 395
[19] [2015] 3 CLJ 1114
[20] PU(A) 205/2012, Order 1A20
[21] Ibid. Order 92 Rule 421
[22] Carlson White (M) Sdn Bhd v Mutiara Metropolis Sdn Bhd [1999] 3 CLJ 395; Mohd Bakri Mohd Noor v Ketua Pengarah Insolvensi Bagi Aset Dan Liabiliti Syarikat Taba Silver Sdn Bhd [2015] 3 CLJ 1114

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SPECIAL VOLUNTARY DISCLOSURE PROGRAMME

TAXPAYER'S PERSPECTIVE

Kenneth Yong Voon Ken & Lee Fook Koon

UNVEILED BY THE MINISTER OF FINANCE DURING THE 2019 BUDGET ANNOUNCEMENT, MALAYSIA'S SPECIAL VOLUNTARY DISCLOSURE PROGRAMME (SVDP) WAS OFFICIALLY KICKED OFF ON 3 NOVEMBER 2018. FOR A LIMITED TIME, TAXPAYERS COULD EMBRACE THE SVDP TO REPORT ANY PREVIOUSLY UNDECLARED INCOME/GAINS/STAMP DUTY AT SIGNIFICANTLY REDUCED PENALTY RATES.

But Malaysians are no strangers to amnesty programmes – SVDP conjures feelings of deja vu reminiscent of heavily discounted traffic fines that are rolled out occasionally to raise compliance and collections.

Malaysia's SVDP covers income tax, real property gains tax, stamp duty and petroleum income tax. However, it is the former (i.e. income tax) that has stirred the most 'interest' among taxpayers, and will be the focus of this article which takes a taxpayer-centric view of the entire affair.

BASICS OF SVDP

For income tax payers, the Inland Revenue Board Malaysia (IRBM) targets the following groups under the SVDP, namely:

(i) Taxpayers who are not yet registered with the IRBM
(ii) Taxpayers who are registered but have not yet submitted some or all of their tax returns
(iii) Taxpayers who under-declared their taxes in tax return submissions

Under the SVDP, the reduced penalty rates depend on when the voluntary disclosure is made, with reduced penalty rates standing at 10% or 15%. Compare this to 45% - the current penalty rate for 'first time offence' under tax audits – and we can see what the fuss is all about: a significant savings of up to 35% (i.e. 45% minus 10% under the SVDP).

Nonetheless, the reduced penalty rates do not apply to transfer pricing issues which have a different reporting procedure for voluntary disclosure. Furthermore, the SVDP does not cover monthly tax deductions.

COVERAGE YEARS

Initially, the SVDP was applicable only for Year of assessment 2017 and preceding years.

However, on 21 March 2019, the IRBM expanded the coverage years for income tax to include Year of Assessment 2018 for companies with financial years ending:
(i) 31 January 2018;
(ii) 28 February 2018; and
(iii)31 March 2018.

This coverage expansion was to ensure such companies were not left out as they would have already submitted their YA 2018 tax returns before the SVDP announcement and, based on a 2017 cut-off, this would have deprived them from the opportunity for voluntary disclosure.

INITIAL REACH TO TAXPAYERS

To build awareness, the IRBM deployed various channels to communicate the SVDP to the public at large: seminars and roadshows; flyers and banners; street LED ads and online ads; and even letters by post and by email in an outreach effort spanning more than eight million individual and corporate taxpayers.

But rather than being a straightforward awareness exercise, the taxpayer's first encounter with the SVDP communications is rather more mixed.

Letters were sent out en masse, and sometimes, indiscriminately. Some housewives, senior citizens and retirees – who likely had no income – also received the IRBM letters encouraging them to sign up for the SVDP, which must have been an unsettling affair for persons who had withdrawn from active duty.

Some corporate taxpayers were even beckoned by the IRBM's tax audit teams to brace for upcoming tax audits, but with the prudent option to go for the SVDP, and thus, avert a full-blown probe.

Specific individual taxpayers also received the IRBM letters revealing that the IRBM knew of their overseas bank accounts, with the undertone that such taxpayers with unreported income should embrace the SVDP.

If anything, this was a showcase of the IRBM's database capabilities and the vast data intelligence at their fingertips.

OVERSEAS BANK ACCOUNTS

But of greater concern is: How did the IRBM come into possession of overseas bank account information? The answer lies with the Automatic Exchange of Information (AEOI) initiative – an agreement Malaysia signed with 100 countries for sharing of info on bank account ownership under the Common Reporting Standard (CRS) aimed at combating tax evasion.

Since September 2018, Malaysia has received information from 57 countries revealing 455,000 overseas bank accounts opened by Malaysians. This explains why some Malaysians studying abroad (who may not even have an income tax file) have become recipients of the SVDP letters from the IRBM.

The authorities have stated

blatantly that their focus for SVDP was on taxpayers with extraordinary wealth that is 'unexplained', especially those with large balances parked in overseas bank accounts. According to the Minister of Finance, YB Lim Guan Eng: "The SVDP focuses primarily on taxpayers who have bank accounts abroad and have income generated in Malaysia but have not reported it to the IRBM." (The Sun Daily 8 April 2019).

OVERSEAS INCOME

The sense of panic that gripped Malaysians who are overseas bank account holders was evident. Many of such account holders held misconceptions that the entire overseas bank account balance was subjected to Malaysian income tax – this is clearly erroneous.

Malaysia operates a territorial tax system whereby Section 3 of the Income Tax Act 1967 only brings to tax "any income accruing in or derived from Malaysia". It does not cover income generated from overseas (exempted under Schedule 6 Para 28, or earlier under Income Tax Exemption No. 48 Order 1997).

In ***'Ketua Pengarah Hasil Dalam Negeri v Cardinal Health Malaysia 211 Sdn. Bhd. (2011)'***, the taxpayer (CHMSB) invested surplus funds (profits from its Malaysian business) as loans to a Netherlands borrower through agreements made overseas, and CHMSB received interest income. Such interest income was held to be not derived from Malaysia, even though the source of the funds (i.e. the business profits) were generated in Malaysia.

> Case citation: "… the funds *per se* do not produce the interest income. … it is the … provision of loans … that is the originating cause that produced the interest income".

The case above is a reminder that any income generated from overseas is not taxable in Malaysia, even if the source of funds was initially from Malaysia. However, Malaysian income that has been stashed overseas is still taxable in Malaysia.

UNEXPLAINED VS UNEXPLAINABLE WEALTH

With the global cooperation of 100 countries under CRS and the seamless movement of digital information, taxpayers with 'unexplained' wealth – wealth that they probably knew had not been reported – now face the prospect of exposure. For them, the SVDP was an excellent opportunity to come clean.

Yet, the SVDP also pushes anxiety upon another group of taxpayers: those with 'unexplainable' wealth – wealth that they could never explain the origins of, due to genuine reasons such as:

(a) overseas assets inherited from parents who have passed away, and the children have no practical means of uncovering the origins of such assets; or
(b) overseas wealth that had multiplied tremendously through capital appreciation in overseas property or overseas shares over decades, but documentary evidence of the modest acquisition prices have long been lost with the passage of time.

Would such taxpayers be investigated in future for possession of 'unexplainable' wealth? Would the entire overseas bank balances be subject to Malaysian income tax? Should they embrace the SVDP at reduced penalties? These are some of the distressing thoughts swooping through the minds of such taxpayers.

SUBSEQUENT TIME EXTENSION FOR THE SVDP

The initial period for SVDP was till 31 March 2019 (10% penalty) and 30 June 2019 (15% penalty). However, an extension was announced on 7 April 2019, with the new timeline as shown in **Table 1** on **page 25**.

Effectively, this gave taxpayers until 30 June 2019 to declare and be subject to a concessionary 10% penalty, and up until 30 September 2019 to declare with an imposition of a 15% penalty.

Interestingly, the announcement was not just for a time extension up to 30 September 2019, but also a reversion of the post-SVDP penalty rate back to 45% (previously announced as 80% to 300%) after the SVDP ends.

WHY PENALTY RATES REVERTED?

So why has the post-SVDP penalty rate reverted to 45% (from between 80% and 300%)? While the exact reasoning for this policy decision remains unknown, some conjectures can be made.

Firstly, a post-SVDP penalty rate of 80% to 300% is extremely high, and risks reversing the feel-good 'amnesty' factor of the SVDP, especially given that taxpayers are struggling with weak business conditions and rising cost of living.

Secondly, given that Malaysia operates a Self-Assessment System, it is the taxpayer who bears the penalties for any errors in tax reporting, even for "grey areas". While commendable efforts have been made by the IRBM in providing clarification through Public Rulings, there still exists pockets of "grey areas" in tax treatment to warrant concern, especially if the penalty rate was 80% to 300%.

Thirdly, it is possible the heightened 80% to 300% penalty was intended to produce a stark contrast and induce greater take-up of the SVDP's much lower 10% penalty. In any event, the reversion of the post-SVDP penalty back to 45% restores the status quo as previous tax audit penalties were also at 45% for a first-time offence.

WHY THE TIME-EXTENSION OF THE SVDP?

The SVDP time extension also elicits some speculation.

Possibly, the time-extension was prompted by a slow take-up of the SVDP (at least in the earlier months). With a targeted the SVDP tax collection of about RM10 billion, and the targeted number of the SVDP participants of 1 million taxpayers, it was apparent in February / March 2019 that the SVDP's 'progress' was falling behind.

As at 8 March 2019, only 225,000 taxpayers had participated in the SVDP, suggesting that there is some way to go before achieving the targeted 1 million taxpayers.

Surprisingly, by 31 March 2019, this number shot up dramatically to 381,979 (representing an undeniable surge of 156,979 taxpayers or 70% increase in merely three weeks), strongly suggesting that taxpayers were starting to warm up to the idea of the SVDP.

This meteoric rise in the SVDP participation also typifies Malaysians' last minute mentality to grab the lower 10% penalty rate ending on 31 March 2019, and perhaps hinted that there were still many taxpayers who would become the SVDP adopters given a slight nudge. An SVDP time extension would be an opportunity to enfold those undecided SVDP fence-sitters.

TAXPAYER PSYCHOLOGY

So why did taxpayers only act on this last minute frenzy toward end March 2019? Of the various factors contributing to this, one was most likely: initial scepticism.

Any voluntary disclosure programme, no matter how well-intended, would quite understandably be met with a large dose of scepticism and fear. Was this too good to be true? Was this going to backfire? Would I be investigated?

Such were the suspicions gushing through the minds of would-be SVDP adopters.

In fact, the IRBM's media release dated 3 February 2019 seemed to target these specific taxpayers: persons with monthly employment income of RM4,000 and above; and sole proprietors with annual net income of at least RM48,000. However, the media release did clarify that those earning below these numbers could ignore the SVDP letters.

The weaker-than-expected initial take-up of the SVDP could also be attributable to the undertone emanating from the IRBM's media releases.

EVOLUTION OF THE IRBM'S TONE

It was clear that in order for SVDP to win over the taxpayer, the IRBM had to build trust. Initially, the IRBM's Operational Guideline dated 3 November 2018 had provided some encouragement: "(Para) 5.10 The IRBM will accept in good faith all voluntary disclosures made during the Special Programme period. Further review will not be made on the reported information."

But the sentence that followed this poured cold water over would-be SVDP adopters:

> "(Para) 5.11-If additional information from third party shows that the income has not

been correctly reported and the information is within the taxpayer's knowledge, penalty will be imposed…"

One of the greatest fears gripping would-be SVDP adopters was being audited or investigated. The above sentence literally precipitated such worries – the SVDP adopters would take some convincing before they came forward.

Surprisingly, the IRBM was fast to react. The wording in Para 5.11 was quickly dropped from the subsequent IRBM Operational Guide dated 30 November 2018, making way for a gentler no-questions-asked approach when receiving declarations under the SVDP.

But the most significant positive reassurance came on 8 March 2019 when an IRBM Media Release carried the title "No audit or investigation for those taking part in … SVDP". The media release was even penned off by the Director General of Inland Revenue himself to add reassurance.

FIRST MILESTONE ON 31 MARCH 2019

Arguably, this was the single most comforting message to radiate from the authorities, and provided the important impetus for taxpayers to confidently report their undeclared income under the SVDP without fear of being investigated. From here on, participation in the SVDP gathered momentum, culminating in the tally of 381,979 as at 31 March 2019.

Facilitating matters, the IRBM opened its doors on Saturday and Sunday (30 and 31 March 2019) to process last-minute SVDP submissions, involving a total of 36 IRBM branches, 44 Service Centres and 12 Urban Transformation Centres throughout Malaysia.

As a positive sweetener, the SVDP adopters who reported correctly would generally receive a clearance letter from the IRBM stating that they would not be tax audited for the years of assessment where they had declared under the SVDP – an important indicator that the IRBM was serious in fulfilling their promise.

CAN THE IRBM CHANGE ITS MIND?

But despite the above reassurance, central to taxpayers' concerns is: can the IRBM change its mind and re-open a tax case years later?

The case of ***'Teruntum Theatre Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (1998)'*** provides a litmus test for this.

In this case, the IRBM had taxed a company under Real Property Gains Tax Act 1976. But the IRBM later changed its mind and taxed the same transaction under Income Tax Act 1967 instead (cancelling the earlier assessment under the Real Property Gains Tax Act'). The Malaysian Courts confirmed that the IRBM is allowed to reopen the case under Income Tax Act 1967, thus paving the way for a possibility of a change of mind by the IRBM. This was an important reminder that, in absence of a composite assessment under section 96A, the IRBM has the power to change its mind.

However, the above case may be distinguished from the SVDP whereby the Director General of the Inland Revenue Board has stated that "no audit or investigation will be carried out" under the SVDP. Like in the case of Public Rulings, although they (Public Rulings) did not have the force of law, they are nonetheless, binding on the IRBM, and it is hoped a similar principle is at work for the SVDP.

IMPLICATIONS OF VOLUNTARY DECLARATION

While the positive spinoff of declaring is the temporary closure to past assessments at reduced penalties, the SVDP may also carry other implications to taxpayers:

(a) SVDP participants may have set a reminder for themselves that future income tax reporting should include the 'unreported income component' (e.g. when the SVDP participants declare previously omitted rental income, such rental will need to be consistently declared in all future periods – thus, ensuring a higher level of tax compliance).

(b) SVDP also forces upon all taxpayers to reconsider the taxability of all their income sources – something that they would otherwise ignore without the publicity generated from the SVDP. Taxpayers have relooked at undeclared income sources such as solar generation, direct-selling commission, online sales and property rental (e.g. rental from Airbnb) to name a few.

