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Section 140 of the Malaysian Income Tax Act 1967

Death and Real Property Gains Tax

E-Commerce and Tax Chaos

THE 2014 BUDGET

GRADUAL EROSION OF TAXPAYERS' RIGHTS?

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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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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.

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From the President's Desk

SM THANNEERMALAI

Since the beginning of the year, CTIM has been actively involved in engaging the authorities on two key matters:

A. KEY POST BUDGET ISSUES

i. Amendments relating to the right of appeal and right to produce documents beyond the time permitted by the IRB to support the taxpayers' position.

I am glad to inform you that the IRB has indicated that they will issue a Public Ruling which will allow a greater leeway to retain our right of appeal, albeit, the original unfettered and unconditional right will not be totally reinstated. We have also advised the IRB that since the public ruling is an interpretation or application of the existing law, the public ruling will keep within the spirit of the law.

On the latter issue, I am happy to inform you that the IRB will not be unreasonable in imposing deadlines and will accommodate submission of documents beyond the given time provided there are valid genuine reasons which were beyond the control of the taxpayers eg., fire, flood, death of the key person or destruction of documents caused by circumstances beyond one's control, etc. We have also agreed this understanding will be noted in writing between CTIM and IRB.

ii. Requirement to submit audited accounts when filing your corporate tax returns.

As we pointed out in our correspondence to the MoF and IRB that there are instances where there is no requirement to prepare audited accounts for companies under liquidation, etc .

The IRB have agreed to issue a public ruling which will accommodate the above type of situations.

iii. Where a company loans or advances any money from the internal funds of the company to a person who is a director of that company, the company shall be deemed to have a gross income consisting of interest from such a loan or advances for that basis period.

This provision in Section 140B has become effective from Y/A 2014 and contains a retrospective element ie., applicable for basis periods beginning prior to 1 January 2014.

The IRB has indicated that a letter or a public ruling will be issued in due course to apply this provision from 1 January 2014.

B. GST LICENCING ISSUE

The rumour mill has been in full swing on this matter and there is a significant concern that by the time the GST is implemented on 1 April 2015, many tax practitioners may not be licenced since the 10-day GST training sessions (conducted by Customs personnel) only have a limited capacity and the number of sessions have been limited.

In light of the above, I am in touch with the Authorities to find ways to overcome this bottleneck. I will keep you informed through our eCTIMs . Please keep a close eye on the developments here through our eCTIMs.

OTHER MATTERS

All the other Committees are quietly executing their responsibilities effectively.

The Education Committee has been active in convincing students of the benefits of taking up Taxation as a career.

The Public Practice Committee has written to seek an appointment with the Chairman of the Malaysia Competition Commission to discuss the possibility of recommending a range of minimum fees for the suite of services we provide to our clients.

CPD has increased the number of events and I note the uptake by our members has increased.

The three Technical Committees have been a hive of activity from reviewing the self-assessment provisions in the Income Tax Act, stamp duty laws and providing frequent feedback on the GST guides to the Tax Review Panel etc.

The Editorial Committee has been sprucing up our Tax Journal by focussing more on the relevant technical issues.

The Examinations Committee has spent many hours to revise our syllabus to make it more relevant to our current requirements.

I would also like to thank all the other Committees and the Secretariat for their continued support given to CTIM .

Good luck and let us have a great year ahead.

Editor'sNote

K. SANDRA SEGARAN

LEGISLATIVE CHANGES: TOUGH ROAD AHEAD FOR TAXPAYERS

The legislative changes announced in the 2014 Budget announcement and the Finance Bill were gazetted on the 23 January 2014 without any change despite the concerns expressed by various quarters. Stakeholders have commented that the recent legislative changes are drastic, fundamentally eroding taxpayer rights and strengthening the hands of the Revenue authorities especially on areas of technical disputes that have prolonged for decades. While the previous issue highlighted the salient changes, in this issue, Renuka Bhupalan examines the ramifications of two critical issues that 'erodes' the fundamental rights of a taxpayer to appeal under the self-assessment system and the new Section 39(1A) which disallows an expense when a taxpayer does not provide information on a timely basis. It is feared that with these amendments, taxpayers would not have any avenue for legal redress under the Income Tax Act in respect of these issues. Also note the latest developments from the President's message.

Vijey R. Mohana Krishnan examines Section 140 of the Income Tax Act in detail. Is Section 140 a shield to protect national coffers or a weapon for all seasons to raise more revenue? Read this detailed analysis which includes a revisit of the significant case law development in Malaysia to find out if taxpayer fears are founded. Due to the length of the Section and space constraints, it has been omitted from the article.

When it comes to taxes, even death does not prevent the making of an assessment in respect of disposals by the individual before his death. "Till death do us part", often have you heard this solemn promise, but it doesn't work that way when it comes to taxes is what you learn in this short but very useful article by Richard Thornton and Thenesh Kannaa on "Death and Real Property Gains Tax." In addition, the role, responsibilities and the liability of an executor and trustee and the position of a beneficiary is also explained.

With the announcement of the introduction of GST in Malaysia, companies and groups of companies must be frantically evaluating their needs to get ready and implement this new consumption tax which will replace the Sales and Service Tax regime. To the uninitiated and the docile, perhaps it is timely to ask the relevant questions and seek proper guidance and explore the ramifications. The article by David Lai and Jeff O'Connell highlights the big picture issues in the implementation of GST and provides a verdict if the implementation will be a simple process. The experience faced in Australia which implemented GST on 1 July 2000 is shared therein. As has happened elsewhere in more than 150 countries that have already implemented GST, Malaysia too is likely to face such issues. The authors opine that although GST is intended to be a simple tax, complexities for implementation may be caused by classification, apportionment, timing and transitional issues. This issue also highlights several GST Tribunal and High Court cases in the UK as we prepare to face similar situations in Malaysia.

On the international front, Dr. Nakha Ratnam Somasundaram, a regular contributor to the *Tax Guardian*, writes on the emergence of the internet and e-commerce, and the chaos created in the process for revenue agencies. His article reviews the Guideline on Taxation of Electronic Commerce issued by the Inland Revenue Board of Malaysia, as well as approaches to the tax treatment of e-commerce transactions in some selected countries and also the e-commerce scenario in Malaysia.

We hope you will find the above and the other regular columns on updates, news and Learning Curve useful and insightful. Happy reading.

CPD WORKSHOPS

A series of workshops were conducted in the 1st quarter 2014 as follows:

- Half-day Seminar on Transfer Pricing Documentation
- Limited Liability Partnerships – A New Taxation Entity
- Withholding Tax on Payments to Non-Residents
- Tax Implications for Property Investors after the 2014 Budget
- Half-day Seminar by Public Practice Committee
- Understanding the Basics of Computing Corporate Income Tax-with 2014 Budget updates
- Tax Planning for Individuals in collaboration with MAICSA
- Capital Allowances on Plant, Machinery & Buildings
- Goods and Services Tax (GST) Training Course No. 1/2014

The two-day workshop on 'Understanding the Basics of Computing Corporate Income Tax-with 2014 Budget Updates' was conducted by Mr. Kularaj at the CTIM Training Room from 18 to 19 February 2014.The workshop provided participants with a sound knowledge of income tax laws and regulations pertaining to corporate income taxes and also focused on critical areas relating to tax computations. Participants were exposed to common compliance related provisions provided in the ITA as well as decisions from selected tax cases.

CTIM President, Mr. SM Thanneermalai conducted a half-day seminar on Transfer Pricing Documentation in three various regions i.e Penang (6 January 2014), Kuala Lumpur (18 January 2014) and Johor Bahru (27 January 2014). The seminar covered the practical issues faced in preparing contemporaneous transfer pricing documentation.

Mr. Vincent Josef who is a regular speaker for CTIM conducted a series of workshops on 'Limited Liability Partnerships – A New Taxation Entity. Through this workshops, participants were introduced to the features of an LLP and the differences between limited companies, conventional partnerships, and the limited liability partnerships. The workshop examined the three related laws, i.e., the Limited Liability Partnerships Act 2012, the Limited Liability Partnerships Regulations 2012, and in particular, the Income Tax Act 1967. Apart from the above workshops, Mr. Vincent also conducted a workshop on 'Tax Planning for Individuals' which was held on 25 February 2014 in collaboration with MAICSA

Several workshops were conducted by Mr. Thenesh Kannaa during the month of January and February 2014 covering the following topics:

- Withholding Tax on Payments to Non-Residents conducted on 27 January 2014
- Tax Implications for Property Investors after the 2014 Budget conducted on 10 February 2014
- Capital Allowances on Plant, Machinery & Buildings conducted on 26 February 2014

Classified

JOB OPPORTUNITIES IN CTIM

The Chartered Tax Institute of Malaysia (CTIM) is an organisation for tax professionals and persons in commerce interested in or concerned with taxation matters in Malaysia. CTIM is a premier body that provides effective institutional support to members and has the highest standard of technical and professional competency in revenue law and practice in Malaysia. The Institute is seeking suitable candidates to fill the Managerial and Executive vacancies in the Technical, Education and Examination Departments :-

- ***Minimum Bachelor's degree or professional qualifications in related field.***
- ***Minimum 2 years relevant working experience.***
- ***Have excellent communication, writing and analytical skills.***
- ***Flexible, positive working attitude, able to multitask and meet timelines.***

Remuneration will be based on experience and qualification. Kindly submit your detailed resume by email or post, in confidence, to:

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THE 2014 BUDGET

GRADUAL EROSION OF TAXPAYERS' RIGHTS?