SVDP AND ILLEGAL INCOME

Is illegal income taxable? The courts have held that illegality of the income is not relevant in assessing the income to tax [see Malaysian case of ***TST v Director General of Inland Revenue (1988)*** where an illegal book-maker was taxable on his illegal income from acting as a bookie; or ***CIR v Aken (1990)*** where a prostitute was taxable on her illegal income].

But a more pressing and related question is: Will the IRBM report to other government agencies if a SVDP participant declares income from illegal activities?

To this, the IRBM has replied in its SVDP FAQ that it "is bound by confidentiality" of taxpayer's information, seemingly suggesting that the IRBM would not report to other government agencies on the illegal activities.

According to the CEO of the IRBM, Datuk Seri Sabin Samitah: "I assure you that your declaration and any information provided will be duly treated as confidential … not be shared or made known to a third party" (The Edge Financial Daily, 15.1.2019).

While this would add to the appeal of the the SVDP, there is something inescapably paradoxical here. Could the SVDP encourage money from illegal sources to surface, to be taxed, and then, be white-washed? Some of the SVDP implications are teasingly controversial.

OMISSIONS IN SVDP DECLARATIONS

In making declaration under the SVDP, the IRBM expects that: "Taxpayers must make sure that ALL taxable income has been accounted for in the voluntary disclosure made" (IRBM Operational Guidelines 24 April 2019).

The phrase "ALL taxable income" which was only introduce in the April 2019 iteration of the Operational Guidelines (previously absent) is far-reaching, as it may also include income that the taxpayer is not consciously aware of, either through a genuine lapse of memory, or through misinterpreting a grey area in tax law.

So, if there are errors or omissions in the SVDP declaration, meaning income was still omitted, what would happen to the SVDP participant?

The IRBM has confirmed that the SVDP participants are "allowed to make voluntary disclosure more than once" (IRBM FAQ dated 12-2-2019 on the SVDP), thus providing participants with the opportunity to make 'revisions'. But in view that the IRBM would not audit or investigate the declaration, it remains to be seen just how the IRBM would ascertain whether "ALL taxable income" has been declared.

CONCLUSION

Malaysia has set its sights at a targeted RM10b to be collected under the SVDP. To achieve this, the IRBM has taken many commendable steps: publicity campaign; issuing over eight million letters and emails; outreach to holders of overseas bank accounts; issuing FAQs and Guidelines; assurance of "no tax audit or investigation"; time extension for reduced penalties etc. But even then, the success of the SVDP is by no means assured.

Ultimately, to attain their targeted tax collection, the IRBM needs to build trust and motivate taxpayers to come forward. Reduced penalty, just like heavily discounted traffic fines, is undoubtedly a welcome clarion to draw forth taxpayers.

But beyond the reduced penalty rates, the SVDP's main appeal must be the fulfilment of the no-questions-asked approach of accepting voluntary declarations without reopening any investigations into past years' taxes – a factor, more than any other, upon which the ultimate success of the SVDP hinges.

Table 1

Period of Disclosure	Penalty Rate (originally)	Penalty Rate (revised 7.4.2019)
Before 3.11.2018	45% onwards	45% onwards
3.11.2018 to 31.3.2019	10%	10%
1.4.2019 to 30.6.2019	15%	10%
1.7.2019 to 30.9.2019	80% - 300%	15%
1.10.2019 onwards	80% - 300%	45% onwards

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COMMON AUDIT FINDINGS IN TRANSFER PRICING

Hairaneey Mhd

> Transfer prices serve to determine the income of parties involved in the cross-border transactions. These can include transfers of intellectual property, tangible goods, services, and loans or other financing transactions.

Inter-company transactions, domestically and across borders, are growing rapidly and are becoming much more complex. The increase in transfer pricing audits is itself an indication of the increasing importance of transfer pricing. In recent years, the number of transfer pricing audits has dramatically increased.

It is common for transfer pricing audit requiring the arm's length analysis and the corresponding transfer pricing documentation for tax purposes. It is the common understanding that the functional/ FAR analysis (functions, assets and risk) is the pivotal point for transfer pricing audit. The information in the transfer pricing documentation will help the auditors to understand the overall business activities, the supply chain, business model, products/ services offered, FAR analysis, related parties' transactions and the company and group structure.

ROUTINE VS ENTREPRENEUR FUNCTIONS

Several taxpayers, either manufacturing or distributor, commonly characterise their business operations as routine functions. A taxpayer who performs routine functions including manufacturers and distributors that do not bear any market and inventory risk and do not engage in strategic decision-making activities shall not incur losses. The interpretation of these taxpayer that fall into the characterisation of routine function should be highly subjective and need to be examined thoroughly as it will consequently give rise to dispute regarding the losses and the actual characterisation of the taxpayer's business operations.

It is often found in the audit process that taxpayers incur losses or obtain low profits in business and it will be abnormal if the losses are incurred for a limited period. These losses or low profits incurred by the taxpayer in this situation may be an indication for transfer pricing audit by the tax authorities. There could be various commercial reasons for the losses incurred and taxpayers need to document and provide reasonable justification for the commercial reasons together with relevant business analysis and documented supporting document.

Taxpayers need to demonstrate to the tax authorities that the losses or low profit does not conflict with the arm's length principle adopted in determining their pricing policy. Unfortunately, most taxpayers lack in documenting those evidence and fail to provide reasonable justification together with proper analysis and supporting document.

Establishing that the losses or low profit is a result of commercial reasons and not because of non-arm's length pricing policy of controlled transactions poses a challenge to the tax authorities. The tax authorities must scrutinise the information during audit checking and interviewing the relevant respective personnel in the company. In an independent scenario, business entity cannot continue to suffer losses for a longer period where it eventually will cease to exist. However, in a controlled situation, the related party may continue to suffer losses for longer period if its business is beneficial to the group. Therefore, it is important in transfer pricing audit to evaluate whether the losses or low profit incurred is due to non-arm's length pricing of controlled transaction or due to certain business or commercial reason (e.g. start-up cost, unfavourable economic conditions, inefficiency etc) and not influenced by the related party relationship.

> **"A taxpayer who performs routine functions including manufacturers and distributors that do not bear any market and inventory risk and do not engage in strategic decision-making activities shall not incur losses."**

Characterisation of business entity is also important while performing the functional analysis for losses or low profit-making company. Being an entrepreneur if any business entity suffers losses; it may not be considered unusual since the entrepreneur assumes the various business risks and performing more functions and they are responsible for the profit or losses in their business. Therefore, it is very important to document the detailed FAR of a business entity which shows that the business entity has performed functions and assume the risk of being an entrepreneur. Further confirmation on the FAR of the company through audit checking by interviewing the relevant respective personnel is needed to verify the FAR.

CONTRACT MANUFACTURING

In the manufacturing operations, tax authorities encounter numerous audit findings in terms of transfer pricing audit especially when these manufacturing operations suffer losses or low profit. A functional analysis of the key manufacturing risks, such as the product liability risks, inventory risk, warranty risk, capacity risk, technology R&D risk and market risk are critical to the transfer pricing arrangement of a manufacturer. It is also important to ensure that the manufacturing arrangement is appropriately remunerated, and benefits allocated in a manner consistent with the functions, assets and risks. A proper review of the actual conduct of manufacturing entities through fact finding interviews and site visits can ensure that the contractual arrangements and transfer pricing policy are consistent with the activities on the ground.

In the situation where a contract manufacturing arrangement suffers losses, it will trigger a comprehensive checking of transfer pricing audit. Generally, a contract manufacturing arrangement should not suffer losses since it has been guaranteed with a specific margin for performing the function as a contract manufacturer. The relationships in contract manufacturing arrangements under examination could be unique and complex. Therefore, each contract will raise issues unique to the parties and different circumstances involved, and specialty areas of the law will likely be implicated. While a company may decide to allocate risks differently from the normal contract manufacturing arrangement, the tax authorities' main goal is to highlight some of the common risks unique to contract manufacturing arrangements based on actual conduct in order to determine the arm's length return.

Tax authorities will start to look at the contractual agreement under the law obligation. The starting point for such contractual is to understand the written contract signed by the parties in the relationship. Quite often that the contractual relationship is defined by a set of documents such as the main contract agreement or other documents such as orders or invoices. The document will help to understand the definition of the contractual relationship. Even if there is no formal written agreement in the contract manufacturing arrangement, the actual conduct based on the contractual understanding between the related party executed over the years will be scrutinised. The main point to understand in the contractual agreement is which party will have to face the damages or assume the risks if the contractual relationship fails.

INTRAGROUP TRANSACTIONS:

Another issue found in the transfer pricing audit is in respect of intragroup services. Most Multinational Companies (MNCs) will charge for services provided to other entities within the same group of companies. These related party transactions are classed as intercompany service fees or charges. On the international level, intragroup services are quite challenging for tax authorities, as companies use these transactions to optimise with taxes. Services are commonly used for shifting untaxed profit to a country, where a lower income tax rate applies. Therefore, the intragroup transactions have caught the interest of the tax authorities and are being constantly monitored.

A service is defined as an activity which provides an entity with economic or commercial value which enhances its commercial position. During the transfer pricing audit process, firstly it is important to identify whether intragroup services have been rendered and the related party receiving the services really benefited from those services. This can be determined by whether an independent enterprise would pay for an activity (service) provided by an outside entity, or if it could have sourced it in-house.

Getting the proof that the service is received is the major issue in a transfer pricing audit. The companies must be able to prove that the service has been received and is beneficial for the company's business activity (benefit test). The tax authorities would analyse whether a third party in similar circumstances would consume these services on similar terms or whether to outsource or consume it internally. The supporting evidences were expected to show the existence of the services as well as the benefit received. Many cases showed that the taxpayers were not able to provide enough evidence as requested for the purpose of testing the reasonableness of the intra-group services.

The tax authorities insist on producing evidence of the receipt of services and that those services were general in nature. As per the tax authorities, the evidence of receipt of services does not lie in mere documents viz. emails exchanged,

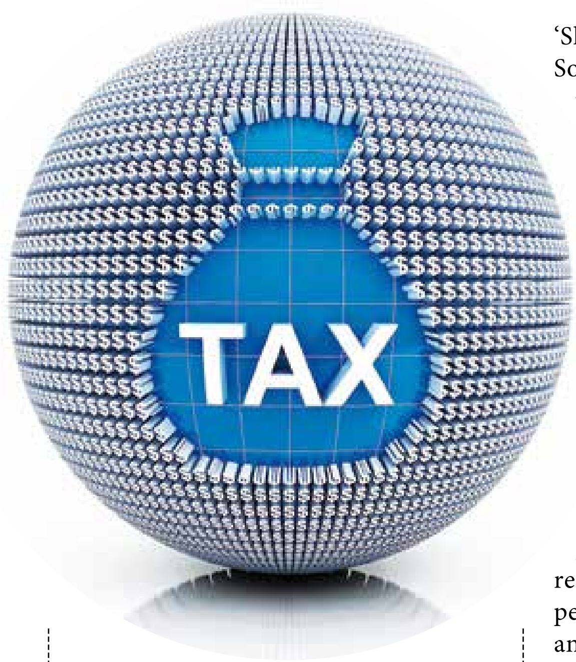
MIA representatives visiting CTIM to discuss cooperation of relevant areas of common interest.

agreement entered between related parties. The biggest evidence of all is the benefit derived from receipt of services. Accordingly, the taxpayer should maintain robust documentation to demonstrate evidence on the rendition of services reasonably enough.

The next issue for the tax authorities would be to analyse the pricing policy of the services. In the case of services between related parties, it is important that the pricing policy of the services is in accordance with the arm's length principle. Therefore, the pricing policy should correspond to the pricing, which is used between non-related parties in similar conditions. Typically, services provided within the group are remunerated based on cost plus method (costs + mark-up). In the case of determining the pricing policy of a service transaction, it is important to analyse the formulation of the cost base and whether the service is low or high value-added service.

Generally, the cost base should be calculated as follows: total costs (direct + indirect) – directly charged costs (costs, which can directly be allocated to service recipient) – shareholders costs = costs, which should be charged to service recipients. In case of cost allocation, different allocation keys such as number of employees, revenue etc. are used when it is not possible to charge the costs directly to service recipients and based on how much services have been consumed by the recipients. In most cases, the information on the cost base and allocation keys for the intragroup services are often left out in the transfer pricing documentation.

Intragroup services can broadly be divided into two categories namely administrative/ management services and commercial services. Whilst administrative/ management services are more focused on management and staff related activities of an organisation viz. accounting, information technology, human resource management etc., the commercial services category refers to the popular line functions. Generally, Multinational Enterprises (MNEs) operate through designing global policies made at the head-office level or in a centralised manner for undertaking



management and administrative activities at group level in order to avoid work repetitions and procedural hick-ups and delays.

On the other hand, income producing services are services that are core to the business undertaken by an entity within a group namely R&D, product development, sharing of know-how etc. The aforesaid income producing activity are income generating and have associated operational and commercial risks involved. Accordingly, such functions may command a higher mark-up or charge. It is also pertinent to note that the characterisation of a service into administrative or business in nature shall depend upon facts and circumstances of each case. A particular transaction may constitute management or administrative services for one corporation and at the same time it may be characterised as a commercial or income-producing services for another.

CENTRALISED PROCUREMENT – SOGO SHOSHA COMPANIES:

'Sogo' means general and 'Shosha' means trading company. Sogo Shosha companies are large trading companies that trade in a wide range of products having huge volumes. Sogo Shosha companies engage in both import and export globally and generally tend to have large volumes with thin margins. Generally, the group subsidiary of a Sogo Shosha company assists its parent company in procurement and sales related activities. The procurement company obtains the title of goods to be sold to its overseas related parties for a very short period, usually called as "flash title" and since it enters into a back to back trading cycle, the risk of inventory is almost negligible. There is no value-add function undertaken by the company after acquiring the product for further sale to the foreign related parties.

The agreement for the supply of goods between a procurement company and its overseas related parties is usually on a principal to principal basis. Accordingly, this company does not fall within the definition of a commission agent although the profit margins are as low as that of a commission agent.

This is primarily due to the absence of any unique intangibles and the low risk profile of the business due to confirmed orders from foreign related parties and back to back bookings of goods. However, both sales and purchase entries are typically found in the books of such a procurement company which is in complete contrast to a commission agent who does not maintain inventory and never takes the title of goods even for a short period of time. With the above contrasts in the FAR analysis of a procurement company with that of a commission agent, there are multiple benchmarking related issues that emerge from a transfer pricing perspective.

One of the key issues while benchmarking such a transaction between a procurement company and its Sogo Shosha counterpart is the lack of availability of comparables in the public domain with this type of unique FAR profile. Therefore, it becomes difficult to characterise such a procurement company as a simple trader or a plain service provider. Another benchmarking challenge with such procurement companies is the selection of profit level indicator (PLI) for computing arm's length margins.

Another issue typical of such a procurement company is since they acquire the flash title to the goods sourced and sold to its overseas related parties, there is inventory reflected in their profit and loss account, even though they have such inventory for a very short duration and do not bear the inventory risk at all. In such circumstances, adopting a PLI based on operating revenue computed as a return on value of goods (Cost of Goods Sold) may provide misleading results and an exorbitantly high return. Ideally, a PLI that excludes COGS should be taken into account. On the other hand, a PLI based on value added operating expenses should be adopted. Further, COGS is a measure of return on value of goods traded, sourced or handled. It is not a measure of return on value add functions. Accordingly, COGS is not relevant from a benchmarking perspective in the case of such companies.

In the current situation, some MNE with the Sogo Shosha structure adopt the Berry Ratio for a fair measure of benchmarking the value of functions performed by a low risk distributor and/ or service provider. The Berry Ratio can be used as a PLI depicting operating expenses where no unique intangibles are employed and no expenses pertaining to manufacturing or warehousing are incurred. In such situations, COGS depicting the value of goods handled becomes irrelevant and the operating cost (excluding COGS) represents the value-added services undertaken by the procurement entity. Accordingly, the Berry Ratio may be used for arm's length benchmarking in cases of limited risk distributors, service providers and procurement entities.

CONCLUSION

It is important for MNEs to prepare and gather all relevant information explaining the business rationale and this should be put in writing in the transfer pricing documentation and supported by relevant agreements that have been prepared and make it readily available when the audit comes up.

This documentation includes not just the transfer pricing benchmarking study but should provide all relevant information and it is most important to be transparent. In many cases, the tax authorities will also be interested in inter-company contracts that clearly set out the functions of, and the risks incurred by, the parties and information on the benefits the local entity derived from parental service charges, to the extent that inter-company services are provided. Therefore, it is advisable that the material assembled in response to inquiries by the tax authority include not only the formal documentation policies, but also other materials the tax authorities could likely find persuasive.

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BASE EROSION AND PROFIT SHIFTING (BEPS) AND INTANGIBLES

TRACKING THE UNSEEN AND EXAMINING THE UNEXAMINED – PART II

Venkataraman Ganesan

"The unseen is almost always underlined with the unsaid."
-**Viet Thanh Nguyen**, *in The Sympathizer*[1]

A. INTRODUCTION

The first part in this series[2] concentrated primarily on Action Items 8 in general (9 & 10 are on Intra Group charges and Low Value Added Services respectively), with specific emphasis on the definition of intangibles, and the DEMPE functions that endeavour to allocate risks and returns relating to intangibles across the enterprise value chain, by seeking to ensure that transfer pricing outcomes are in line with value creation.

The second part attempts to fathom both the concept of Hard-To-Value-Intangibles ("HTVI) forming part of the OECD Action Items 8 -10, titled "Intangibles, Risks and Capital and High Risk Transactions", as well as an additional Guidance Note issued further clarifying the theory. This article will also attempt to illustrate the applicability of the guidance with specific references to examples as provided by the OECD.

Prior to dissecting the salient points of the additional Guidance, it would be appropriate to provide a fundamental overview underlying the concept of "HTVI".

B. HTVI & ACTION ITEMS 8-10

Action Items 8-10, titled "Intangibles, Risks and Capital and High Risk Transactions" issued by the OECD on 5 October 2015[3] defines the term HTVI to:

> *"cover intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises:*

- *no reliable comparables exist, and*
- *at the time the transactions were entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer."*[4]

Prima facie the aforementioned definition seems to be couched in uncertainty and embodying a significant degree of unpredictability. From an arm's length perspective, the definition is more an agglomeration of tricky problems rather than a precise methodology to identify the exact nature of the subject in question.

With a view to shedding more light on the peculiarities characterising HTVI, the Action Item identifies the following features of a HTVI:

- The intangible is only partially developed at the time of the transfer;
- The intangible is not expected to be exploited commercially until several years following the transaction;
- The intangible does not itself fall within the definition of HTVI but is integral to the development or enhancement of other intangibles which fall within that definition of HTVI;
- The intangible is expected to be exploited in a manner that is novel at the time of the transfer and the absence of a track record of development or exploitation of similar intangibles makes projections highly uncertain;
- The intangible, meeting the definition of HTVI, has been transferred to an associated enterprise for a lump sum payment; and
- The intangible is either used in connection with or developed under a Cost Contribution Arrangement (CCA) or similar arrangements.

From a perusal of the 'checklist' as set out above and also from a harmonious interpretation of the OECD Action Item, at the core of HTVI lies the time related concepts of *ex-ante*[5] (based on forecasts rather than on actual results) and *ex-post*[6] (actual returns). The OECD recognises that there are and would be information asymmetries between taxpayers and tax administrations. Such situations would inevitably lead to transfer pricing risk. In the context of a transaction involving the transfer of intangibles or rights in such intangibles, there may arise a difference, between the developments or events considered relevant for pricing such a transaction at the time the transaction was entered into (*ex-ante*) and the developments or events considered relevant for pricing such a transaction once the full potential of such an intangible is ultimately realised (*ex-post*).

Even though the terminology is new and guidance relating to the same have been formally ushered in with the issue of the BEPS Action Item, the concept of making adjustments on account of an asymmetry between *ex-ante* and *ex-post* circumstances is something that is not devoid of any precedence. In fact, in a Swedish case decided way back in 1979, such retrospective adjustments for intangibles was upheld by the Courts.

This was a case that had at its background the payment of royalties between entities within the Nestle Group of Companies. Findus AB, a Swedish entity remitted royalties to its Associated Enterprise (AE), Produit Findus SA, a company incorporated in Switzerland for rights to use certain intangibles like trademarks. While the trademarks were formerly owned by Findus AB, the same were subsequently transferred to Produit Findus SA for zero consideration. Upon an appeal lodged by the tax authorities, the Court concluded that royalty payments made in a situation where the intangibles were transferred for free constituted a situation not comparable to that of a corresponding agreement that would have been consummated between two or more independent parties. This resulted in an increased taxation of the Swedish group company by way of disallowed royalties. The Findus case thus established that *ex- post* corrections could be justified in situations where the *ex-ante* circumstances were reflective of a

non-arm's length arrangement[7].

The Action Item then goes on to provide an example highlighting the predicament a tax administration may face in dealing with HTVI[8]. An enterprise may transfer intangibles at an early stage of development to an AE, at a royalty rate that does not reflect the value of the intangible at the time of the transfer. The enterprise may later adopt the position that it was not possible at the time of the transfer to predict the subsequent success of the product with full certainty. This difference between the *ex-ante* and *ex-post* value of the intangible would therefore be claimed by the taxpayer to be attributable not to any related party influences, but on the contrary, to more favourable developments than what was originally anticipated. The conundrum faced by a tax administration in such circumstances being they are bereft of specific business insights or access to the information to be able to examine the taxpayer's claim and to demonstrate that the difference between the *ex-ante* and *ex-post* value of the intangible is due to non-arm's length pricing assumptions made by the taxpayer.

However, the Action Item also recognises that a favourable or positive outcome between the *ex-ante* and *ex-post* time phases might also be genuinely due to factors that are extrinsic to the transfer pricing arrangements established between the two transacting entities in question. In those situations, the Action Item[9], exempts the provisions of this Action Item to transactions involving HTVI provided the taxpayer demonstrates/fulfils the following conditions:

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[1] *https://www.theguardian.com/books/2016/mar/12/the-sympathizer-viet-thanh-nguyen-review-debut*

[2] *tax guardian, Vol. 12/No.1/2019/Q1 Pages 38 - 44*

[3] *https://www.oecd.org/tax/aligning-transfer-pricing-outcomes-with-value-creation-actions-8-10-2015-final-reports-9789264241244-en.htm*

[4] *Paragraph 6.189 of Section D in the Action Item*

[5] *As per the Merriam-Webster Dictionary, the term ex ante is defined as, "based on assumption and prediction and being essentially subjective and estimative"*

[6] *As per the Merriam-Webster Dictionary, the term ex post is defined as, "based on knowledge and retrospection and being essentially objective and factual"*

[7] *RÅ 1979, 1:98.*

[8] *Paragraph 6.186 of Section D*

[9] *Paragraph 6.193 of Section D*

- Details of the *ex-ante* projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and the appropriateness of its consideration of reasonably foreseeable events and other risks, and the probability of occurrence; and,
- Reliable evidence that any significant difference between the financial projections and actual outcomes is due to: a) unforeseeable developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction; or b) the playing out of probability of occurrence of foreseeable outcomes, and that these probabilities were not significantly overestimated or underestimated at the time of the transaction;
- The transfer of the HTVI is covered by a bilateral or multilateral advance pricing arrangement in effect for the period in question between the countries of the transferee and the transferor;
- Any significant difference between the financial projections and actual outcomes mentioned above does not have the effect of reducing or increasing the compensation for the HTVI by more than 20% of the compensation determined at the time of the transaction;
- A commercialisation period of five years has passed following the year in which the HTVI first generated unrelated party revenues for the transferee and in which commercialisation period any significant difference between the financial projections and actual outcomes mentioned above was not greater than 20% of the projections for that period.

C. HTVI & ADDITIONAL GUIDANCE

Action Items 8-10, whilst introducing the concept of HTVI were remarkably silent in setting out either illustrations or practical guideposts which could serve as a reference, if not a barometer for both the taxpayers as well as tax administrations.

With a view to achieving a fruitful implementation of all BEPS Action Items, the OECD established an Inclusive Framework on BEPS[10], bringing all interested and committed countries and jurisdictions on an equal footing in the Committee on Fiscal Affairs and all its subsidiary bodies. The Inclusive Framework, which already has more than 110 members, is monitoring and peer reviewing the implementation of the minimum standards as well as completing the work on standard setting to address BEPS issues. In addition to BEPS members, other international organisations and regional tax bodies are involved in the work of the Inclusive Framework, which also consults business and the civil society on its different work streams. The Inclusive Framework, in furtherance of the work performed on HTVI prepared a report titled, **"Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles."**[11] This Report was approved on 4 June 2018 and subsequently published by the OECD Secretariat.

D. SALIENT FEATURES OF THE ADDITIONAL GUIDANCE

The primary purpose of this guidance is to foster a common understanding and facilitate an amicably acceptable practice among tax administrations on how to apply adjustments resulting from the application of the HTVI approach. Such a move would according to the OECD not only enhance consistency but also significantly reduce the risk of economic double taxation. There are three pillars that form the cornerstone of this Additional Guidance, namely[12]:

- Presentation of the principles that should underlie the

application of the HTVI approach by tax administrations;
- Provision of concrete examples clarifying the application of the HTVI approach in different scenarios; and
- Addressing the interaction between the HTVI approach and the access to the mutual agreement procedure under the applicable tax treaty.

APPLICATION OF THE HTVI APPROACH BY TAX ADMINISTRATIONS

- With a view to lending certainty to outcomes, the Guidance Note proposes for tax administrations to take into consideration not only the ex post outcomes taken as presumptive evidence about the appropriateness of the ex ante pricing arrangement, *"but also any other relevant information related to the HTVI transaction that becomes available to the tax administrations and that could or should reasonably have been known and considered by the associated enterprises at the time the transaction was entered into."*[13] Such an approach has the potential to both promote tax certainty as well as reduce the risk of double taxation.
- Tax administrations are also encouraged to put in place audit practices to ensure that HTVI transactions are identified and acted upon as early as possible. However, considering the singularly unique nature of the HTVI and the fact that at the time of entering into a transaction involving HTVI, the conduct of an assessment might be precluded from an inadequacy of relevant information, the Guidance concedes that a contemporaneous assessment might not be possible;[14]
- In the event where the only possible assessment is a historical one, on account of the constraints mentioned in the preceding paragraph, the Guidance provides for tax administrations to employ ex post outcomes to consider the reasonableness of the projections and probability weightings taken into account in the valuation at the time of the transaction;[15]
- One important clarification set out by the guidance is one concerning audits. The process of identification, evaluation and assessment of HTVI and the underlying arm's length tests should neither deter not defer normal audit procedures.[16] Nothing contained within the confines of this guidance would change limitations of statutes as adopted by the legislations of the jurisdictions under consideration;
- To provide an element of tax certainty for taxpayers and reduce the risk of double taxation, the Guidance also recognises

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[10] *https://www.oecd.org/tax/beps/beps-about.htm*

[11] *https://www.oecd.org/tax/transfer-pricing/guidance-for-tax-administrations-on-the-application-of-the-approach-to-hard-to-value-intangibles-BEPS-action-8.pdf*

[12] *Executive Summary of the Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles*

[13] *Paragraph 8 of the Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles*

[14] *Paragraph 13 of the Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles*

[15] *Ibid*

[16] *Paragraph 14 of the Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles*

a need for consistency in the application of the HTVI approach. There may arise circumstances where countries may face practical constraints in the application of the HTVI approach on account of factors such as short audit cycles or a short statute of limitations. This guidance does not postulate a promulgation of separate legislation to tide over such constraints.[17]

EXAMPLES ILLUSTRATING THE APPLICATION OF THE HTVI APPROACH BY TAX ADMINISTRATIONS

Example 1

Company A, a resident of Country A, has patented a pharmaceutical compound. Company A has concluded pre-clinical tests for the compound and has successfully taken the compound through Phases I and II of the clinical trials. Company A transfers in Year 0 the patent rights to an affiliate, Company S, a resident of Country S. Company S will be responsible for the Phase III trials following the transfer. In order to determine the price for the patent on the partially developed drug, the parties made an estimation of expected income or cash flows that will be obtained upon exploitation of the drug once finalized over the remaining life of the patent. Assume the price so derived at the time of the transfer was 700 and that this was paid as a lump sum in Year 0.

In particular, the taxpayer assumed sales would not exceed 1,000 a year and that commercialisation would not commence until Year 6. The discount rate was determined by referring to external data analysing the risk of failure for drugs in a similar therapeutic category at the same stage of development. Even if the tax administration of Country A had been aware of these facts relating to the transfer of the patent rights in Year 0, it would have had little means of verifying the reasonableness of the taxpayer's assumptions relating to sales.