Renuka Bhupalan

Income taxes account for a significant percentage of the nation's revenue. As announced during the 2014 Budget proposals, for 2014, close to 48% of the nation's revenue will be earned from income taxes. This contribution comes from a small percentage of taxpayers, thought to be made up of approximately sixteen per cent of companies and between one to two million individual taxpayers. Hence a small number of taxpayers contribute a significant amount of revenue to the nation. It is widely agreed that the number of taxpayers should be higher and the proposed introduction of Goods and Services Tax (GST) should address this conundrum to some extent. However, it is also important that Malaysian taxpayers, both current and in the future should have rights, and that these rights should be protected.

The 2014 Budget proposals which have been enacted by the Finance Act 2014, have brought about several important tax changes, including the introduction of GST. Aside from GST which has garnered most of the limelight, several other changes were introduced to the Income Tax Act 1967 (ITA) including a narrowing of the provisions governing the timing of the deductibility of interest costs, a tightening of the deductibility of entertainment costs, and the changes discussed below. These changes have attracted less attention from taxpayers and businesses generally, but have attracted the scrutiny of tax practitioners and the tax profession at large as these changes have a significant impact on taxpayers' rights.

This article will focus on two specific changes which result in a significant erosion of taxpayers' rights. This is a key concern for a nation seeking to attract private sector investment and foreign investment while aiming to achieve developed nation status in six years' time, particularly given the small taxpayer base that currently exists. In any holistically developed tax system, taxpayers' rights are of fundamental importance. It is imperative that these rights should be clearly outlined and provided for in the legislation and where necessary, appropriate rulings or guides should be in place to provide clarity. Such rights are particularly important in jurisdictions such as Malaysia which operate a self-assessment system of taxation. Furthermore, these rights take on more significance here in Malaysia where the tax authorities are very diligent in meeting revenue collection targets, which continue to increase exponentially each year.

THE CHANGES

The two changes which are the subject of this article involve changes to Section 99, the general appeal provision, and Section 39 which relates to specifically disallowable expenditure.

SECTION 99

Section 99(1) provides as follows:

"A person aggrieved by an assessment made in respect of him may appeal to the Special Commissioners against the assessment by giving to the Director-General within thirty days after the services of the notice of assessment or, …. a written notice of appeal in the prescribed form stating the grounds of appeal and containing such particulars as may be required by that form"

Section 99 is the general appeal provision which has not been subject to any major change since its inception, notwithstanding the introduction of the self-assessment system in the year 2000. Section 99 grants the taxpayer the right to appeal against an assessment (including a deemed assessment under the self-assessment regime) within one month from the date of the assessment.

Prior to the introduction of the self-assessment regime, the traditional assessment system involved taxpayers submitting their tax returns which would be reviewed by the Inland Revenue Board (IRB) prior to the issuance of an assessment (Form J). Upon issuance of the Form J, taxpayers were granted one month to file an appeal (pursuant to Section 99(1)) to the Special Commissioners of Income Tax (SCIT). Although in law, the requirement was that appeals needed to be filed with the SCIT, in practice, the IRB accepted appeals in the form of simple letters sent directly to the relevant assessment branch of the IRB. The practice of accepting general appeals (which involved the taxpayer merely sending in written notification to the IRB to state that they disagreed with the assessment) gradually changed to require taxpayers to state their specific grounds of appeal in a detailed appeal letter. In more recent years, the IRB has ceased the practice of accepting a letter of appeal and taxpayers are required to follow the letter of the law and file their appeals to the SCIT via a Form Q.

In the self-assessment environment, the appeal process has proved to be somewhat tricky, with taxpayers filing their returns and thereafter appealing against their own returns (as these are deemed to be assessments). Typically, such a scenario would arise when a taxpayer files a tax return on a conservative basis, principally to avoid the imposition of penalties, but wishes to appeal against the prudent treatment adopted in the return. For instance, a taxpayer may be of the view that a particular item of expense is deductible from a technical perspective, but the IRB may not accept this view. Hence the taxpayer would disallow a deduction for this particular item of expense in arriving at adjusted income, but would thereafter proceed to file a Form Q against the deemed assessment (to claim a deduction for the 'disputed' expense item).

The appeal process allows the taxpayer and the DG an opportunity to reach a settlement in relation to the appeal. The DG is required to review the appeal within twelve months from the date of the appeal, and where an agreement cannot be reached between the two parties, the DG is required to forward the appeal to the SCIT. This provides an avenue for the parties to reach a settlement within a twelve month time frame before the SCIT's actual involvement.

The change to Section 99 involves the introduction of the following sub-section:

Section 99(4): "This section shall not apply to an assessment made under subsection 90(1) or Section 91A, except where a person in respect of such assessment is aggrieved by the public ruling made under Section 138A."

The introduction of Section 99(4) is of grave concern to taxpayers for whom the right of appeal against an assessment should be a fundamental right which should not be diluted under any circumstances. This is an essential feature of a fair self-assessment system and the introduction of Section 99(4) to limit the right of appeal to situations where a PR results in a taxpayer being aggrieved by an assessment, unfairly narrows the right of appeal. Section 99(4) works on the assumption that the IRB has issued PRs on all provisions of the ITA which may give rise to dispute. While it is noted that the IRB has issued numerous PRs (as well as several addendums to the PRs), there remain areas of the law which continue to give rise to conflicting interpretations. It is overly simplistic to assume that the IRB has already anticipated each and every potential area of uncertainty in the ITA which could give rise to a technical dispute and that it has issued PRs on all such provisions. It is inconceivable that PRs have been or will be issued in respect of all provisions of the law which are open to different interpretations. Is it therefore fair to restrict the right of appeal to areas covered by PRs only?

While there are provisions in the ITA to allow for the submission of amended returns and to seek relief

WHAT IS THE IMPACT OF THE NEW SECTION 99(4)?

Effectively this means that a taxpayer will not be entitled to file an appeal unless this relates to an issue that has been addressed in one of the many Public Rulings (PR) issued by the IRB. Public Rulings are issued by the IRB pursuant to Section 138A of the ITA. While it is widely acknowledged that these are helpful in setting out the IRB's interpretation of the law on specific matters, it is also clear that PR's do not constitute law and hence are not binding on taxpayers. However, the IRB is bound to follow the PRs.

for incorrect returns, these provisions are distinct from the right of appeal enshrined in Section 99(1).

The introduction of Section 99(4) unfairly erodes taxpayers' rights of appeal and gives rise to cause for concern, particularly in a self-assessment environment where certainty and transparency are essential. The proposed change gives rise to too many uncertainties and unnecessarily exposes a taxpayer to penalties.

Example:

- A taxpayer has incurred an item of expense (referred to for simplicity as Expense X), the treatment of which is not covered by any PR.
- Assume that tax treatment of Expense X is grey and while there are grounds to argue that the expense is deductible, the IRB has also been known to disallow a deduction for this type of expense.
- Should the taxpayer disallow a deduction for Expense X and appeal against the disallowance, or should the taxpayer claim a deduction for Expense X?

Comments:

- As Expense X is not covered by any PR, the taxpayer will not be able to appeal on this issue. Hence, the taxpayer may in a sense be forced to claim a deduction for Expense X although the tax treatment is grey. Arguably, the taxpayer is effectively discouraged from adopting a conservative position of disallowing a deduction for Expense X and subsequently appealing against the tax treatment adopted.
- In the event of an audit, if the IRB disallows the deduction claimed for Expense X, an additional assessment will be issued and penalties will be imposed. Only then will the taxpayer be allowed to appeal against the assessment but it should be noted that additional costs will be incurred from the inevitable imposition of penalties.
- Prior to the introduction of the new Section 99(4), the taxpayer could have adopted a conservative approach by disallowing a deduction for Expense X and thereafter appealing against the tax treatment adopted. This would have mitigated the risk of penalties for the taxpayer.

- It is also interesting to consider the implications if the taxpayer is not audited within a five year period. In such a situation, the IRB would arguably be time-barred from raising an additional assessment.
- On the flip side, if the taxpayer disallows the deduction for Expense X, there would be no avenue for any appeal pursuant to Section 99. If subsequent case law is decided on the same issue in favour of the taxpayer, would the taxpayer be entitled to any relief? The only potential avenue for relief in practice would be via Section 131, but the latter can only be invoked where an assessment has not been finalised. This in itself gives rise to an anomaly as technically a return would be deemed to be final and conclusive where no valid notice of appeal has been submitted (as provided in Section 97). Even if the IRB were to allow the use of Section 131 in practice (notwithstanding Section 97), this section can only be used within five years after the end of the relevant year of assessment. Hence if a case law decision in favour of the taxpayer arises after the five year time frame, there will be no avenue for relief at all.

The above illustrates how the introduction of Section 99(4) may cause undue hardship on taxpayers. The reason for the introduction of Section 99(4) has not been adequately justified by the authorities. There is arguably no need for this from a tax collection perspective as taxpayers who appeal against their deemed assessments would have to pay the tax assessed upfront pending the outcome of their appeal. Section 99(4) runs counter to the features of an enlightened and developed tax system and it is hoped that the authorities will issue some guidelines to set out the framework within which taxpayers will be given some leeway to appeal notwithstanding the fact that they

may not be aggrieved by a specific PR *per se*.

Let us now consider the amendment to Section 39.

SECTION 39

Section 39 of the ITA is an important provision and is inextricably linked to the computation of adjusted income. While Section 33(1) lays down the general test for the deductibility of expenditure for tax purposes, Section 39 imposes restrictions on the deductibility of expenditure notwithstanding the fact that the Section 33 test may have been met (i.e that an expense must be wholly and exclusively incurred in the particular period in the production of gross income from a particular source). The scope of Section 39 has gradually grown over the years, and the latest addition to Section 39 has been enacted via the Finance Act 2014. Section 39 now includes a new subsection, Section 39(1A). This provides as follows:

> ***"Notwithstanding any provision of this Act, where a person is required under Section 81 to furnish to the Director-General any information within the time specified in a notice or such other time as may be allowed by the Director-General and that information concerns wholly or in part a deduction claimed by that person in arriving at the adjusted income of that person from a source for the basis period for a year of assessment, no deduction from the gross income from that source for that period shall be allowed in respect of such claim if the person fails to provide such information within the time specified in that notice or such extended time as allowed by the Director-General."***

What does this provision achieve? This Section basically gives rise to an express statutory provision to disallow a deduction for an item of expenditure which is the subject of query by the IRB where the information is not furnished on a timely basis. This Section will typically kick in where a taxpayer is audited and the IRB requests for information pursuant to Section 81 of the ITA. Where the taxpayer is not able to provide that information within the prescribed time frame or such extended time as may be allowed, Section 39(1A) will operate to disallow a deduction for the expense, potentially resulting in additional taxes and penalties.

It is acknowledged that some taxpayers are, at times, reticent to provide information to the IRB on a timely basis and are not co-operative. However, there are many instances when it is difficult to retrieve information, particularly where information is stored off-site or where information needs to be obtained from a third party. Additionally, information may be destroyed due to other circumstances, including flooding, which is becoming an increasingly common phenomenon in many parts of the country. In situations where it is genuinely difficult to obtain information, a deduction should not be statutorily prohibited and should arguably be left to the decision of the Court should the taxpayer choose to appeal. Although it is noted that Section 39(1A) provides that the DG may grant an extended period of time to furnish the information requested, this is a matter of the DG exercising his discretion to do so, and does not provide taxpayers with adequate assurance that additional time will be provided in genuine cases where information cannot be readily obtained. Indeed, as indicated above, there may be real situations where information may no longer be available. In such circumstances, based on the changes brought about by Section 39(1A), taxpayers would not have any avenue for legal redress under the ITA. Another disappointing erosion of taxpayers' rights!

The ITA has a comprehensive penalty regime to address problems faced by the IRB with regard to delinquent taxpayers. Section 81 of the ITA and its related penalty provision under Section 120 arguably provide an adequate and equitable framework for dealing with non-submission of information by taxpayers within a specified time frame. The appropriate way to handle situations of non-compliance under Section 81 would be for the DG to disallow the item of information in question and to raise an additional assessment pursuant to Section 91. Taxpayers would then be able to appeal against such assessments (which are not affected by the new Section 99(4)) and to argue their position based on the merits of their case. Contrary to what the authorities may allege, this is unlikely to cause an influx of appeals to the SCIT, as taxpayers would generally be reluctant to incur significant legal or other costs involved when pursuing an appeal to the SCIT and thereafter through the Courts, unless they have a reasonable and sound basis for doing so. In the meantime, the DG would have collected the additional taxes arising as a result of the additional assessment pending the outcome of the appeal. This would be a fair and equitable way of dealing with the problem of taxpayers not furnishing information on a timely basis. Therefore, Section 39(1A) is an unnecessary and somewhat harsh provision which inequitably erodes taxpayers' rights.

CONCLUSION

It is with some concern that we note the trend and patterns emerging with regard to tax policy. Although not the subject of this article, there has been a clear pattern of changes being made to the ITA when the Courts have ruled against the IRB, and now, as a result of the provisions outlined above, it is evident that there appears to be gradual disregard of fundamental taxpayers' rights. While the need to collect revenues is paramount in any nation, it is hoped that the authorities will take note of the importance of taxpayers' rights, particularly in a self-assessment system. These rights are fundamental as we, as a nation, move towards a more developed tax system and as we progress towards achieving Vision 2020.

Renuka Bhupalan *is the Managing Director of TAXAND MALAYSIA Sdn Bhd, which is part of the TAXAND Global Organisation, the first global organisation of independent tax advisers with a presence in nearly 50 countries. She can be contacted at rb@taxand.com.my. The views expressed are her own.*

SECTION 140 OF THE MALAYSIAN INCOME TAX ACT 1967

Vijey R. Mohana Krishnan

THIS ARTICLE ANALYSES SECTION 140 OF THE MALAYSIAN INCOME TAX ACT 1967 ("ITA") IN LIGHT OF DECISIONS IN MALAYSIAN CASES.

Section 140 is a general anti-avoidance provision that cloaks the Director-General of Inland Revenue ("DG") with discretion to make adjustments as he deems fit in cases of "tax avoidance" notwithstanding that the transaction(s) concerned are valid at law.

The problem of course with discretionary powers in tax matters is obvious, certainty takes a beating and businessmen don't like that! Today, with an increasingly egregious tax environment in Malaysia, there is fear that instead of being used as a shield to protect national coffers from attempts to exploit legislation to gain a tax advantage never intended,[1] Section 140 may be used simply as one of the means to raise more taxes.

This is not entirely an irrational fear but some peace of mind can be had from the fact that Malaysian courts have always recognised that a balance needs to be struck. In *Government of Malaysia v Jasanusa Sdn Bhd [1995[2 CLJ 701,* when considering whether a stay of execution should be granted on income taxes payable, the Malaysian Supreme Court said :-

"Matters of this nature involve, inter alia, balancing the need of the government to realise the taxes and the need of the taxpayer to be protected

against arbitrary or incorrect assessments. The court should also bear in mind the possibility of arbitrary or incorrect assessments, brought about by fallible officers who have to fulfill the collection of a certain publicly declared targeted amount of taxes and whose assessments, as a result, may be influenced by the target to be achieved rather than the correctness of the assessment..."

It is not the intention of the author to go through the various foreign judicial pronouncements on anti-avoidance. These have become textbook authorities and suffice to say these fundamental principles derived from a large and evolving body of authorities have enriched our tax jurisprudence:

- It is the duty of the directors to take such lawful steps as are open to them to minimise the impact of tax on the company's profits
- Since the advent of income tax everyone is trying their best within the law to pay as little tax as possible. All kinds of schemes are thought of. No commercial person in his right sense is going to carry out commercial transactions except on the footing of paying the smallest amount of tax involved. There is nothing wrong at all for a company to organise its affairs in such a way as to minimise tax.
- No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property so as to enable the revenue to put the largest possible shovel in his stores.
- Tax mitigation reduces tax liability by taking advantage of options provided in the law and genuinely suffers the economic consequences – incurs expenditure or suffers a loss or reduces his income.
- Is the tax scheme carried out with a commercial or business purpose or was the primary purpose only to obtain a tax advantage?

Now, is Section 140 really as all pervasive as feared?

Let's start with its troubled birth. The Parliamentary debates that precede the section are amusing. These are excerpts from debates on the ITA and Section 140 in particular which took place in August 1967:-

DR. TAN CHEE KHOON (leader of the opposition): … Judged by what I have said, this Bill that we have before us today falls far short of what is expected of an important statue as the Income Tax Bill, for this Bill is a hasty, ill-worded, and ill-considered piece of legislation, which, if bulldozed through this House today may well have disastrous results for the thousands of taxpayers in this country…

… Mr. Speaker, Sir, life in this country is complicated enough without having the Comptroller-General being vested with such vast powers to breath down and frighten the humble taxpayer out of his wits. …

TUN TAN SIEW SIN (Minister of Finance): Mr. Speaker, Sir, I must say that I have listened with very great interest to the speeches, which have been made on this Bill, and I shall try to reply as comprehensively and briefly as possible to the major points which have been made. …

…He also refers to the dictatorial powers of the Comptroller-General and, in particular, he picks on Section 140 where the words "is of the opinion" appear. I am told that the Comptroller-General tried to convince him that even though these words have been inserted, the actions of the Comptroller-General acting under the section are appealable. In other words, if the Comptroller-General were to act arbitrarily or unfairly, his actions will be subject to appeal to

the Special Commissioners in the first instance; and if the taxpayer is still dissatisfied, there is, as I have indicated in my speech on the second reading of the Bill, an appeal to the High Court, and eventually to the Federal Court itself. It will, therefore, be seen that the Comptroller-General is not as powerful as that and, if he acts unfairly, his actions will clearly be reversed on the various appeals, which are allowed under the Bill. …

DR. TAN CHEE KHOON
Mr. Chairman, Sir, I rise to move the amendment standing in my name, viz:

Clause 140 (1) – In line 1, delete the words "where he is of the opinion" and substitute therefor the words "where he has reason to believe".