Scenario A

In Year 4, the tax administration of Country A audits Company A for Years 0-2 and obtains information that commercialisation in fact started during Year 3 since the Phase III trials were completed earlier than projected. Sales in Years 3 and 4 correspond to sales that were projected, at the time of the transfer, to be achieved in Years 6 and 7. The taxpayer cannot demonstrate that its original valuation took into account the possibility that sales would arise in earlier periods, and cannot demonstrate that such a development was unforeseeable.

The tax administration uses the presumptive evidence provided by the ex post outcome to determine that the valuation made at the time the transaction took place did not consider the possibility of sales occurring in earlier years. The taxpayer's original valuation is revised to include the appropriately risk-adjusted possibility of earlier sales resulting in a revised net present value of the drug in Year 0 of 1,000 instead of 700. The revised net present value also takes into account the functions performed, assets used and risks assumed in relation to the HTVI by each of the parties before the transaction and reasonably anticipated, at the time of the transaction, to be performed, used or assumed by each of the parties after the transaction. Therefore, assume for the purposes of example that the arm's length price anticipated in Year 0 should have been 1,000. Note that the value of 1,000 is not necessarily the net present value of the transferred rights based solely on the actual outcome (see paragraph 6 of this guidance).

In accordance with the approach to HTVI, the tax administration is entitled to make an adjustment to assess the additional profits of 300 in Year 0.

Scenario B

The tax administration uses the presumptive evidence provided by the *ex-post* outcomes to determine that the valuation made at the time the transaction took place,

did not consider the possibility of sales occurring in earlier years. The taxpayer's original valuation is revised to include the appropriately risk-adjusted possibility of sales occurring in earlier years resulting in a revised net present value of the drug in Year 0 of 800 instead of 700. Therefore, assume for the purposes of the example that the arm's length price anticipated in Year 0 should have been 800. Note that the value of 800 is not necessarily the net present value of the transferred rights based solely on the actual outcome (see paragraph 6 of this guidance).

In accordance with the approach to HTVI, the tax administration is entitled to make an adjustment to assess the additional profits of 100 in Year 0. However, in this example, the exemption provided by item (iii) in paragraph 6.193 applies since the adjustment to the compensation for the transfer is within 20% of the compensation determined at the time of the transaction.

Example 2

The facts are the same as in Example 1. Based on those facts, assume that in Year 7, the tax administration of Country A audits Company A for Years 3-5 and obtains information that sales in Years 5 and 6 of the product to which the patent relates were significantly higher than those projected. In the original valuation, the taxpayer had not projected sales any higher than 1,000 in any year, but outcomes in each of Years 5 and 6 show sales of 1,500. The taxpayer cannot demonstrate that its original valuation took into account the possibility that sales would reach these levels, and cannot demonstrate that reaching that level of sales was due to an unforeseeable development.

The tax administration uses the presumptive evidence provided by the ex post outcomes to determine that the possibility of higher sales should have been taken into account in the valuation. The taxpayer's original valuation is revised to include the appropriately risk-adjusted possibility of sales occurring in earlier years, resulting in a revised net present value of the drug in Year 0 of 1,300 instead of 700. The revised net present value also takes into account the functions performed, assets used and risks assumed in relation to the HTVI by each of the parties before the transaction and reasonably anticipated, at the time of the transaction, to be performed, used or assumed by each of the parties after the transaction. Therefore, assume for the purposes of the example that the arm's length price anticipated in Year 0 should have been 1,300. Note that the value of 1,300 is not necessarily the net present value of the transferred rights based solely on the actual outcome.

In accordance with the approach to HTVI, the tax administration is entitled to make an adjustment to assess the additional profits of 600. Assume for the purposes of this example that none of the exemptions listed in paragraph 6.193 of Chapter VI of the Guidelines applies.

One way to implement the adjustment is to re-assess the price paid in Year 0. However, the significant revision of the lump-sum payment highlights the risks posed by the high uncertainty in valuing the intangible and gives rise to consideration, in light of this significant uncertainty, of whether adjustments consistent with an alternative payment structure might be more consistent with what unrelated parties would have done.

Evidence of pricing arrangements for the transfer of intangibles in comparable circumstances to address high valuation uncertainty may point to appropriate alternatives to making the adjustment in Year 0. For example, assume that in the pharmaceutical sector it is common to transfer patent rights to independent parties through a combination of an initial lump sum payment and additional contingent payment arrangements based on the successful completion of development phases or regulatory approvals in a particular market. In this case, assume that the first market approvals were obtained

[17] *Paragraph 15 of the Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles*

in Year 3. The tax administration may, therefore, determine that it is consistent with arm's length practices in comparable circumstances to recover the underpayment through a further payment in Year 3. Note that this paragraph is not intended to, and does not, imply that modification of the payment form can only occur when there is a common practice in the relevant business sector regarding the form of payment for the transfer of a particular type of intangible.

The principles illustrated by this example apply irrespective of whether the tax administration in fact carries out an audit for Years 0-2 and then a second audit for Years 3-5, or whether it audits only for Years 3-5. In both scenarios, a revision to the original valuation is justified based on ex post evidence emerging in Year 7, and, subject to any treaty or domestic law limitations, the undervaluation may be recovered based on the HTVI approach contained in Section D.4 of Chapter VI.

HTVI AND DISPUTE RESOLUTION

- The purpose of this guidance is to improve consistency in the application of the HTVI approach by jurisdictions, thus reducing the risk of economic double taxation. In addition to this guidance, there may be other tools at the disposal of taxpayers to avoid instances of double taxation and enhance tax certainty in HTVI transactions;
- Recognising the complexities involved in transactions involving HTVIs, the Guidance exhorts the taxpayers to avail the dispute resolution tools such as advance pricing arrangements (APAs), which if concluded bilaterally or multilaterally between treaty partner competent authorities provide an increased level of certainty in the jurisdictions involved, lessen the likelihood of double taxation, and may proactively prevent transfer pricing disputes;
- Paragraph 6.193 of these Guidelines prevents the application of the HTVI approach when the transfer of the HTVI is covered by a bilateral or multilateral APA in effect for the period in questions between the jurisdictions of the transferee and the transferor;
- Where the application of the HTVI approach leads to double taxation, the guidance in paragraph 6.195 states that it would be important to permit resolution of such cases through access to the mutual agreement procedure under the applicable treaty. Accordingly, this guidance should be read in conjunction with Article 25 and its Commentary and the commitment made in the Final BEPS Report on Action 14.[18]

CONCLUSION

As is the case involving dealing with any intangible, HTVI poses tricky challenges both from the perspective of a taxpayer and the tax administration. While the taxpayer expects certainty and the avoidance of the risks of double taxation, the tax administration would be concerned with revenue leakages that would be triggered between the differing circumstances between *ex-ante* and *ex-post* circumstances. The additional Guidance issued by the OECD is a welcome step in an endeavor to mitigate risks that may arise on a conduct of an evaluation of HTVIs. But considering the very nature and complication of the underlying intangibles, there are still some creases that need ironing.

[18] *http://www.oecd.org/tax/beps/beps-actions/action14/*

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The column only covers selected developments from countries identified by the CTIM and relates to the period 16 February 2019 to 15 May 2019.

CHINA (PEOPLE'S REPUBLIC)

Rules on fees for tax withholding and collection agents published

On 2 February 2019, the Ministry of Finance (MoF), the State Taxation Administration (STA) and the People's Bank of China jointly issued Circular Cai Han [2019] No.11 (the circular) clarifying the rules on fees that have to be paid by the tax authority to tax withholding and collection agents that have been assigned to collect taxes.

Unless specifically prescribed by law or administrative regulations, fees paid to agents are limited and/or capped at a maximum amount. The following limitations apply:

Tax	Limitation	Cap
income tax	2% of the tax withheld	CNY700,000 a year
vehicle and vessel tax	3% of the tax payable	none
consumption tax consigned processing (no fee payment is allowed where the principal and the agent are related)	2% of the tax payable	none
vehicle purchase tax	none	CNY15 per vehicle
stamp duty collected by security company	0.03% of the duty payable	CNY10 million a year
sale of stamps for stamp duty purposes	5% of the amount of the stamps	none
taxes collected by postal services	3% of the tax collected	none
tax collected by markets or individuals	5% of the tax collected	none

The circular also provides that one tax authority is not allowed to pay fees to another tax authority for the collection of taxes. The payment of the fees must be settled on an annual basis. In order to obtain the fees, the withholding or collection agent must submit the required information to the tax authority before 30 March of the following tax year.

The circular took effect from the date of promulgation. On that same date, the Circular on Further Strengthening of the Commission Management of Withholding Tax (Circular Cai Han [2005] No. 365) and the Circular on the Withholding Tax Commission of Insurance Company (Circular Cai Han [2007] No. 695) will be abolished.

New Foreign Investment Law published

On 15 March 2019, China published its Foreign Investment Law (the Law) which will take effect on 1 January 2020 and replace the current Law on Wholly Foreign-Owned Enterprises, the Law on Chinese-Foreign Equity Joint Ventures and the Law on Chinese-Foreign Cooperative Joint Ventures. The Law contains 6 chapters and 42 articles; its main provisions are summarised below.

Scope of application

The Law applies to foreign investors (enterprises, individuals or other organisations) that make direct or indirect investments in China, including establishing a foreign investment enterprise (alone or together with other partners), acquiring an interest such as shares or participation in a Chinese enterprise or making investments in a new investment project.

A foreign investment enterprise is referred to as an enterprise that is wholly or partly invested in by foreign investors and established and registered in China in accordance with Chinese laws and regulations.

As regards the legal forms of business organisation used to carry out the investment, the Company Law and the Law of Partnership will apply.

Investment restrictions

Foreign investment is not allowed in projects or sectors listed in the "negative list" which is issued by the State Council. Foreign investment in sectors such as banking, insurance, and security is subject to relevant laws and regulations. Further, foreign investment is subject to the scrutiny of the Anti-trust Law and the Regulations on National Security.

Foreign investment protection

Foreign investors will be granted national treatment but are also entitled to treatment under an international treaty or agreement that is more favourable than the national treatment. The Law expressly states that foreign investors must be equally treated in government procurement activities and participation in standardisation.

Foreign investors may not be dispossessed of their investment in China. Where expropriation is necessary in special circumstances, foreign investors must be fairly compensated.

Foreign investors are permitted to transfer funds abroad or bring funds in for purposes of profit repatriation, returns of investment, capital gains, capital contribution, payments of royalties and lawful compensations in foreign or Chinese currency. Also, foreign investors are permitted to issue shares, bonds or raise capital in other forms.

The Law firmly states that intellectual properties and commercial secrets will be protected and foreign investment enterprises and foreign investors will not be forced by government officials to transfer technology when making investments in China. Local governments are urged to fulfil the terms and conditions of the contracts concluded with foreign investors and honour any promises made.

Foreign investors will be consulted in advance in respect of the introduction or amendment of (new) laws and regulations relevant to foreign investment enterprises.

A complaints and appeal mechanism will be established for foreign investment enterprises in cases where their rights are infringed and their problems are not dealt with.

Investors' obligations

In addition to observing the rules on business registration and licences, labour protection, social security insurances, accounting and taxation, etc., foreign investment enterprises are required to set up a workers' union and provide information on their investment to the government agency in charge. Failure to provide such information will result in a fine of between CNY100,000 and CNY 500,000.

Other matters

If Chinese outbound investment is discriminated in a foreign country or region, foreign investment from that country or region can be similarly treated on a reciprocal basis.

Depending on development needs, China may establish "special economic zones" or designate specific regions where foreign investment is encouraged and special policies or incentives are trialled.

Foreign investment enterprises operating as wholly foreign-owned enterprises, a Chinese-foreign equity joint venture or a Chinese-foreign cooperative joint venture may continue to conduct business in these forms for up to five years after 1 January 2020. The State Council will announce detailed rules for this transitional period.

Significant amendments to VAT announced

The MoF, the STA and General Custom Administration jointly issued Circular [2019] No.39 on 20 March 2019 announcing the amendments to VAT which apply from 1 April 2019.

VAT rates

The 16% VAT rate currently applicable to general VAT taxpayers will be reduced to 13%, whilst the 13% VAT will be reduced to 9%. Correspondingly, the VAT export refund rates will be respectively reduced from 16% to 13% and from 13% to 9%.

Input tax credit

Input tax credit for VAT taxpayers purchasing agricultural products will be adjusted from 10% to 9%, and for those purchasing agricultural products for production or contract processing will be 10%. Meanwhile, input VAT on purchases

made by real estate companies, including any remaining input VAT from the previous period, may be offset against output VAT in the current period, as opposed to the current rule that input VAT deduction must be spread over two years. Input tax on domestic passenger transport services purchased by VAT taxpayers may be offset against output VAT. The circular specifies that ordinary invoices or tickets may be used if no special VAT invoice is available.

VAT super deduction

From 1 April 2019 to 31 December 2021, the allowable input VAT in the current period may be increased by 10% for VAT taxpayers engaged in manufacturing or lifestyle services.

Any "increased" input VAT that cannot be offset due to insufficient output VAT can be carried over to the following periods. Once the taxpayer elects to apply VAT super deduction, the choice may not be changed within 1 year. Whether the VAT super deduction can be applied in the subsequent years depends on the turnover of the preceding year. The VAT super deduction does not apply to export of goods or services and cross-border taxable events.

VAT refund

The VAT refund for foreign passengers leaving China will be reduced from 13% to 11%. Where the current refund rate is 9%, the refund rate will be reduced to 8%.

From 1 April 2019, the tax authority will introduce refunds of non-offset input VAT that has been increased after March 2019 (currently, input VAT can in principle only be offset against output VAT). Non-offset input VAT can only be refunded at the request of VAT taxpayers if certain conditions are satisfied. The conditions include, among others, that the increased non-offset VAT within six months exceeds CNY 500,000 and the VAT taxpayer applying for the refund is rated as an A or B taxpayer (under a credit system for taxpayer behaviour).

Public notice on certificate of residence

On 1 April 2019, the STA issued Public Notice [2019] No. 17 (the notice) updating the certificate of residence. The notice applies as from 1 May 2019. Articles 2 and 4 plus attachments 1 and 2 of the SAT Public Notice [2016] No. 40 as amended by SAT Public Notice [2018] No. 31 will be abolished on the same date.

The applicant of a certificate of residence (the official name in the Chinese application form: Certificate of Chinese Fiscal Resident) must apply for it to the local competent tax bureau at the county level. In the case of a foreign or domestic branch of a Chinese resident enterprise, the head office has to apply to the competent tax bureau of the head office; in the case of a partnership, the applicant must be the partner himself.

All necessary documents must be submitted in Chinese. Any document in a foreign language needs to be accompanied by a Chinese translation and any copy of the authentic document must be stamped or signed by the applicant.