Clause 140 – In line 16, delete the words "or vary the transaction".

Despite the assurance of the Honourable Minister of Finance, I have been advised that the powers conferred on the Comptroller-General under this clause is far too great. It says here "where he is of the opinion". Now, if a person is of the opinion, he may well be of the opinion that those of us sitting on this side of the House, not that I say he will do so, but he may be of the opinion, that all of us sitting on this side of the House deserve consideration under this clause and that he should vary the transaction. I maintain that in a court of law it will be very difficult to refute an opinion. If it is considered judgement that the Member for Batu should have a certain transaction varied, I do not think that I can get that changed in a court of law, despite the assurance of the Minister of Finance that all the powers given under this section to the Comptroller-General is appealable in a court of law. I have been advised that it is not so, that under this clause one cannot appeal to a court of law, and if the Comptroller-General is of the opinion that the transaction should be varied, then he had it.

Pursuant to the said exchanges, the triggering provisions in Section 140 changed from "where the DG is of the opinion" to "where the DG has reason to believe". Whether this change in fact fortified the protection afforded to taxpayers has with the passing of more than 40 years become academic. It is however abundantly clear from the express wording in Section 140 that the DG must have "reason to believe". This

belief must be reasonable and can be challenged in court.

OTHER JURISDICTIONS

Before we look at Malaysian authorities on Section 140 of the ITA, it would be useful to look at other jurisdictions which have similar statutory provisions on anti-avoidance. Given the similarity in their provisions to Section 140, the Australian and New Zealand provisions are worth considering.

AUSTRALIA

In Australia, the General Anti-Avoidance Rule ("GAAR") is found in Section 260 of the Australian Income Tax Assessment Act 1936. Section 260(1) provides :-

"(1) Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly –

a. altering the incidence of any income tax;
b. relieving any person from liability to pay any income tax or make any return;
c. defeating, evading or avoiding any duty or liability imposed on any person by this Act; or
d. preventing the operation of this Act in any respect, be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose."

Section 260 of the Australian Income Tax Assessment Act 1936 was considered by the Privy Council in *Newton v Commissioner of Taxation [1958] AC 540* in which Lord Denning said that in applying the section, one must "by the very words of it, look at the arrangement itself and see which is its effect – which it does – irrespective of the motives of the persons who made it. His Lordship continued to say that in order to bring an arrangement within the section, one must be able to predicate by looking at the acts by which it was implemented, that the acts were implemented in that way so as to avoid tax. If one could not predicate so, and the transactions can be explained by reference to ordinary business or family dealing, then the arrangement would not fall within the section. This is called the predication principle. Lord Denning added that the word 'effect' means "the end accomplished or achieved" and that it "denotes concerted action to an end – the end of avoiding tax".

Later, the Australian High Court considered Section 260 in light of the business deduction provision in the case of *John v Federal Commissioner of Taxation (1989) 166 CLR 417*. It was held that Section 260 cannot defeat the deductibility of the loss or outgoing claimed if the arrangement made does not operate in any of the ways specified in paras (a) to (d) of Section 260. . The court went on to say:

> "…because the question of deductibility under Section 51[2] is always going to be answered by the ascertainment of a past event (i.e. a lost or outgoing having been incurred), Section 260 cannot apply to defeat or reduce any deduction otherwise truly allowable under Section 51…"

NEW ZEALAND

The GAAR in New Zealand was first introduced in Section 99 of the New Zealand Income Tax Act 1976 which was in *pari materia* with Section 140 of the ITA. The New Zealand Income Tax Act 2007 was then enacted to include the words 'purpose' and 'effect' in the general anti-avoidance section. Now, Section BG1 of the New Zealand Income Tax Act 2007 provides that "a tax avoidance arrangement is void" and that "the Commissioner may counteract a tax advantage that a person has obtained from or under a tax advantage arrangement". 'Tax avoidance arrangement' is defined in Section YA1 of the 2007 Act as any arrangement either (a) having tax avoidance "as its purpose or effect" or (b) having tax avoidance "as one of its purpose or effects, whether or not any other purpose of effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental".

The Privy Council in *Commissioner of Inland Revenue v Challenge Corporation [1987] 1 AC 155* considered the original Section 99. It was held that Section 99 of the New Zealand Income Tax Act 1976 would not apply to tax mitigation but applies to tax avoidance. Tax mitigation is where the taxpayer "obtains a tax advantage by reducing

his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability." Tax avoidance is when the tax advantage is derived from an arrangement where "the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction".

The Privy Council then in *Richard Dale Peterson v Commissioner of Inland Revenue [2005] UKPC 5* held that there was a distinction between an acceptable tax advantage not caught by Section 99 and an unacceptable tax advantage, which is tax avoidance. It was held that it is acceptable when income tax is mitigated by a taxpayer who had actually reduced his income or incurred expenditure that entitled him to a reduction in his tax liability. Their Lordships then made reference to the English case of *Commissioners of Inland Revenue v Willoughby (1977) 70 TC 57* in which it was stated that:

"The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability."

In the later New Zealand Supreme Court case of *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue [2009] 2 NZLR 289* the court laid down a two-stage approach when a taxpayer seeks to rely on a specific provision to claim that he is entitled to a deduction. The first stage is when the taxpayer would have to satisfy the court that the use of the specific provision is within its intended scope. If that is shown, the second stage is concerned with the "taxpayer's use of the specific provision viewed in the light of the arrangement as a whole". If the taxpayer has used the specific provision in a way that "cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement would be a tax avoidance arrangement".

The High Court of Singapore in *AQQ v Comptroller of Income Tax [2012] SGHC 249* endorsed the Ben Nevis case as a "scheme and purpose" test. The predication principle as applied in Australia and New Zealand was applied to Section 33(1)[3].

MALAYSIAN AUTHORITIES

A review of Malaysian authorities can be divided into authorities on the procedural aspects and the substantive aspects of Section 140. That is cases on what the Director-General must do when seeking to apply Section 140 and cases dealing with circumstances under which Section 140 will actually apply.

MALAYSIA - PROCEDURAL ASPECTS

In *Lahad Datu Timber Sdn Bhd v Director-General of Inland Revenue [1981] 2 MLJ 97*, a parcel of state land was alienated to a co-operative society for agricultural development. The society was given a licence with rights to extract, remove and sell timber. Agreements had been entered into between the Society and the Appellant whereby the Appellant undertook to fell and cut the timber and export it. The Appellant not having the requisite expertise or equipment, in turn, contracted with a 3rd party to fell the timber and sell the same. One of the issues in the case was whether fees received by the Appellant were liable to timber profits tax. The Privy Council held that by their contract with the Society, the Appellant took over the position of the Society and that the proceeds from the sale of timber which the Appellant was entitled to amounted to income derived from timber operations. Given this, there would be no need to resort to Section 140. The importance of this case, however lies in the fact that the Privy Council was clearly of the view that failure to give notice under Section 140(5) meant that the provisions of Section 140 were not available to the Revenue. The furnishing of particulars of adjustment under Section 140(5) is a mandatory requirement.

In *Director-General of Inland Revenue V Hup Cheong Timber (Labis) Sdn Bhd [1985] 2 MLJ 322*, the taxpayer claimed a deduction on account of consideration paid to an Association for the exclusive right to fell, exploit and extract timber on a certain piece of land. On the application of the taxpayer with the consent of the Association, a logging license was issued directly to the taxpayer. The issue was whether the sum paid to the Association should be disallowed under Section 39(1)(g) as pertaining to sums payable for the use of a licence or permit to extract timber. It was held that there was nothing in the agreement between the taxpayer and the Association to show that any part of the sum in question was intended to be consideration for giving consent to the issue of the licence to the taxpayer. The Supreme Court also held that if the payment in question was paid to the Association for the purpose of evading or avoiding tax, action should be taken to invoke Section 140 but in such an event particulars should be given under Section 140(5).

In *Bandar Utama City Corporation Sdn Bhd (Formerly known as Damansara Jaya Sdn Bhd) v Director-General of Inland Revenue [1998] 7 MLJ 303*, the taxpayer sought an order directing the Revenue to provide reasons and the basis of computations for additional and ordinary assessments by the respondent pursuant to Section 140(1)(c). The Revenue had alleged that the applicants had evaded or avoided liability by way of accounts irregularities and under-declaration of income but did not provide any basis for such allegations. The Revenue argued that under Section 140(1) of the ITA, the DG was given power to disregard certain transactions and it was not a provision for making assessments but rather adjustments as the respondent thought fit and that the rules of natural justice would only apply at the appeals stage. The High Court held that Section 140(5) of the ITA imposes a duty on the Revenue to give particulars of the adjustments of assessments together with the notice of assessments. Where the Revenue is under a duty to give particulars, the taxpayer has a correlative right to be furnished with such particulars. This was necessary to ensure that the taxpayer's appeal before the Special Commissioners was not rendered futile. The appeal would be futile if the taxpayer was not given particulars of the adjustment and this would cause manifest injustice to the taxpayer. Note that this was a case where an application was made for receipt of particulars from the DG with a view to enabling the taxpayer to proceed with an appeal before the Special Commissioners, since the taxpayer would be equipped with the necessary particulars. The approach taken in the Port Dickson Power case mentioned below is different.

In *Director-General of Inland Revenue V Rakyat Berjaya Sdn Bhd [1984] 1 MLJ 248*, the Sabah Foundation assigned to the Respondent its rights and liabilities under a timber concession. The consideration was payable in instalments and interest was payable on all outstanding amounts. The issue was whether the said interest was deductible. The Federal Court held that such interest cannot be deducted under Section 33(1) (a) but can be deducted under the opening part of Section 33(1) as outgoings and expenses wholly and exclusively incurred in the production of gross income. With reference to Section 140, the Federal Court said that this was not raised by the parties nor relied upon by the Revenue but if the DG wished to invoke the provisions of Section 140, particulars of the adjustment were

required to be furnished along with the notice of assessment.

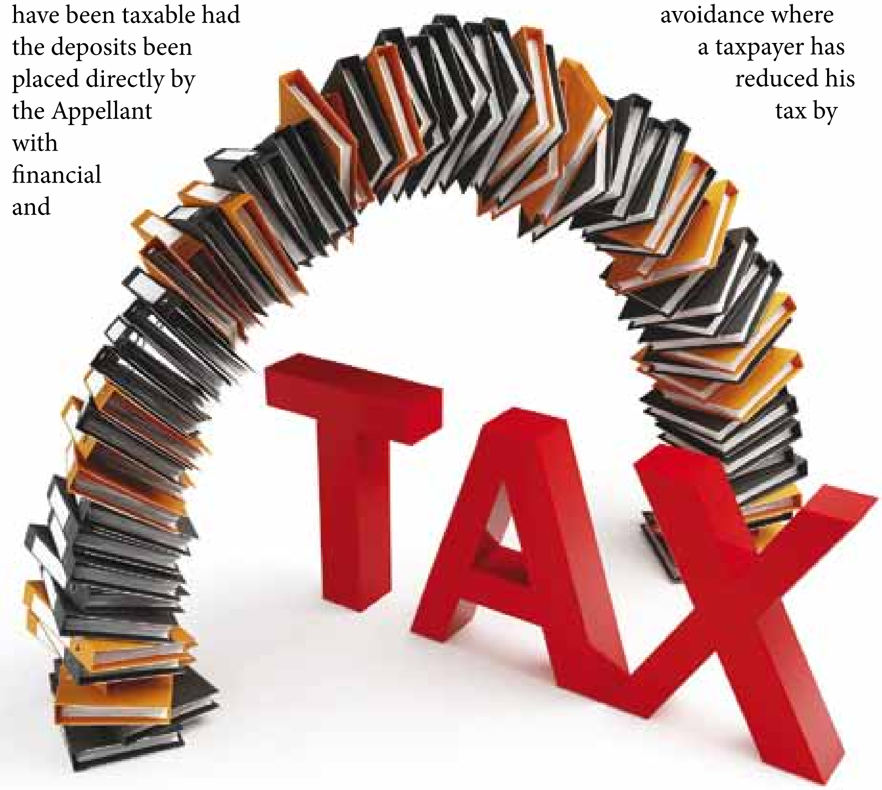
In the more recent case of *Port Dickson Power Bhd v KPHDN (2012) MSTC 30-045*, the DG invoked powers under Section 140 in connection with loan stock carrying an interest rate of 12%, that was issued by the taxpayer in order to raise capital. An application was made to quash the decision of the DG who had disallowed deduction of the interest expense. The High Court held that the failure to comply with the mandatory provisions of Section 140(5) which requires particulars to be given with the assessment had rendered the decision of the DG null and void. The High Court also held that if the financing structure was a sham, the burden would rest on the DG to prove this. Note that unlike in the Bandar Utama case where the taxpayer had sought judicial review to obtain particulars in order to proceed with an appeal before the Special Commissioners, in the Port Dickson Power case, the taxpayer has sought to quash the decision of the DG. Interestingly, at about the time of writing of this article, the Court of Appeal has allowed an appeal by the Revenue in this case. The grounds however are not known. The writer speculates that the issue may surround whether it was appropriate for the High Court via judicial review proceedings to consider the merits of the exercise of power under Section 140 or whether this is a matter for the Special Commissioners. This issue was clearly raised by the Revenue as a preliminary objection at the High Court stage and it is understood that this was raised again by the Revenue at the Court of Appeal. One hopes that the Court of Appeal will issue appropriate grounds for this case. In any event, the case would sound a caution as to the use of judicial review to challenge assessments. Whilst the existence of an express mode of remedy (i.e. a "Form Q" appeal under Section 99 of the ITA) does not automatically shut out the possibility of judicial review, the resort to judicial review in such cases as a means to discharge an assessment ought to be in exceptional situations rather than as a norm.

MALAYSIA - SUBSTANTIVE ASPECTS

In the leading case of *Sabah Berjaya Sdn. Bhd. v Ketua Pengarah Jabatan Hasil Dalam Negeri [1999] 3 MLJ 145*, the taxpayer was one of the subsidiaries of the Sabah Foundation and had for a period of eight years donated all its profits to the Foundation (an approved organisation under Section 44(6)) pursuant to a letter issued by State Minister of Finance to the Managing Director of subsidiaries of the Foundation. The Chief Minister of Sabah at that time was the Chairman of the taxpayer and the Foundation. The issue was whether the donations were deductible. The Special Commissioners held that the donations amounted to tax avoidance and therefore were rightly disregarded under Section 140. On appeal, the High Court held that the donations were not deductible because they were not "gifts" within Section 44(6) in the sense that they were a product of compulsion. The Court of Appeal finally held that the donations were gifts and Section 140 thus did not apply. There was a payment that reduced the appellant's income in circumstances under which the ITA by way of Section 44(6) clearly afforded a reduction in tax liability. The court relied on the Privy Council case of *Commissioner of Inland Revenue v Challenge Corporation Ltd [1986] STC 548* where Lord Templemen had distinguished tax avoidance, tax mitigation and tax evasion[4].

Clearly in this case, the existence of a specific deduction provision and the making of payments that fell squarely within the deduction provision meant that there was no room for employing the general anti-avoidance provisions in Section 140.

The Sabah Berjaya case was applied by the High Court in *Yeoh Eng Hock Holdings Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2011] MLJU 867*. In this case, the Appellant gave interest-free loans to directors with no terms for repayment. The directors kept monies in sums of not more than RM100,000 in several financial and banking institutions. Interest earned by an individual on such deposits was exempt. Such interest would have been taxable had the deposits been placed directly by the Appellant with financial and banking institutions. Whenever the Appellant needed funds, the directors would withdraw the deposits and remit the same to the Appellant. The Special Commissioners found the money to be the Appellant's money and also held that the Appellant had perpetrated a scheme with an intention to alter the tax of the Appellant. The High Court upheld the Special Commissioners' decision quoting the Sabah Berjaya and Challenge Corporation case. The facts and decision in this case are however curious. There is no mention of whether the interest portion earned was ever remitted back to the Appellant. One would assume that the directors did not in fact remit any interest portion back to the Appellant (since the loan to the directors was stated as being interest-free). Assuming this to be the case, it begs to be asked as to how would a proper application of the Sabah Berjaya and Challenge Corporation lead to the Appellant being seen as guilty of tax avoidance. There should be no tax avoidance where a taxpayer has reduced his tax by reducing his income. It is not for the Revenue to insist that the Appellant should earn interest. The Appellant could have chosen to keep the money in a non-interest bearing current account and surely that would not attract the provisions of Section 140. On the other hand, if in fact the directors had remitted the interest to the Appellant, arguably, the interest would have been taxable in the hands of the Appellant anyway as gain or profit and there would have been no need to resort to Section 140.



Since the Yeoh Eng Hock case,

we understand that the Special Commissioners have decided on a Section 140 case involving interest-free loans to a subsidiary. This case has however not been reported. If and when reported, the grounds set out therein will be useful to the tax fraternity.