Reduction in rates for social security contributions announced

On 4 April 2019, the General Office of the State Council released a comprehensive plan for a reduction in the rates for social security contributions that took effect from 1 May 2019. Its main amendments are summarised below.

Old-age pension insurance

The employer's contribution to old-age pension insurance will be reduced to 16% in cases where the actual percentage exceeds 16%. Self-employed and employees with flexible employment contracts have the right to choose the basis for contribution to old-age pension insurance between 60% and 300% of the average wages of employees in the same province.

Unemployment insurance

For provinces implementing the reduced total unemployment insurance contribution rate of 1%, the deadline for reducing the contribution rate in stages is extended until 30 April 2020.

Occupational injury insurance

The deadline for gradually reducing the occupational injury insurance contribution rate is extended until 30 April 2020. The contribution rate may be reduced by 20% of the current rate if the accumulated balance of the insurance is sufficient for payment for 18 to 23 months in the coordination area where the insurance contribution is collected. Furthermore, the contribution rate may be reduced by 50%, provided that the accumulated balance of the insurance is sufficient for payment for more than 24 months.

HONG KONG

Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Bill 2018 passed

On 20 February 2019, the Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Bill 2018 was passed by the Legislative Council to provide profits tax exemption for eligible onshore and offshore funds operating in Hong Kong.

The Bill also seeks to address the concerns of the Council of the European Union over the ring-fencing features of Hong Kong's tax regimes for privately offered offshore funds and enhance competitiveness of Hong Kong's tax regimes by creating a level playing field for all funds operating in Hong Kong.

The new tax regime came into operation from 1 April 2019.

Budget for 2019/20 – proposals

The Budget for 2019/20 was presented to the Legislative Council by the Financial Secretary on 27 February 2019. The tax-related proposals require legislative amendments before implementation and apply from 1 April 2019.

The main proposals include:

- a one-off tax reduction of 75% on profits tax, salaries tax and tax under personal assessment for the year of assessment 2018/19, subject to a maximum of HKD20,000 per case; and
- a waiver of business registration fees for 2019/20.

Amendments to legislative framework of AEOI to come into force

The Inland Revenue (Amendment) (No. 2) Ordinance 2019 (Amendment Ordinance) was gazetted by the government on 1 March 2019. The legislative framework of automatic exchange of financial account information in

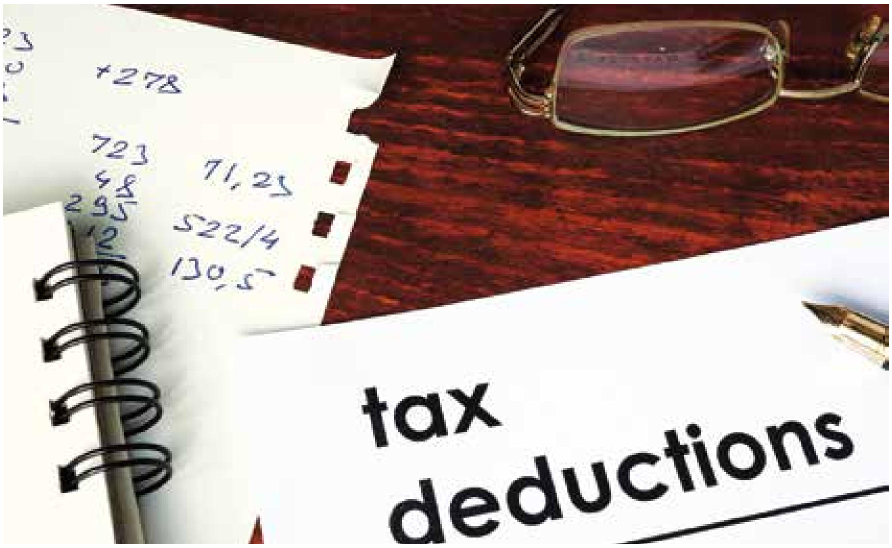
tax matters (AEOI) under the Inland Revenue Ordinance (Cap. 112) (IRO) will be refined with effect from 1 January 2020 for better aligning the relevant provisions with the requirements promulgated by the OECD.

The Amendment Ordinance requires Mandatory Provident Fund Schemes, Occupational Retirement Schemes registered under the Occupational Retirement Schemes Ordinance (Cap. 426), pooling agreements, approved pooled investment funds and credit unions to comply with the due diligence and reporting obligations relating to AEOI starting from year 2020. If members of the institutions concerned are tax residents of the reportable jurisdictions, such institutions are required to report for the first time to the Inland Revenue Department (IRD) the financial account information of the relevant members (covering the year 2020) for transmission to the relevant tax authorities in the year 2021.

In addition, Hong Kong's network for tax information exchange has been expanded since the Convention on Mutual Administrative Assistance in Tax Matters came into force in Hong Kong on 1 September 2018. The Amendment Ordinance increases the number of reportable jurisdictions under the IRO from the current 75 to 126.

Tax deductions for annuity premiums and MPF voluntary contributions approved

The Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Bill 2018 was approved by the Legislative Council on 20 March 2019. The new Ordinance gives effect to the tax deductions that were proposed in the 2018-19 Budget. From the year of assessment 2019/20, taxpayers are entitled to tax deductions under salaries tax and personal



assessment for their premiums paid to qualifying deferred annuities and contributions made to tax deductible Mandatory Provident Fund (MPF) voluntary contribution accounts. The maximum tax-deductible limit for a taxpayer is HKD60,000 per year.

Under the new arrangement, a taxpayer can claim tax deduction for deferred annuity premiums covering the taxpayer's spouse as joint annuitant, or either the taxpayer or the taxpayer's spouse as a sole annuitant. A taxpaying couple is allowed to allocate tax deduction for deferred annuity premiums between themselves in order to claim total annual deductions of HKD120,000, provided that the deduction claimed by each taxpayer does not exceed the individual limit. Tax-deductible MPF voluntary contributions are subject to "preservation requirements", meaning that the accrued benefits can be withdrawn only upon reaching the age of 65 or based on statutory grounds.

INDIA

Interim Budget 2019/20 – President assents to Finance Bill 2019

The Finance Minister presented the Interim Union Budget 2019/20 before Parliament on 1 February 2019. The Finance Bill 2019, including amendments to the Stamp Act, was placed before the President, who gave his assent to it on 21 February 2019. No substantial changes were made to the Finance Act 2019.

Notifications of implementation of various decisions taken by the GST Council for MSME sector and other GST amendments

A number of notifications have been issued on the implementation of three decisions made by the GST Council for the Micro, Small and Medium-sized Enterprises (MSME) sector in its 32nd meeting held on 10 January 2019. The notifications came into effect from 1 April 2019.

Notification No. 10/2019 – Central Tax

This notification relates to the increase in the threshold limit for the exemption from GST registration for suppliers of goods to INR4 million, subject to certain conditions. The Indian states have the option of adopting the higher threshold or the current threshold of INR2 million. The registration thresholds for service providers and special category states remain unchanged at INR2 million and INR1 million, respectively.

Notification No. 2/2019 – Central Tax (Rate)

This notification provides for a composition scheme to be made available to suppliers of services and mixed suppliers with annual turnover of up to INR5 million, subject to certain conditions.

Notification No. 14/2019 – Central Tax

This notification relates to the increase in the turnover limit to avail of the existing composition scheme for goods to INR15 million (currently INR10 million).

GST rates for under-construction residential properties have been decreased as follows:

- with respect to affordable housing, the effective GST rate has been decreased from 8% with input tax credit (ITC) to 1% without ITC; and
- with respect to residential properties outside the affordable segment, the effective GST rate has been decreased from 12% with ITC to 5% without ITC.

Changes were also made to the tax treatment of the transfer of development rights (TDR), floor space index (FSI) and long-term lease (premium) of land for projects commencing after 1 April 2019.

Public consultation on proposal to amend rules for profit attribution to PE in India

On 18 April 2019, the Central Board of Direct Taxes (CBDT) published a report on profit attribution to a permanent establishment (PE) in India, inviting suggestions and/or comments on the report from both stakeholders and the general public. The report was prepared by a committee formed to examine the existing scheme of profit attribution to PEs under article 7 of tax treaties concluded by India, as well as recommend changes to Rule 10 of the Income Tax Rules, 1962.

The committee considered various issues relating to the attribution of profits to a PE, including the taxation of business profits under the Income Tax Act, 1961 and the tax treaties concluded by India; the economic basis for allocation of taxing rights in respect of income from business; the different approaches to profit attribution and international practices; and the court decisions on profit attribution in India. The main recommendations made by the committee concerning profit attribution to a PE are summarised below.

- Profits attributable to operations in India should be determined by apportioning the profits derived from Indian operations on the basis of three equally weighted factors of sales, employees (manpower and wages) and assets.
- Profits derived from Indian operations should be the higher of: the amount arrived at by multiplying the revenue derived from Indian operations with the global operational profit margin; and 2% of the revenue derived from Indian operations.
- For cases where the business

connection is primarily the existence of users beyond the prescribed threshold, income from such business that is attributable to operations in India should be determined by taking into account a fourth factor, the users, in addition to sales, employees (manpower and wages) and assets. The users should be assigned a weight of 10% (in cases of low and medium user intensity) or 20% (in cases of digital models with high user intensity).

SINGAPORE

Budget for 2019 presented

The Budget for 2019 was presented to Parliament by the Finance Minister on 18 February 2019. Details of the Budget, which unless stated otherwise apply from 19 February 2019, are summarised below.

Corporate taxation

Incentive schemes for funds managed by Singapore-based fund managers are extended until 2024. In addition, the Budget announcements include refinements of the incentives that are designed to keep the incentives relevant and ease the compliance burden, which includes a removal of counterparty and currency restrictions on investments by qualifying funds.

Personal taxation

- A personal income tax rebate of 50% of income tax payable (capped at SGD200) is granted to all resident individuals for the year of assessment 2019 (YA 2019), i.e. the calendar year ended 31 December 2018).
- The not ordinary resident (NOR) scheme will lapse after YA 2020, which means that the last NOR status will be granted in YA 2020 and will expire in YA 2024. The NOR scheme allows time apportionment of Singapore employment income between the time spent in Singapore and time spent outside Singapore. The latter is subject to preferential taxation.

VAT

GST import relief for travellers is reduced from SGD600 to SGD500 (and from SGD150 to SGD100 for travellers spending less than 48 hours outside Singapore).

Customs duties

The duty-free allowance for liquor products is reduced from three litres to two litres.

Tax treatment of Public-Private Partnership arrangements

The e-tax guide on the tax treatment of Public-Private Partnership (PPP) arrangements was first issued on 10 September 2009, subsequently amended on 27 December 2013 and most recently amended on 22 February 2019.

The guide explains the approach the Inland Revenue Authority of Singapore (IRAS) takes to establish the scope of services carried on by the private sector operator involved in a PPP project and provides details on the income tax treatment that would apply.

Income tax treatment of foreign exchange gains or losses for businesses – e-Tax guide updated

On 14 March 2019, the Inland Revenue Authority of Singapore (IRAS) issued an updated e-tax guide on tax treatment of foreign exchange gains and losses for businesses. The guide was first issued on 29 June 2012.

The IRAS accepts, for tax purposes, the accounting treatment adopted by businesses for revenue exchange differences. In this regard, all revenue foreign exchange differences (regardless of whether they are realised or unrealised) will be taxable or deductible in the year that they are charged to the profit and loss account.

This tax treatment is applied automatically to businesses other than banks since the year of assessment 2004 (unless the business opted out of this tax treatment when submitting the income tax for the year of assessment 2004).

The guide has been updated with information regarding the introduction of Section 34AB of the Income Tax Act which provides the legislative basis for the tax treatment above. From 12 November 2018, businesses that had previously opted out of the tax treatment in 2004 (previously irrevocable) could now make an election to IRAS to adopt the tax treatment when filing their income tax returns.

The guide is also updated to specify the exclusions from the default capital tax treatment for bank accounts and also provides clarification as to when a bank account will not be regarded as a designated bank account. Additionally, the guide also provides guidance on the administrative requirements for businesses which intend to claim the revenue tax treatment for designated bank accounts.

THAILAND

New land and building tax Act

The new Land and Building Tax Act B.E. 2562 (2019) (the Act) of 12 March 2019 was published to replace the old House and Land Tax Act B.E. 2475 (1932). The tax collection under the Act will take effect from 1 January 2020.

The important changes under the Act are set out below.

- A change has been made to the tax base, from the yearly rent to the value of the land or buildings as appraised by the government.
- The local government authority will announce its yearly tax rates before 1 February of every year.
- The yearly tax rates vary according to the type of use of the property, which will be prescribed in the Royal Decree laws by the local government, provided that such rates do not exceed the following maximum rates:

Type of use	Tax rate ceiling (%)
agriculture	0.15
residential	0.3
commercial	1.2
vacant (or not in use for any purpose)	1.2

** The tax rate will be increased by 0.3% in the fourth year if it is still vacant or not in use for any purpose, and another 0.3% for the subsequent three years until it reaches a maximum tax rate of 3%*

- Individuals and companies with ownership and/or rights of use of land and buildings (including condominiums) must pay land and building tax to their local district office by April of every year.
- The Act also provides a broad tax exemption for land and buildings used for certain reasons, such as social or economic necessity. Separate royal decrees are expected to be provided for more details.

Existing ROH, IHQ and ITC tax benefits – repeal proposed

On 26 March 2019, the Cabinet announced it wished to repeal all tax benefits granted to the previous Board of Investment (BOI) incentive programmes: Regional Headquarters (ROHs), International Headquarters (IHQs), and International Trade Centres (ITCs).

Previously, following the introduction of the International Business Centre (IBC) to replace the abovementioned incentive regimes, the existing entities under the ROH, IHQ and ITC regimes were to remain eligible under existing conditions until their status expired. However,

the official announcement of the proposal to repeal the grandfathered tax incentives means all existing qualifying entities will lose their currently enjoyed tax benefits, which includes corporate incentives (effective from 1 June 2019) and individual incentives (effective from 1 January 2020). Payments on dividends and interest declared from profits earned before 1 June 2019 and paid to foreign entities by 31 December 2020 will continue to be exempted from corporate income tax.

The proposal above is still subject to further legislative processes and enactment.

Personal income tax measures (excluding partnerships and juristic groups of persons)

- An allowance of up to THB 15,000 will be granted for purchases of educational and sports equipment made between 1 May 2019 and 30 June 2019.
- In order to promote domestic tourism, an allowance of up to THB15,000 (in major provinces) and THB20,000 (in secondary provinces) for spending on services provided by local tour operators and accommodation in hotels, certified homestay or accommodation. This is applicable for expenses paid between 30 April 2019 and 30 June 2019. If expenses are made in relation to both categories, i.e. spending in major and secondary provinces, the expenses allowed will not exceed THB20,000 in total.
- An allowance of up to THB 15,000 will be entitled for purchases of local products that are registered and certified by the Community Development Department under the Ministry of Interior. This is applicable for purchases made between 30 April 2019 and 30 June 2019.
- Expenses for purchases of books or e-books (excluding newspapers and magazines) will be entitled to tax allowances of up to THB15,000. This is applicable for purchases made between 1 January 2019 and 31 December 2019.
- A tax allowance of up to THB 200,000 will be granted for the purchase of a building with land or a condominium unit with a value of up to THB5 million, provided that:
  - the unit or building is used for residential purposes and it is the first purchase of real estate for the respective eligible taxpayer;
  - the sale and purchase agreement, and construction agreement must not be executed separately;
  - eligible taxpayers must not disposed of the property purchased under this measure for at least five years; and
  - this is applicable for purchases made between 30 April 2019 and 31 December 2019.

(Note: all proposed personal tax measures above has been approved subsequently on 13 May 2019, via various Ministerial Regulations issued under the Revenue Code.)

Corporate income tax measures

Eligible companies or juristic partnerships will be allowed a double tax deduction on the expenses paid for investing in an electronic tax system such as point-of-sale systems, e-tax invoices, and cloud services. The eligible companies or juristic partnerships must be VAT registrants. This is applicable for expenses made between 30 April 2019 and 31 December 2019.

***Rachel Saw** and **Janice Loke** 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.*

TechnicalUpdates

The technical updates published here are summarised from selected government gazette notifications published between 17 February 2019 and 16 May 2019 including Public Rulings (PRs) and guidelines issued by the Inland Revenue Board Malaysia (IRBM), the Royal Malaysian Customs Department and other regulatory authorities.

INCOME TAX

Income tax exemptions for Malaysia Japanese Yen Bonds – Series A (2019) (Effective: Year of assessment (YA) 2019)

The Income Tax (Exemption) Order 2019 [P.U.(A) 53], gazetted on 25 February 2019, provides that any non-resident person is exempted from the payment of income tax in respect of income derived from Malaysia on:

a) Interest referred to in Section 4(c) of the Income Tax Act 1967 (ITA); or
b) Technical services referred to in Section 4A(ii) of the ITA

in relation to the issuance of the Malaysia Japanese Yen Bonds – Series A (2019) guaranteed by the Japan Bank for International Cooperation (for Qualified Institutional Investors only) (Tekikaku Kikan Toshika Gentei) with a nominal value of up to 200 billion Yen, other than convertible loan stock, issued by the government of Malaysia. The exemption is for a period of 10 years, commencing from the YA 2019.

50% tax exemption on rental income received by a Malaysian citizen (Effective: YA 2018 only)

The Income Tax (Exemption) (No. 2) Order 2019 [P.U.(A) 55], gazetted on 27 February 2019, provides that a landlord who rents out his residential property is exempted from the payment of income tax in respect of 50% of his statutory income derived from such rental.

The Order also provides that where a landlord receives rent from two (2) or more residential properties, each residential property shall be treated as separate and distinct sources of rent. As such, a separate account should be maintained for the rent received from each residential property.

Income Tax (Deduction for Expenditure on issuance of Retail Debenture and Retail Sukuk) Rules 2019 (Effective: YA 2019 and YA 2020)

The Income Tax (Deduction for Expenditure on issuance of Retail Debenture and Retail *Sukuk*) Rules 2019 [P.U.(A) 117], gazetted on 25 April 2019, provide that the following "additional expenses" incurred on the issuance of retail debenture and retail *sukuk* shall be allowed as a deduction (single and/or double) in ascertaining the adjusted income of a company resident in Malaysia:

a) Double deduction on the additional expenses incurred on the issuance of the retail debenture
b) Double deduction on the additional expenses incurred on the issuance of the retail *sukuk* structured under the principle of *Murabahah* or *Bai' Bithaman Ajil* (based on the concept of *Tawarruq*), *Mudharabah*, *Musyarakah*, *Istisna'* or any *Shariah* principle other than the principles mentioned in paragraph

(c) below, approved or authorised by the Securities Commission of Malaysia (SC) under the Capital Markets and Services Act 2007 (CMSA)
c) Single deduction on the additional expenses incurred on the issuance of the retail *sukuk* structured under the principle of *Ijarah* or *Wakalah* comprising a mixed component of asset and debt, approved or authorised by the SC under the CMSA

The additional expenses incurred on the issuance of the retail debenture and retail *sukuk* that qualify for the deductions above include:

- Professional fees relating to due diligence, drafting and preparation of the prospectus
- The printing cost of the prospectus
- The advertisement cost of the prospectus
- The SC prospectus registration fee
- The Bursa Malaysia processing fee and initial listing fee
- The Bursa Malaysia new issue crediting fee
- The primary distribution fee

Income Tax (Deduction for Expenditure on issuance of Sukuk) Rules 2019 (Effective: YA 2019 and YA 2020)

The Income Tax (Deduction for Expenditure on issuance of *Sukuk*) Rules 2019 [P.U.(A) 118], gazetted on 25 April 2019, provide that expenditure incurred on the issuance of *sukuk* (under the principles of *Ijarah* or *Wakalah*) shall be allowed as a deduction to ascertain the adjusted income of a company. The issuance of *sukuk* must be approved by either the SC or the Labuan Financial Services Authority.

Public Ruling No. 2/2019 – Director's Liability

Public Ruling (PR) No. 2/2019: Director's Liability, dated 14 March 2019, explains the liabilities of a company director in respect of his company's tax pursuant to Section 75A of the ITA, i.e.:

a) Any tax that is due and payable by a company; and
b) Any debt that is due and payable by a company as an employer in relation to tax deductions from emoluments and pensions under the monthly tax deduction (MTD)

Broadly, the PR explains the definition of a director, situations in which directors are/are not liable for the company's tax and any debt that is due and payable by the company, and actions that may be taken against the directors to recover the company's tax and/or debt.

The PR also highlights that actions that can be taken to recover a company's taxes or debts include preventing a director from leaving the country, or a civil suit under Section 106(1) of the ITA.

Important updates on the Special Voluntary Disclosure Programme (SVDP)

The IRBM has recently issued various media releases and the updated Operational Guidelines No. 1/2019 on the SVDP dated 24 April 2019. Some of the important updates on the SVDP are as follows:

Extension of the SVDP

The Ministry of Finance (MoF) will extend the SVDP period as follows:

Penalty rate	Period of voluntary disclosure based on original timeline	Period of voluntary disclosure based on extended timeline
10%	1 November 2018 to 31 March 2019	1 November 2018 to 30 June 2019
15%	1 April 2019 to 30 June 2019	1 July 2019 to 30 September 2019

Eligibility of companies with financial years ended (FYE) 31 January 2018, 28 February 2018 and 31 March 2018 to participate in the SVDP

In its media release dated 21 March 2019, the IRBM clarified that companies with the above-mentioned FYE that have not submitted their 2018 income tax return forms (ITRF) are eligible to participate in and enjoy the lower penalty rates offered under the SVDP.

The IRBM further clarified in its media release dated 27 March 2019 that companies with the above-mentioned FYE that have submitted their 2018 ITRF prior to the announcement of the SVDP in Budget 2019 are also eligible to participate in the SVDP if they wish to report any additional income for the YA 2018 and before. In addition, companies with the above-mentioned FYE whose previous applications were rejected, are encouraged to resubmit their applications.

Update on the penalty rates after the SVDP period

Paragraphs 6.1 and 6.2 of the Operational Guidelines No. 1/2018 have been updated to stipulate that the penalty rates after the SVDP period expires will be as follows:

	Penalty rate based on earlier Guidelines	Penalty rate based on revised Guidelines
Taxpayers who fail to submit ITRF / Petroleum Return Form (PRF) / Real Property Gains Tax Return Form (RPGTF)	Minimum rate of 80% to 300%	Minimum rate of 45%
Taxpayers who fail to report the correct income	Minimum rate of 80% to 100%	Minimum rate of 45%

- Full disclosure should be made for all income or gains on disposal of assets in the voluntary disclosure made.
- The new Guidelines now state that whilst the IRBM will accept in good faith all voluntary disclosures made, the computation of tax submitted will be checked to ensure accuracy of the voluntary disclosure made. Audit and/or investigations however would not be carried out on the YAs for which voluntary disclosures have been made.
- The new Guidelines clarify the penalties that may be imposed under the various legislations after the SVDP period ends. In particular, the Guidelines highlight that where group relief is claimed and a surrendering company has provided incorrect information in its income tax return, the surrendering company may be required to pay a penalty equal to the tax undercharged on the claimant company as a result of such error.

Guidelines on Dispute Resolution Proceeding (DRP)

The IRBM has recently published on its website the Guidelines on Dispute Resolution Proceeding (DRP) (Guidelines) to:

a) Provide information regarding DRP as a mechanism to resolve disputes arising from an appeal or application for relief filed by a taxpayer; and
b) Spread awareness of a taxpayer's rights and responsibilities in relation to DRP

The DRP initiative was introduced on 1 July 2013. It provides taxpayers an opportunity to be heard (e.g. clarify reasons for the appeal / application for relief) by an independent DRP panel who was not involved in the raising of the assessment. The goal is to achieve an out-of-court settlement before the taxpayers' appeal or application for relief is forwarded to the Special Commissioners of Income Tax (SCIT).

Updated guidelines for submission of amended tax return

The IRBM has published on its website the updated Guidelines, in Bahasa Malaysia, on the procedures for submitting an amended tax return. The Guidelines are dated 22 April 2019 and are titled "Prosedur Pengemukaan Borang Nyata Terpinda". This new five-page Operational Guidelines No. 3/2019 document replaces the earlier Operational Guidelines No. 1/2010 dated 30 November 2010 (see Tax Alert No. 26/2010). The 2019 Guidelines are broadly similar to the 2010 Guidelines, with some minor changes.

STAMP DUTY

Stamp duty remission on the purchase of first residential home (Effective: 1 July 2019)

The Stamp Duty (Remission) Order 2019 [P.U.(A) 49], gazetted on 22 February 2019, provides that stamp duty amounting to RM5,000 shall be remitted on any instrument of transfer to finance the purchase of a residential property valued between RM300,001 and RM500,000. This Order will only apply if:

a) The sale and purchase agreement (SPA) is executed between 1 July 2019 and 31 December 2020; and
b) The individual has never owned any residential property, including a residential property obtained by way of inheritance or gift, which is held either individually or jointly The application for the remission of the stamp duty will have to be accompanied by a declaration by the individual confirming point (b) above.

Stamp duty exemption on Malaysia Japanese Yen Bonds – Series A (2019) (Effective date: 26 February 2019)

The Stamp Duty (Exemption) Order 2019 [P.U.(A) 52], gazetted on 25 February 2019, provides a stamp duty exemption for any instrument in respect of the issuance, guarantee and services in relation to Malaysia Japanese Yen Bonds – Series A (2019) guaranteed by the Japan Bank for International Cooperation (for Qualified Institutional Investors only) (Tekikaku Kikan Toshika Gentei) by the government of Malaysia, which is executed between 26 February 2019 and 31 December 2019.

Guidelines on relief from stamp duty pursuant to Sections 15 and 15A of the Stamp Act 1949

On 26 February 2019, the IRBM published on its website Guidelines, in Bahasa Malaysia, on the application for relief from stamp duty under Sections 15 and 15A of the Stamp Act 1949 (SA), as follows:

Garis Panduan Permohonan Pelepasan Duti Setem Di Bawah Seksyen 15, Akta Setem 1949

Section 15 of the SA provides relief from stamp duty in cases of reconstructions or amalgamations of companies.

The Guidelines stipulate that to qualify for the exemption, the application will have to be lodged with the Collector of Stamp Duties (Collector) via submission to any State Offices, or online via the IRBM's website through the Stamp Duty Assessment and Payment System (STAMPS), followed by the submission of supporting documents by hand. The statutory declaration for the application of this relief is provided in the Appendix to the Guidelines.

The process for approved or rejected applications is also explained in the Guidelines. In addition, the Guidelines also outline the documents which are to be furnished in support of the application.

Garis Panduan Permohonan Pelepasan Duti Setem Di Bawah Seksyen 15A, Akta Setem 1949

Section 15A of the SA provides relief from stamp duty in cases of transfer of property between associated companies.

The Finance Act 2018 amended Sections 15A(2) and 15A(4) of the SA to introduce a number of additional requirements to be adhered to in order to qualify for the relief. One of the additional requirements is that the transfer of property is to achieve "greater efficiency" in the operations of both transferor and transferee. The Guidelines explain that to justify "greater efficiency", a three-year operational plan of both companies will need to be provided. The operational plan should include an explanation of "greater efficiency" in the form of a narrative, graph, chart, schedule etc. It should also outline clearly the objective and strategy in achieving the level of stipulated operational efficiency in three (3) years, along with any other supporting documents, where relevant. If "greater efficiency" will not be achieved, the company will need to provide a reasonable justification for the Collectors' consideration. It is to be noted that the Collectors' decision is final.

Similar to the application for relief under Section 15 of the SA, the application will have to be lodged with the Collector via submission to any State Offices, or online via the IRBM's website through STAMPS, followed by the submission of supporting documents by hand. The statutory declaration for the application of this relief is provided in the Appendix to the Guidelines.

The Guidelines also outline the documents which are to be furnished in the application for the exemption.

Stamp duty exemption on the purchase of residential property under the National Home Ownership Campaign 2019

Exemption Orders	Exemptions
Stamp Duty (Exemption) (No. 2) Order 2019 [P.U.(A) 81] (Effective: 1 January 2019)	The Order provides that any loan agreement to finance the purchase of a residential property valued from RM300,001 to RM2.5 million under the National Home Ownership Campaign 2019, will be exempted from stamp duty.
Stamp Duty (Exemption) (No. 3) Order 2019 [P.U.(A) 82] (Effective: 1 January 2019)	The Order provides that any instrument of transfer for the purchase of a residential property valued from RM300,001 to RM2.5 million (based on market value) under the National Home Ownership Campaign 2019, will be exempted from stamp duty in respect of up to RM1 million of the market value of the residential property. Stamp duty of 3% is to be charged on the remaining value of the residential property which is in excess of RM1 million.

The Exemption Orders will apply only if:

a) The sale and purchase agreement (SPA) is executed between 1 January 2019 and 30 June 2019 and is stamped at any branch of the IRBM;
b) The SPA for the purchase of the residential property is between an individual and a property developer; and
c) The purchase price in the SPA is a price after a discount of 10% by the property developer, except for a residential property which is subject to controlled pricing.