In *SPS v Ketua Pengarah Hasil Dalam Negeri (2011) MSTC 10-030*, the taxpayer, a property developer was in the business of buying and developing land and selling it for a profit. Profits arising therefrom would usually be subject to income tax. Sometime in 1992, the taxpayer bought a piece of land with the intention of building commercial units and leasing them out on a long term basis. The taxpayer then proceeded to incorporate a subsidiary in early 1994 and sold the land to the latter. The subsidiary developed the land via a turnkey contract with the taxpayer. The properties were rented out by the subsidiary until they were sold in 2003 to a company related to the taxpayer. The subsidiary was then wound-up. The Revenue subjected the taxpayer to income tax on the disposal by its subsidiary. The Revenue claimed that a tax evasion scheme had occurred. The High Court upheld the assessment. There are however peculiar findings characterising this case. Evidence accepted by the courts seems to suggest that there were overt acts amounting to avoidance. From correspondence between the taxpayer and its consultants, the court seems to have come to the conclusion that a scheme was adopted to try and show that the property was held for investment so that income tax would not apply. It was found that this was not the genuine intention and the intention all along was to dispose the properties. Whilst it might be debatable whether such findings could have been properly drawn from the correspondence in question, with such findings, the case does not seem out of sync with the circumstances under which Section 140 can be invoked.

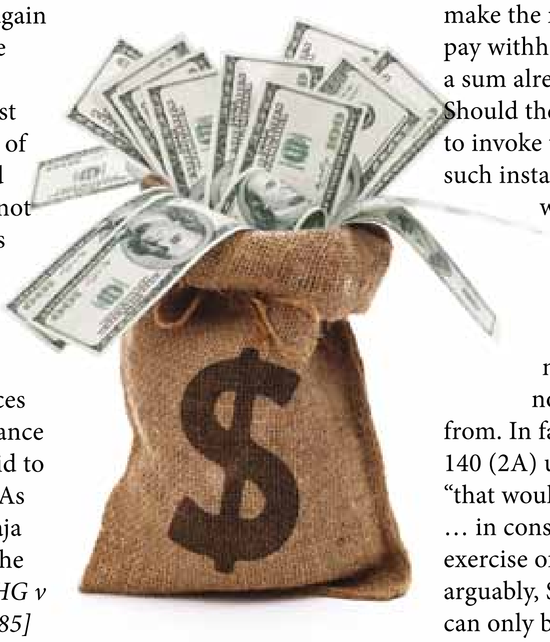
This case also dealt with the imposition of a penalty under Section 113(2) of the Act and the High Court held that there was no good reason for the court to intervene in the exercise of discretion by the DG to impose a penalty. An important point arises here. Can the DG impose a penalty under Section 113(2) in consequence of a Section 140 adjustment? Essentially, the discretion (which has to be imposed reasonably) to impose a penalty under Section 113(2) is triggered when there is an incorrect return. Wasn't the return when filed by the taxpayer accurate in all respects? It is the subsequent exercise of discretion under Section 140 (because Section 140 uses the word "may", it is not mandatory for the DG to invoke the section) and the making of adjustments that alters the tax position but that does not deter from the fact that the return when filed by the taxpayer was accurate. It would be interesting to see if there are future Malaysian case law developments on this front.

In a more recent case, *Ketua Pengarah Hasil Dalam Negeri v Bee Garden Sdn Bhd [2014] 1 MLJ 604*, the issue was whether rebates given by the disposer should be taken into account when calculating the chargeable gain for real property gains tax purposes. When considering the issue of the applicability of Section 25(2) of the Real Property Gains Tax Act 1976 (this section is similar to Section 140(1) of the ITA), the High Court held applying the Sabah Berjaya and Challenge Corporation case that the section does not apply where tax liability is reduced by a reduction in income. In this case, as the rebates were found to have actually been given, there is no issue of tax avoidance.

CONCLUSION

Clearly, Malaysian case law on anti-avoidance has not begun to deal with complex structures and transactions. They do however provide valuable guidance on how the courts will approach tax avoidance issues.

A review of authorities and applicable principles show that Section 140 is not all pervasive. Its application is limited to the extreme circumstances where obvious abuse occurs. This is consistent with the right of the taxpayer to plan his affairs. In fact, the courts have been time and time again conscious of the need to protect taxpayers against any abusive use of Section 140 and this extends to not only procedures that need to be followed when applying the section but the circumstances when tax avoidance can really be said to have occurred. As described by Raja Azlan Shah (as he then was) in *UHG v DGIR [1950-1985] MSTC 145*, the powers under it are wide but not plenary.



In fact arguably in recognition of the limitations of Section 140, in recent times legislative amendments have been made to fortify or add to the general anti-avoidance provisions. The most glaring of which is the introduction of Section 140A of the ITA (which came into effect from the year of assessment 2009) to deal with transfer pricing and thin capitalisation issues. Whilst there is no published case law authority on this, it is suggested that a view can be taken that Section 140 was never sufficient for the purposes of transfer pricing adjustments and this lead to the enactment of Section 140A. Whether Section 140A itself is sufficient basis for current transfer pricing practices of the Revenue and the 2012 guidelines and rules is perhaps an ideal subject matter for another article.

There is also the matter of the insertion of Section 140(2A) with effect from 24 January 2014. This provision hasn't had the chance of being tested adequately before the Courts. Suffice to say that there are serious issues pertaining to whether it is sufficient to make the maker of payment pay withholding tax on a sum already remitted. Should the DG attempt to invoke the provision in such instance, the maker would effectively need to bear the tax since the payment has already been made and there is nothing to deduct from. In fact, since Section 140 (2A) uses the words "that would be deducted … in consequence of his exercise of those powers" arguably, Section 140 (2A) can only be invoked for payments not already made.

Lastly, given perhaps the nature of Section 140 and tax avoidance itself, one can expect Malaysian case law to grow in this area. As it stands, there are a number of transfer pricing appeals where Section 140 has been invoked, waiting for their turn before the Special Commissioners. Other issues will continue to plague the tax fraternity until adequately dealt with by the courts. One such issue is the use of Labuan in leasing and other structures and the insistence that Section 140 must be applied where there is purportedly no "substance" in the Labuan arm of the transaction. Such arguments seek to defy express exemption provisions made under the ITA, the nature of offshore jurisdictions, the separate regulatory and licensing regime that exits in Labuan and years of efforts by government agencies to promote Labuan. Surely the courts will be kept busy for some time dealing with this genre of issues.

1. *The UK Revenue ("HMRC") describes Tax Avoidance as "An attempt to exploit legislation to gain a tax advantage that was never intended. This often involves artificial transactions that serve little or no purpose other than to produce a tax advantage. But tax avoidance is not the same as tax planning, which involves applying tax legislation in the way it was intended".*
2. *Section 51 is broadly similar to Section 33(1) of the ITA*
3. *Broadly, Section 33(1) of the Singapore Income Tax Act 1948 provides that where the Comptroller is "satisfied that the purpose or effect" of any arrangement directly or indirectly is tax avoidance, the Comptroller may disregard or vary the arrangement and make adjustments as he sees fit, so as to counteract any tax advantage obtained. This adjustment would not prejudice the validity of the arrangement.*
4. *Tax evasion occurs when the commissioner is not informed of all the facts relevant to an assessment of tax. Tax mitigation is where a taxpayer reduces his income or incurs expenditure that reduces his assessable income or entitles him to reduce his tax liability. Tax avoidance is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction.*

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Organised by:

LHDN MALAYSIA

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CHARTERED TAX INSTITUTE OF MALAYSIA

IRB-CTIM TAX FORUM 2014

Date	Venue	Event Code
27 March 2014	Seri Pacific Hotel, Kuala Lumpur	RS/001
8 April 2014	KSL Hotel & Resort, Johor Bahru	RS/002
3 April 2014	Perdana Hotel, Kota Bharu	RS/003
7 April 2014	Traders Hotel, Pulau Pinang	RS/004
9 April 2014	Sutera Harbour, Kota Kinabalu	RS/005
10 April 2014	Four Points Sheraton, Kuching	RS/006

Time: 9.00 am to 1.00pm

We are pleased to announce that the Chartered Tax Institute of Malaysia (CTIM) and Inland Revenue Board of Malaysia (IRB) will be organising the "IRB-CTIM Tax Forum 2014" where the senior IRB officials and CTIM representatives will be participating as speakers and panelists. Tax professionals will be able to understand the practical requirements of IRB and their approach to reviewing the tax returns. This will certainly help avoid routine penalties. The forum will enable tax professionals and tax authorities to build better relationships with each other.

Kuala Lumpur Programme *(subject to amendment)*

8.15 am — Registration & Welcome Coffee/Tea

9.00 am — Introduction
by Mr SM Thanneermalai
President
Chartered Tax Institute of Malaysia (CTIM)

9.15 am — Keynote Address
by YBhg Tan Sri Dr Mohd Shukor Haji Mahfar
Chief Executive Officer
Inland Revenue Board of Malaysia (IRB)

9.30 am — Morning Refreshments

10.00 am — Operational Issues
Chairman cum Panelist: CTIM
Speaker: IRB

11.00 am — Question & Answer Session

11.30 am — Deductibility of Financing Costs
Chairman: CTIM
Speaker: CTIM
Panelist: IRB

12.30 pm — Question & Answer Session

1.00 pm — End of Programme & Networking Lunch

1. *The programme for the other locations will be similar to Kuala Lumpur except for Introduction and Keynote Address.*
2. *Name of Chairman, speaker and panelist will be notified prior to the event date.*

4 CPD points

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DEATH AND REAL PROPERTY GAINS TAX

TO HIMSELF EVERYONE IS IMMORTAL; HE MAY KNOW THAT HE IS GOING TO DIE, BUT HE CAN NEVER KNOW THAT HE IS DEAD.

~Samuel Butler

Richard Thornton and Thenesh Kannaa

His own death is always the first event in which a person cannot participate. His estate, whatever it consists of, large or small, becomes the responsibility of others immediately on his passing. This article describes the specific provisions in the Real Property Gains Tax Act 1976 (RPGTA) that statutorily deem various matters requiring to be dealt with as a result of a death. Simple and practical examples are provided throughout the article to illustrate these provisions.

Before proceeding to the tax considerations, readers are invited to peruse the glossary in **Table 2** to gain an understanding of the meaning of certain important terms used in this article.

ASSETS DISPOSED OF DURING THE DECEASED'S LIFETIME

Death does not prevent the making of an assessment in respect of disposals by the individual before his death. The notice of assessment may be served on the executor, but the assessment cannot be made more than three years after the end of the year of assessment in which the notice of death has been notified to the Director-General in the prescribed form, i.e. Form CP 57.

Example:

Chong disposed of his house in November 2013, and was not eligible to elect for private residence exemption. Unfortunately, he met with an accident and passed away on 15 January 2014. On 1 March 2014, his executor submitted the Form CP 57 to the Director-General. In relation to the house disposed of by Chong, the Director-General may raise an assessment to Real Property Gains Tax (RPGT) not later than 31 December 2017 and serve it on the executor.

DEVOLUTION OF ASSETS OF A DECEASED

Any real properties of the deceased person remaining at his death would devolve either:

- on his executor or legatee under a will or intestacy; or
- on the trustees of a trust created under a will.

Such devolution is treated as a no gain/no loss disposal, i.e. the disposal price is deemed to be equal to the original acquisition price of the deceased.

THE EXECUTOR OR TRUSTEE

The executor or trustee is assessable and chargeable to RPGT in respect of any chargeable gains accruing on the disposal by him of any real properties of the estate. Joint executors and joint trustees are jointly and severally liable for payment of the tax assessed.

Where an asset of a deceased person is disposed of (other than to a legatee) by the executor or by the trustee of a trust created under his will, it is deemed to have been acquired by him on the date of death at an acquisition price equal to the market value of the asset at the date of death (less any sums of the kind described in Sch. 2 para 4(1) received or forfeited by him).

Example:

Chong left behind another house which he acquired for RM500,000 in December 2010 and was worth RM700,000 on 15 January 2014, the date of Chong's death. Chong's executor disposed of the house to an unconnected third party on 1 May 2014 for RM740,000 and passed on the disposal proceeds to Chong's wife and children.

Although the house had been owned for less than five years from acquisition, there is no gain when, at his death on 15 January 2014, it devolved on his executor as the devolution is deemed to have taken place at the original acquisition price. However, when the executor disposed of the house at RM740,000 on 1 May 2014 he realised a chargeable gain of RM40,000 because he is deemed to have acquired it for RM700,000, the market price at the date of Chong's death, 15 January 2014, which is also the date on which the executor is deemed to have acquired it. This gain is subject to tax at the rate of 30% (calculated under Part 1 of Schedule 5) as it is a disposal within three years from 15 January 2014,. The RPGT payable is RM12,000 (i.e. RM40,000 X 30%), which is lower than the RM14,800 (i.e. 2% of the total of consideration of RM740,000) which the acquirer would have withheld and remitted to the Director-General. Thus, the estate can expect a tax refund of RM2,800.

THE POSITION OF THE BENEFICIARY OR LEGATEE

Where an asset of a deceased person is transferred to a legatee by the executor

(who may himself be the legatee) or by the trustee of a trust created under his will, the legatee is deemed to have acquired the asset on the date of the transfer of ownership to him at an acquisition price equal to the market value at that date (less any sums of the kind described in Sch. 2 para 4(1) received or forfeited by him).

Example:

Chong also left behind a bungalow, which pursuant to his will was transferred by his executor to Chong's eldest son on 1 April 2014 when its market value was RM1 million. If Chong's son disposed of the bungalow in October 2014 for RM1.15 million, his gain for RPGT purposes would be RM150,000. He would be entitled to Sch. 4 para 2 exemption of RM15,000 (i.e. 10% of the gain) and the remainder RM135,000 would be subject to tax at the rate of 30% as the disposal is within three years from his deemed date of acquisition.

Where a legatee accepts a real property in place of a money legacy, he is deemed to have acquired it on the date of the transfer of ownership to him at an acquisition price equal to the amount of the legacy or the market value of the asset as at the date of transfer of ownership whichever is lower (less any sums of the kind described in Sch. 2 para 4(1) received or forfeited by him).

Where the market value of the asset at the date of transfer is substantially different from the amount of the legacy, it is probable that there would be a difference in payment by one party to the other but no provision is made to deal with this.

Example:

Chong's will did not specify the manner in which three of his apartments should be distributed, but it specified that each of his three sons should be given money of RM100,000 from his wealth. As each of the apartments is worth RM120,000, it was decided that each of the sons would be given an apartment in lieu of the money legacy and that each of the sons would pay RM20,000 to the estate.

For RPGT purposes, each of the sons is deemed to have acquired the apartment for RM100,000 (i.e. the money legacy being lower than the market value of the apartment). One might argue that the commercial cost for the sons is RM120,000 (i.e. RM100,000 of money legacy forgone plus RM20,000 of actual payment), but that is not accepted for the purpose of RPGT.

GIFT ON DEATH

Where an asset is gifted on death, the recipient is deemed to have received it on the date of the transfer of ownership to him at an acquisition price equal to the market value at that date (less any sums of the kind described in Sch. 2 para 4(1) received or forfeited by him).

A BENEFICIARY WHO IS A MINOR

Frequently a will provides for a trust to be established if the beneficiary of an estate is a minor or a statutory trust would come about in those circumstances. Such trust would administer the real property until the beneficiary reached a specified age or the age of majority. The RPGT treatment of acquisitions and disposals carried out by the trustee of such a trust is identical to that of an executor, as explained above.

However, care must be taken if the trustee continues to hold the asset even after the beneficiary has ascertained the specified age. The trustee may then be treated as a bare trustee, i.e. trustee for another person absolutely entitled as against the trustee. In such case, any acquisition or disposal carried out by the trustee on behalf of the beneficiary would be treated as an acquisition or disposal carried out in a personal capacity.

Example:

By his will Manimaran, who died in 2001 left two shop lots to his daughter Devi who was then under age. A licenced bank was appointed as executor and trustee of the estate. Devi turned 21 on 15 April 2012 when the shop lots had a market value of RM1,800,000 and the bank acknowledged that it continued to hold the property as bare trustee for Devi. On 30 January 2014, the bank, with Devi's agreement, entered into a sale and purchase agreement to dispose of the properties for RM2 million. Incidental expenses were RM25,000. On completion of the sale, the sale proceeds were paid over to Devi.

If the bank had disposed of the shop lots in its capacity as executor, the bank would have been assessable and chargeable with tax. However, on 15 April 2012, there was an effective transfer of the asset to Devi as the bank acknowledged that it was holding for her absolutely as from that date. The same date i.e. 15 April 2012 is Devi's acquisition date and her deemed acquisition price is RM1,800,000, the market value on that date.

The bank is liable to make an information return to the Director-General by 31 March 2014 (i.e. 60 days from 30 January 2014) and Devi is required to submit a Form CKHT 1A with details of the disposal within the same time limit. The tax will be assessed on Devi and she will need to call on the bank to pay the tax demanded on her behalf, after taking into account any amount deducted by the acquirer.

The tax is calculated as per **Table 1**.

The acquirer would have remitted RM40,000 (i.e. 2% of the total consideration of RM2 million) to the Director-General and the remainder RM7,250 becomes payable when the official assessment is made by the Director-General.