The application for the exemptions will have to be accompanied by a National Home Ownership Campaign 2019 Certification issued by the Real Estate and Housing Developers' Association (REHDA) Malaysia, Sabah Housing and Real Estate Developers Association (SHAREDA) or Sarawak Housing and Real Estate Developers' Associate (SHEDA).

CUSTOMS DUTIES

Customs (Anti-Dumping Duties) Order 2019

The Customs (Anti-Dumping Duties) Order 2019 [P.U.(A) 69] was gazetted on 8 March 2019 and has effect for a period of five years from 8 March 2019 to 7 March 2024. The anti-dumping duties shall be levied on and paid by the importers in respect of the importation of the goods into Malaysia, as enumerated in the corresponding Schedule. The rates of duty imposed range from NIL to 16.13% depending on the tariff code, description of goods, country, and the exporter/producer, as specified in the Schedule.

Customs (Prohibition of Imports) (Amendment) (No.2) Order 2019

The Customs (Prohibition of Imports) (Amendment) (No.2) Order 2019 [P.U. (A) 73] was gazetted on 13 March 2019 and came into operation on 15 March 2019. This Order provides for amendments to the Second Schedule and Third Schedule under the Customs (Prohibition of Imports) Order 2017 [P.U.(A) 103/2017].

Customs Duties (Prohibition of Exports) (Amendment) Order 2019

The Customs Duties (Prohibition of Exports) (Amendment) Order 2019 [P.U.(A) 72] was gazetted on 13 March 2019 and came into operation on 15 March 2019. This Order provides for amendments to the Second Schedule, in relation to item 6 under the Customs (Prohibition of Exports) Order 2017 [P.U.(A) 102/2017].

Customs Duties (Exemption) (Amendment) Order 2019

The Customs Duties (Exemption) (Amendment) Order 2019 [P.U.(A) 74] was gazetted on 13 March 2019 and came into operation on 14 March 2019. This Order provides for amendments to Part I of the Schedule, in relation to item 67 under the Customs Duties (Exemption) Order 2017 [P.U.(A) 445/2017].

Customs Duties (Langkawi) (Amendment) Order 2019

The Customs Duties (Langkawi) (Amendment) Order 2019 [P.U.(A) 85] was gazetted on 26 March 2019 and came into operation on 27 March 2019. This Order provides for amendments to Paragraph 2 under the Customs Duties (Langkawi) Order 1986 [P.U.(A) 489/1986].

Customs Duties (Tioman) (Amendment) Order 2019

The Customs Duties (Tioman) (Amendment) Order 2019 [P.U.(A) 86] was gazetted on 26 March 2019 and came into operation on 27 March 2019. This Order provides for amendments to Paragraph 2 under the Customs Duties (Tioman) Order 2004 [P.U.(A) 239/2004].

Customs Duties (Labuan) (Revocation) Order 2019

The Customs Duties (Labuan) (Revocation) Order 2019 [P.U.(A) 87] was gazetted on 26 March 2019 and came into operation on 27 March 2019. This Order provides for revocation of the Customs Duties (Labuan) Order 2016 [P.U.(A) 286/2016].

Customs (Anti-Dumping Duties) (Extension) Order 2019

The Customs (Anti-Dumping Duties) (Extension) Order 2019 [P.U.(A) 95] was gazetted on 29 March 2019 and came into operation on 30 March 2019. This Order provides for an extension to the effective period of the Customs (Anti-Dumping Duties) Order 2014 [P.U.(A) 81/2014] and Customs (Anti-Dumping Duties) (Administrative Review) Order 2016 [P.U. (A) 239/2016] from 30 March 2019 to 26 September 2019.

Customs (Anti-Dumping Duties) (Administrative Review) Order 2019

The Customs (Anti-Dumping Duties) (Administrative Review) Order 2019 [P.U.(A) 127] was gazetted on 8 May 2019 and has effect for the period from 8 May 2019 to 23 May 2021. This Order provides for an extension of the Customs Duties Order 2017 [P.U.(A) 5/2017]. The anti-dumping duties shall be levied on and paid by the importers in respect of the importation of the goods into Malaysia, as enumerated in the corresponding Schedule. The rates of duty imposed range from NIL to 42.08% depending on the tariff code, description of goods, country, and the exporter/producer, as specified in the Schedule.

Customs (Anti-Dumping Duties) (Revocation) (No.2) Order 2019

The Customs (Anti-Dumping Duties) (Revocation) (No.2) Order 2019 [P.U.(A) 128] was gazetted on 8 May 2019 and came into operation on 8 May 2019. This Order provides for revocation of the Customs (Anti-Dumping Duties) (No.2) Order 2016 [P.U.(A) 144/2016].

SALES TAX

Sales Tax (Imposition of Sales Tax in Respect of Designated Areas) (Amendment) Order 2019

The Sales Tax (Imposition of Sales Tax in respect of Designated Areas) (Amendment) Order 2019 [P.U.(A) 92] was gazetted on 26 March 2019 and came into operation on 27 March 2019. This Order provides for amendments to Paragraph 2 by deleting subparagraph (a) under the Sales Tax (Imposition of Sales Tax in respect of Designated Areas) Order 2018 [P.U.(A) 206/2018].

Sales Tax (Persons Exempted from Payment of Tax) (Amendment) Order 2019

The Sales Tax (Persons Exempted from Payment of Tax) (Amendment) (No.2) Order 2019 [P.U.(A) 93] was gazetted on 26 March 2019 and came into operation on 27 March 2019. This Order provides for amendments to Schedule A under the Sales Tax (Persons Exempted from Payment of Tax) Order 2018 [P.U.(A) 210/2018].

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

CASE 1

WIRA SWIRE SDN BHD V KETUA PENGARAH HASIL DALAM NEGERI

BRIEF FACTS

Wira Swire Sdn Bhd (WS) entered into dealings with ORAPS, a non-resident company providing offshore shipping services in Malaysia and international waters. WS then paid ORAPS for the services provided to them.

WS did not withhold tax for the payments made to ORAPS as Article IX of the DTA entered between Malaysia and ORA's home country clearly states that the profits derived by an enterprise of a contracting state from the operation of ships or aircraft in international traffic shall be taxable only in its home country.

Notwithstanding this, the Director General of Inland Revenue (DGIR) took the stance that the payments made to ORA should have been subjected to withholding tax pursuant to Section 4A(iii) of the ITA. Accordingly, the DGIR invoked Section 39(1)(j) of the Income Tax Act 1967 (ITA) to disallow the deduction of the payments made to ORAPS and raised notices of additional assessments with penalty for the sum of over RM100 million against WS.

The issue is:

> "Whether Article IX of the Malaysia-Denmark Double Taxation Agreement (Malaysia-Denmark DTA) prevails over Section 4A of the Income Tax Act 1967 (ITA) in the event of a conflict?"

DGIR'S ARGUMENTS

At the substantive hearing, the DGIR submitted among others that the payments received by ORAPS from WS are income that falls under Section 4A(iii) of the ITA 1967 and that the provisions of the DTA are not applicable

Further, the DGIR sought to rely on the Federal Court's decision in ***Lembaga Hasil Dalam Negeri Malaysia v Alam Maritim Sdn Bhd [2014] 3 CLJ 421*** which had held that the taxpayer is not entitled to relief from double taxation under the Malaysia-Singapore DTA if the payments fall under Section 4A of the ITA, as this provision has created a special class of income under which the taxpayer's income should be taxed in Malaysia

ITA V DTA

Aggrieved by the DGIR's decision, WS commenced judicial review proceedings against the DGIR. The challenge was mounted on the basis that the DGIR's decision was contrary to, among others, the decisions of our Courts in ***Ketua Pengarah Hasil Dalam Negeri v Damco Logistics Malaysia Sdn Bhd (Rayuan Sivil W-01-424-11), Maersk Malaysia Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2013) MSTC-046*** and ***Thomson Reuters Global Resources v Ketua Pengarah Hasil Dalam Negeri (2015) MSTC 10-048***. These decisions have held that provisions of the DTA would prevail over those of the ITA.

At the leave stage hearing at the High Court, WS succeeded in obtaining leave to apply for judicial review and was granted a stay order against the DGIR.

WS'S ARGUMENTS AND HIGH COURT'S DECISION

WS argued that this similar issue has been decided by the Honorouble Court in the case of ***Orange Rederiet APS v Ketua Pengarah Hasil Dalam Negeri W-01(A)-595-10/2018***. The case concerns the exact same factual fact. The decision had "necessarily and with precision" determined the issue at hand.

Be that as it may, WS further argued that it is trite law whenever there is a conflict between the DTA and ITA, the provisions of the DTA will prevail over the ITA as decided by our Malaysian Courts at all levels.

The High Court adopted, among others, the legal precedents in Damco Logistics, Maersk Malaysia and Thomson Reuters to reinforce the trite principle that DTA provisions are to prevail over that of the ITA in the event of a conflict.

Finally, the High Court also agreed that the Federal Court's decision in Alam Maritim can be distinguished.

In Alam Maritim, the Federal Court had given recognition to and affirmation of the general prominence of the DTA. However, it was held that the Article IV of the Singapore-Malaysia DTA, could not afford relief to the taxpayer as Parliament had subsequently enacted Section 4A of the ITA in 1984. By so doing, Parliament had intended Section 4A to prevail over the DTA.

Counsel for the taxpayer:
MR. S. SARAVANA KUMAR & CHRIS TOH PEI ROO

Counsel for the DGIR:
EN. AHMAD ISHAK & PUAN RUZAIDAH YAACOB

CASE 2

TUNE INSURANCE MALAYSIA BERHAD V KETUA PENGARAH HASIL DALAM NEGERI

The taxpayer is a company incorporated in Malaysia and is licensed to carry on general insurance business in Malaysia. In the course of its insurance business, the taxpayer would be required to make a provision for 'Incurred but Not Reported' (IBNR) claims and 'Provision of Risk Margin for Adverse Deviation' (PRAD) and both these provisions have been recognised to be part of the taxpayer's liabilities in their audited accounts. PRAD is one of the important reserving components used in the IBNR calculation which is a reserve account set up by insurance companies to allocate sufficient funds for expected losses and constitutes a best estimate value of their insurance liabilities. Accordingly, the taxpayer has claimed a deduction for these provisions in their tax computation.

The Director General of Inland Revenue (DGIR) disallowed the taxpayer's claim for deduction and alleged that the PRAD expenses incurred by the taxpayer are not deductible as PRAD is a provision which contains an element of uncertainty. The DGIR then raised the impugned notices of additional assessment against the taxpayer. The taxpayer subsequently filed an application for judicial review to quash the said impugned notices of additional assessment.

The issues were:

1) Whether the DGIR is entitled in law to disregard the decisions of our Courts by disallowing the deduction for the PRAD expenses incurred by the taxpayer; and
2) Whether the DGIR is entitled to disregard the clear provision of Section 60(5)(b)(i) of the Income Tax Act 1967 (ITA) which provides that claims incurred by an insurer in a basis period are deductible in arriving at its adjusted income.

THE DGIR'S ARGUMENT

In essence, the DGIR's contention can be summarised as follows:

i. The PRAD provision claimed has not been incurred by the taxpayer as it has not been disbursed and thus, Section 33(1) and Section 60(5)(b)(i) of the ITA would not apply.
ii. As there is an alternative remedy through an appeal to the Special Commissioners of Income Tax (SCIT) provided under Section 99 of the ITA, the taxpayer cannot also seek for remedy through an application for Judicial

Review as it would amount to an abuse of process.

THE TAXPAYER'S ARGUMENT

i. The DGIR failed to adhere to the clear wordings of Section 33(1) and Section 60(5)(b)(i) in disallowing the deduction for the PRAD expenses incurred by the Taxpayer; and
ii. The DGIR failed to apply the legal principles established by our superior courts which decided that disbursement is not a requirement for an expense to be deductible under Section 33(1).

For ease of reference, Section 33(1) of the ITA reads:

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

Section 33(1) applies to all sources of income and is commonly referred to as "the basket provision". Unless expressly stated that Section 33(1) does not apply, the taxpayer can rely on the general provisions of that section to claim for deduction if the taxpayer is able to show that such outgoings and expenses are actually incurred wholly and exclusively during that period in the production of gross income. Section 60(5)(b)(i) does not preclude the application of Section 33(1). Section 60(5)(b)(i) supplements and applies over and above Section 33(1).

Besides that, the decisions of our Courts in ***Exxon Chemical (Malaysia) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2005] 4 CLJ 810*** and ***Mercedes-Benz Malaysia Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2012) MSTC 30-052*** have settled the law in respect of the meaning of the word "incurred" in Section 33(1) of the ITA whereby expenses incurred by a taxpayer are deductible so long as there is an obligation to pay, i.e. an accrued liability which is undischarged. Therefore, actual disbursement of the expenses is not required for the expenses incurred to be deductible. Accordingly, there are no facts in dispute in the present matter including the amount of the expenses or income. The only issues at hand pertain to questions of law.

The Parliament does not act in vain. Every word written in the Act must be given significance. The taxpayer further argued that is if Parliament had intended to exclude the application of Section 33(1), Parliament would have used express words to that effect. There are no express words in Section 60(5)(b)(i) to exclude the application of Section 33(1) to sources of income of insurance industries. Consequently, the taxpayer submitted that the PRAD expenses could also be allowed as a deduction under Section 33(1).

Moreover, Section 60(5)(b)(i) of the ITA provides that claims incurred by an insurer under its general policies in the basis period are allowed as a deduction in computing its adjusted income.

For ease of reference, Section 60(5)(b)(i) of the ITA reads:

> "The adjusted income for the basis period for a year of assessment from the general business of an insurer resident for the basis year for that year of assessment shall consist of an amount arrived at by—

(b) subject to subsection (7), deducting from that aggregate the amount of—

(i) **claims incurred in that period in connection with his general policies;"**

Since the Taxpayer carries on general insurance business in Malaysia, pursuant to Section 60(5)(b)(i), claims incurred by the taxpayer under its general policies in the basis period are allowed as a deduction in computing its adjusted income. The PRAD expenses would then fall under such claims. The meaning of "incurred" has been settled by various decisions in the country, i.e. the test is whether there is an obligation to pay. There are also many persuasive authorities from the

Commonwealth which decided that an expense is incurred where there is an obligation to pay.

THE HIGH COURT'S DECISION

The learned High Court Judge agreed with the arguments advanced by counsel for the taxpayer and allowed the taxpayer's application and noted that the PRAD expenses can be deducted under the provisions of the ITA.

Counsel for the taxpayer:
MR. S. SARAVANA KUMAR & NG KAR NGAI (PUPIL IN CHAMBERS)

Counsel for the DGIR:
EN. MUHAMMAD FARID JAAFAR & EN. RIDZUAN OTHMAN

CASE 3

RAINFOREST HEIGHTS SDN BHD V KETUA PENGARAH HASIL DALAM NEGERI

BRIEF FACTS

The taxpayer is the developer of a luxury condominium project consisting of 21 units (Project). The Project was conceived in early 2002 by the taxpayer's eight shareholders, all of whom signed a Shareholders' Agreement in March 2002 (Shareholders' Agreement) which provided that, among others, each shareholder would buy a unit at approximately RM380 psf. However, no Sale and Purchase Agreement (SPA) was signed between the shareholders and the taxpayer at that time, as the taxpayer did not receive its developer's licence until 2005.

The eight SPAs for the sale of the units (Initial Units) were signed between 2005 and 2007. In accordance with the Shareholders' Agreement, the sale of the Initial Units was transacted at RM380 psf. Meanwhile, of the remaining 13 units, one was sold to two of those eight shareholders and the other 12 to third parties. The SPAs for the remaining 13 units were also signed between 2005 and 2007 for an average price of RM550 psf.

In 2008, the Director General of Inland Revenue (DGIR) conducted a tax audit on the taxpayer and invoked Section 140(1) of the Income Tax Act 1967 (ITA) to vary the transaction price of the Initial Units from RM380 to RM550 psf. According to the DGIR, the variation was intended to reflect the market value of the Initial Units at the time when the SPA was signed, and this increased the taxpayer's gross income for 2007 artificially.

Being aggrieved by the decision of the DGIR, the taxpayer filed an appeal to the Special Commissioners of Income Tax (SCIT) which eventually allowed the taxpayer's appeal. The High Court subsequently affirmed the SCIT's decision and held that the DGIR had no basis in law to invoke Section 140(1) of the ITA.

TAXPAYER'S ARGUMENTS

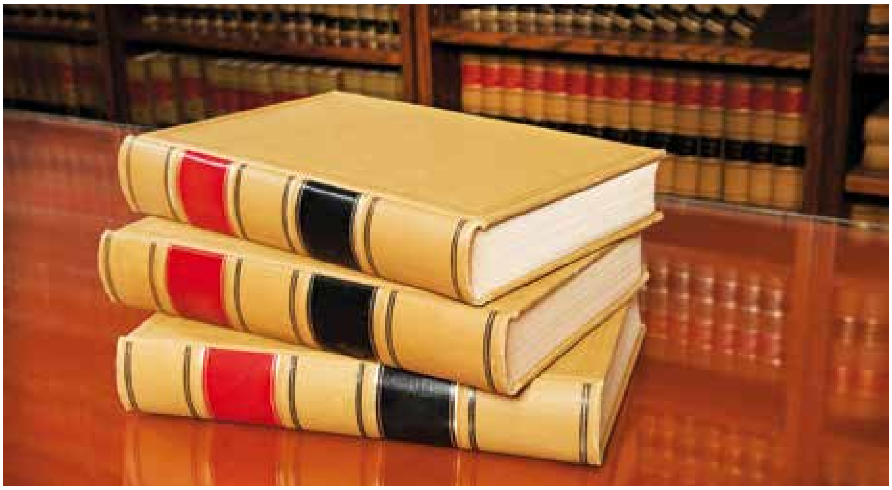
In contending that the assessments raised by the DGIR was erroneous in law and invalid, the arguments put forth by the taxpayer include:

Failure to specify the limb in Section 140(1) of the ITA

Section 140(1) of the ITA lays out four distinct circumstances which allows the DGIR to disregard or vary a transaction or make such adjustments as he thinks fit. Such circumstances include:

(i) Altering the incidence of tax;
(ii) Relieving any person from any liability;
(iii) Evading or avoiding any duty or liability; and
(iv) Hindering or preventing the operation of the ITA.

Our Courts have ruled that it is imperative for the DGIR to inform and specify to taxpayers on the limb of Section 140(1) in which they are relying on. Failure to comply with this requirement deprived the taxpayer of the opportunity to provide the relevant and appropriate response (see ***Port Dickson Power Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2012) MSTC 30-045)***.



Failure to specify the particulars of the adjustment together with the notice of assessment

Section 140(5) of the ITA stipulates in unequivocal terms that the particulars of an adjustment 'shall be given with the notice of assessment'. This requirement has been recognised by our courts to impose a statutory duty on the DGIR to provide the particulars concurrently or together with the assessment; the failure to comply with such duty would render the impugned assessments to be null and void. (see Port Dickson (supra) and ***Director General of Inland Revenue v Hup Cheong Timber (Labis) Sdn Bhd [1985] CLJ (Rep) 107***).

No basis to invoke Section 140(1) of the ITA

Amongst others, the taxpayer contended that a transaction is not entitled to be disregarded or varied by the DGIR if there is a commercial justification for the transaction, even if the incidence of tax is altered. Furthermore, taxpayers have the freedom to structure transactions to their best tax advantage and the DGIR bears the burden to prove that such a transaction is a sham (see ***Ensco Gerudi Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2016) MSTC 30-131*** and ***Sabah Berjaya Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [1993] 3 CLJ 587***).

In the present case, the taxpayer submitted that the price of RM380 psf was a commercial incentive for all the eight shareholders to pre-commit to a unit which has yet to be built and is consistent with the pricing for early commitments at the material time. The DGIR has failed to lead any evidence in showing that the transactions were not at arm's length.

THE SCIT AND HIGH COURT'S DECISION

The High Court affirmed the decision of the SCIT to be correct and found that there was no misconception of law to disturb the findings of the SCIT which decided that the DGIR had arbitrarily invoked Section 140(1) of the ITA.

The SCIT's grounds in their unanimous decision of allowing the taxpayer's appeal can be summarised as such:

- It is imperative for the DGIR to specify the limb in Section 140(1) of the ITA in which the adjustment was made. The failure of the DGIR to do so had deprived the taxpayer of the opportunity to fully understand and provide an appropriate response to the DGIR's action in raising the assessment;
- There were commercial justifications for the sale of the Initial Units at a lower price which was fixed based on a market survey conducted by the shareholders in 2002. There was no evidence to show the existence of any influence or control over the taxpayer in determining the price which was agreed without any advantages given to any of the shareholders;
- The difference in price was the commercial decision of the Appellant based on the situation and market price at the material time. The DGIR was unable to prove the existence of any circumstances or effect which falls under Section 140(6) of the ITA that renders the transaction to not be at arm's length.
- It is a mandatory duty for the DGIR to provide the particulars of the adjustment together with the assessment as prescribed under Section 140(5) of the ITA. The prior discussions between the DGIR and the taxpayer could not be a basis for the DGIR to dispense with its statutory duty. Accordingly, this non-compliance by the DGIR would render the assessment to be null and void.

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BUSINESS DEDUCTIONS: ALLOWANCE

Siva Subramanian Nair

Moving on from business deductions, we embark on our journey to understand the complexities of allowances granted on capital expenditure incurred generally by a business. We have seen that in the tax computation, depreciation is never granted a deduction in ascertaining the adjusted income from a business source. This is primarily because it is neither an expense nor an outgoing [to qualify under Section 33(1). However, in tax, we do realise that there is a deterioration in the economic worth of assets over a period of time, and accordingly allow a claim for allowances in respect of this. The types of allowances are tabulated below:

ACTIVITY	ALLOWANCES	REFERENCE IN ITA *
Business - Plant and machinery	Capital allowances	Schedule 3
Business - Buildings	Industrial building allowances	Schedule 3
Agriculture	Agricultural allowances	Schedule 3
Forest	Forest allowances	Schedule 3
Prospecting	Prospecting allowances	Schedule 4
Mining	Mining allowances	Schedule 2

*ITA- Income Tax Act 1967 (as amended)

The order in which the above allowances appear in the standard tax computation format is reflected in the diagram below.

	RM
Gross Income from business	XX
Less: Mining Allowance	(X)
Adjusted Business Income	XX
Add: Balancing Charge Agricultural Charge / Forest Charge	X
Less: Balancing Allowance Capital Allowance / Industrial Allowance Agricultural Allowance / Forest Allowance	(X)
Statutory Income from Business	XX
Add: Recoveries of Abortive Prospecting Expenditure	X
Aggregate Income	XX
Less: Prospecting Expenditure	(X)
Total Income	XX

We will commence the journey with capital allowances on plant and machinery. Note that the term plant and machinery used in tax literally encompasses all the fixed assets in accounting with the exception of land and building. This is illustrated figuratively below.

TAX
PLANT & MACHINERY

ACCOUNTING

1. Plant and machinery
2. Office Equipment
3. Furniture and fittings
4. Motor vehicles

WHAT IS PLANT AND MACHINERY?

Since the Income Tax Act 1967 is silent on what constitutes plant and machinery, guidance is sought form principles established in tax cases or the practice of the IRBM usually detailed in Public Rulings. Our reference here is Public Ruling [PR] No. 12/2014 on Qualifying Plant and Machinery for Claiming Capital Allowances

A machine is usually identifiable and the PR provides that the basic characteristic of machinery is that it has moving parts. The ease of recognition is not there with a "plant". The starting point in the search for a definition of plant is found in ***Yarmouth v France (1887) 19 QBD 647,*** a Court of Appeal case, concerned not with taxation but with compensation under the Employers' Liability Act 1880, which has been quoted frequently in many judgements that has considered the meaning of plant. The facts on which the decision was based have ceased to be of relevance but the following short quotation from the judgement of Lindley J has become the cornerstone:

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

From the above, candidates should be able to identify certain prerequisites before an asset qualifies as a plant:

- **there must be a business**
  capital allowances cannot be claimed against non-business income
- **that plant is an apparatus;**
  a contrast must be drawn between the 'apparatus with which' and the 'setting within which' a business is conducted.
- **that it includes all goods and chattels...not his stock in trade**
  it excludes inventories (because these enjoy a deduction) and the setting in which the business is conducted
- **fixed or moveable**
  plant can be fixed (such as installed equipment etc.) or moveable such as vehicles or furniture

- **live or dead**
  even live animals which function as an apparatus such as guard dogs in security firms, horses in a riding school, animals performing in a circus can qualify as plant but those kept for selling i.e. inventory will not qualify [as per example 21 of PR 12/2014]
- **it must be kept 'for permanent employment' in the business**
  usually expenditure which does not provide an enduring benefit is generally revenue in nature but the question here is how long is "permanent"? This is answered in PR 6/2015 where the IRBM has confirmed that qualifying expenditure for capital allowances purposes excludes those on assets that have an expected life span of less than two (2) years.

Another point emphasised in PR 12/2014 is that an asset may be regarded as a plant in a business but it is not regarded as a plant in another business. Using the example of a ship, it states that if it is used as a floating restaurant in the restaurant business, it is NOT A PLANT but a ship used in the shipping business IS A PLANT.

The PR also provides certain tests to determine if an asset is a plant.

FUNCTIONAL TEST

Functional test or business use test is applied based on the type of business carried on and the role of the asset in that business activity i.e. if an asset meets the function as a tool which is needed to be used in carrying on a business, then the asset is a plant.

Examples of this in the PR is summarised below so that candidates can clearly identify them in an examination question.:

- *floor mats* – for a business of rental and service of cleaning floor mats.
- *antiques* - for a business of carry out the exhibitions in museums
- *mannequins* – for a clothing and fashion accessories boutique
- *aviary / cages, stables and fenced enclosures; aquariums including blower piping, over flow piping, drain piping & rocket multi stage water filtration system; water tank and fiber glass tank filter; and pump - for a mini zoo*
- *decorative lights, paintings and sculptures* – for a hotel
- *telecommunication tower* – for a business of rental of the telecommunication tower
- *grandstand, race track and stables* – for horse racing clubs
- *golf course and grass* – for a golf resort
- *planted artificial grass* – for business of renting indoor football field
- *training grounds* – for a driving school
- *access road and car park; camp site, concrete rooftop water tank; bathrooms, toilets, dressing rooms, shower area and kitchen; office building; and pitch and watersports training ground - for operator of a training camp*

PREMISE / SETTING TEST

An asset that is used and functioned as a premise or a setting within which a business is carried on is not regarded as plant.

Examples in the PR are again summarised below;

- *a renovated ship* – for a restaurant business
- *boutique lighting for clothes display; flooring with trendy tiles and parquet; and window paneling and motif* - for a clothing and fashion accessories boutique
- *electrical and water installation system including underground cable for its office building – for a mini zoo*
- *statues of deities – for business of selling praying materials*

Other items identified by the PR are tabulated below:

PLANT	NOT A PLANT
Demountable office partition	General, transportable camp and cabin used as an office, store, laboratory, canteen and living accommodation for workers at construction site, or at a place near to the construction site.
Cabin is used as living accommodation for its workers working on farm and other agriculture pursuits.	Payment for developing software such as consulting fees, right to use the software such as licence fee and other incidental charges are not part of the cost for the provision of computer software.
Building built specifically for swiftlet farming	Database * see below
Software package or software system	

*Candidates would probably aware of the recent ruling by the High Court in the case of ***KPHDN v CIMB Bank Berhad*** where it was held that the bank was entitled to claim capital allowances on the capital expenditure incurred by the bank in the acquisition of the database of another bank i.e. the database was a plant.

The learned judge opined that the databases are used as an apparatus in its banking business to reach out to more customers and to sell more products. The arguments by the DGIR [that it is not a plant] are enumerated below with counter arguments for no acceptance by the judge. This will be useful for candidates especially in the Revenue Law paper.

- The DG submitted that the database did not function as a tool in the banking business but merely contained information about the account and credit card holders.
  The Court decided that whether the database functioned on its own or not or that whether it was active or passive was not the only criteria in determining whether it was a plant because another factor to consider is that it was being used as a tool or an apparatus to provide more banking products to more customers which in turn generates more revenue for the bank.
- The DG raise the issue that the database in essence was goodwill.
  The Court's response was that the database contained information and data of the customers and was absolutely unrelated to the good name, reputation and connection of the bank's business and thus was NOT GOODWILL.
- The DG argued that since the bank did not claim capital allowances on its own database, therefore, a claim for capital allowances on the database from the other bank is not justified.
  The retort from the learned judge was that incurred capital expenditure on the acquisition of the database from the other bank whereas the creation of its own database did not entail any expenditure as it comprised of its own customers.

In the next article we shall continue this journey of determining what is plant based on case law.

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