** Given that the deemed acquisition date is 15 April 2012, it is a disposal within three years from acquisition and thus the appropriate tax rate is 30%.*

	RM	RM
DISPOSAL PRICE		
Sale proceeds	2,000,000	
Less: Incidental costs	(25,000)	1,975,000
ACQUISITION PRICE		
Deemed acquisition price	1,800,000	
Incidental costs (not eligible)	nil	1,800,000
Gain		175,000
Less: Sch. 2 para 4 exemption		
(10% of RM175,000, being higher than RM10,000)		(17,500)
Chargeable Gain		157,500
(X) Tax Rate *		30%
RPGT		47,250

Table 1

Table 2

TERM	MEANING
Director-General	Director-General of Inland Revenue
Executor	The meaning of the term "executor" for the purpose of RPGTA is wider than its ordinary meaning. Section 2 of the RPGTA defines "executor" as: • executor; • administrator; or • other person administering the estate of a deceased person. ***Explanations:*** ***(i) Executor.*** In general, an executor is a person appointed by the will of the deceased to administer and/or distribute his assets after his demise. Executors are normally granted probate by the High Court. ***(ii) Administrator.*** Where the deceased is without a valid will, an administrator can be appointed among all persons having an interest in the estate of the deceased. This appointment is normally effected by Letters of Administration from the High Court. ***(iii) Other person administering the estate of a deceased person.*** This is a wide expression and is capable of deeming persons with neither probate nor letters of administration to be an executor for the purposes of the RPGTA. Income Tax Act 1967 has a similar definition for the term 'executor' and the Federal Court in *Kerajaan Malaysia v Yong Siew Choon (2006) MSTC 4,197* decided that the widow of a deceased was an executor, by virtue of this third limb, although she has not been formally appointed as such.
Intestacy	There is no statutory definition for this term. It is commonly agreed that intestacy is the condition of an estate of a person who dies without a valid will.
Legatee	In general terms, legatee is a person (individual or organisation) that is bequeathed an asset under the terms of the will of a deceased person. However, the meaning of this term in the RPGTA is wider than the general meaning. Sch. 2 para 2 of the Act defines legatee to include any person entitled under a: • testamentary disposition (under a will);or • on intestacy (no will); or • partial intestacy (there is a will which covers only part of the deceased's assets).
Real Property	This is defined in Section 2 of the RPGTA as any land situated in Malaysia and any interest, option, or other right in or over such land. The term "land" is defined to include: • the surface of the earth and all substances forming that surface; • the earth below the surface and substances therein (for example, a gold mine); • buildings on land and anything attached to land or permanently fastened to any thing attached to land (whether on or below the surface); • standing timber, trees, crops and other vegetation growing on land; and • land covered by water.
Sch. 2 para 4 exemption	This is an exemption available only for individuals, and not for individuals acting in the capacity of an executor. The amount exempt is the higher of: • 10% of the chargeable gain; or • RM10,000
Trust created under a will	There is no statutory definition for this term. This is often referred to a testamentary trust, which can be distinguished from a trust created during the lifetime of an individual (i.e. inter vivos trust). Generally testamentary trusts are created for young children or relatives with disabilities.
Trustees	There is no statutory definition for this term. It is generally understood that a trustee is any person who holds property, authority, or a position of trust or responsibility for the benefit of another person (i.e. the beneficiary).

CONCLUSION

Usually the acquisition price of an acquirer who obtains a real property through transactions treated as no gain/no loss disposal is based on the transferor's acquisition price (which could be a reflection of the value of the asset many years ago) but the acquisition date is the date of transfer. This means that an acquirer would bear a significant amount of RPGT if he disposed of the real property within five years from the date he received it.

Having said that it is pleasant to note that, although the devolution of the assets of a deceased is treated as a no gain/no loss disposal, the acquisition price of the acquirer is based on the market value of the real property, either on the date of transfer in the case of a legatee, or on the date of death in the case of an executor disposing of an asset to a third party. This is consistent with the government's policy of not imposing taxes on inheritance.

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GST IMPLEMENTATION: IS IT JUST A SIMPLE PROCESS?

David Lai and Jeff O'Connell

THE PRIME MINISTER OF MALAYSIA ANNOUNCED ON 25 OCTOBER 2013 THAT A GOODS AND SERVICES TAX OR GST WILL BE INTRODUCED EFFECTIVE 1 APRIL 2015 WITH A RATE OF 6%. GST IS, AT ITS CORE, A SIMPLE BROAD CONSUMPTION TAX SYSTEM, AND IT HAS BEEN "TRIED AND TESTED" BY OVER 150 COUNTRIES THROUGHOUT THE WORLD. WHAT COULD COMPLICATE THE GST IMPLEMENTATION PROCESS? WHILST GST WILL HAVE DESIGN FEATURES WHICH ARE COMMON THROUGHOUT THE WORLD, THE MALAYSIAN GST WILL, OF COURSE HAVE SPECIFIC GST CLASSIFICATION AND TRANSITIONAL RULES THAT ARE NOT NECESSARILY FOUND IN OTHER COUNTRIES.

WHAT IS GST?

GST is a multi-stage transaction tax imposed at every point in a distribution chain. The burden of a GST, by design, falls on the final consumer or businesses such as banks whilst the responsibility for the payment of the tax, output tax, falls on the supplier. Cascading of tax on tax, which may occur under the present single stage sales and services tax regime, is avoided by an input tax credit mechanism. The value added by suppliers at each stage of the distribution chain is effectively taxed. From a design perspective, the Malaysian GST model has many similarities with the model that Australia adopted in 2000.

The Malaysian GST has four classifications – standard rated, zero-rated, exempt, and out of scope. A business that makes only standard rated or zero-rated supplies would be in a much better position than one that has a combination of supplies across the four classifications. In Malaysia, complexity in the GST implementation process will be most likely caused by provisions relating to exemptions and the transitional provisions. Classification and apportionment issues are still present and are still being debated in Australia even after 14 years since implementation. Numerous Regulations and Guidelines would need to be issued to accompany the GST legislation to assist taxpayers to comply and minimise exposure to errors and penalties.

WHAT SHOULD BUSINESSES DO BETWEEN NOW AND 1 APRIL 2015 TO BE "GST READY"?

Ultimately, the total time, manpower commitment and cost required for successful GST

WHAT DOES BEING "GST COMPLIANT" AND "GST READY" MEAN?

Being "GST compliant" usually refers only to the accounting software which includes a GST module or which has features that allow GST to be correctly captured and computed by the software. Being "GST compliant" is just an IT system prerequisite, and does not imply that a business is necessarily "GST ready".

From a consultant and client perspective, being "GST ready" firstly means being open for business on 1 April 2015 and being able to be confident that your systems and processes are working as they should. For example, from retailers' perspective, they will have to ensure that all point of sale equipment has been updated to produce a valid tax invoice and all price tags need to be changed to reflect a GST inclusive price.

The second most important thing is being able to lodge the first GST return as easily as possible, being confident that the data transmitted to the Royal Malaysian Customs is as accurate as possible. From first-hand experience, many businesses in Australia lodged their first GST in the hope that the data was somewhere near accurate. This can be very disconcerting.

implementation depends on the size and complexity of the business organisation concerned. As GST is a tax on transactions, which for most business organisations is voluminous, the processes and changes required for GST compliance would need to be automated and encapsulated in its IT system.

Prior to the engagement of any consultants to assist with GST implementation, the business needs to select the individuals in the organisation who will form the internal GST team or GST task force. Whilst it is important to have a senior member of management on the team for overall control and direction, the internal project manager must have a reasonable grasp of the company's operations with a finance background if possible. Whilst GST necessarily requires someone with finance credentials to head the team, GST impacts all facets of business operations, from sales to human resources. The internal project manager needs to be able to identify the relevant internal resources to assist in a successful GST implementation. It must also be recognised that the internal project manager will need to devote considerable time to the GST project and therefore, it may be necessary for some of their normal duties to be delegated to another staff member.

Most consultants will advise that GST implementation is a three stage process.

The first stage, the Impact Study, is an information gathering exercise. Business needs to identify the processes/procedures that may be impacted by GST, but not their likely solutions. One major issue for virtually all businesses is the impact that GST will have on cash flow. Will I have to lodge my GST return before I have been paid by my customers?

Another major issue which is usually identified in Stage 1 is the adequacy of the IT systems. GST is a transaction tax and is very difficult to administer if records have to be maintained manually. Other issues identified could relate to classification, apportionment, timing and transitional issues.

It is essential for the Impact Study to be conducted thoroughly across all business sectors and functions of an organisation to ensure that any critical GST issues affected by the underlying business structure are addressed. Any decisions required for amending the underlying business structure must be made at an early stage. This Impact Study stage could take as long as three months depending on the complexity of the business.

The second stage is generally devoted to the provision of solutions to issues identified in Stage 1. For example, a cash flow analysis for a retailer may reveal that because most customers pay by cash or credit card, the retailer may actually have the GST component of the price from month end until the end of the following month when the GST return needs to be lodged. This result should be cash flow positive.

From an IT perspective, a detailed analysis of the present system may find that the GST capability exists within the present system but just

needs to be activated; or in a worst case scenario, the present system cannot support GST and needs to be completely replaced. In this situation, it is much more advantageous to know this information early in the project and be able to plan accordingly rather than only find out later and need to obtain scarce IT systems resources.

This stage would generally take up to four months to complete.

The third stage of the project involves implementing the solutions identified in Stage 2. For example, if the cash flow analysis performed in Stage 2 did not produce favourable results, then a solution identified in Stage 2 would involve a review of the company's terms of trade or invoicing process to see whether these could be amended to ease any cash flow issues.

Another integral part of Stage 3 would involve a trial run of the IT system to test and identify any errors. Ideally Stage 3 should be completed by November/December 2014 allowing the companies an additional three months before going live on 1 April 2015.

As can be appreciated from this short discussion of an implementation plan, the earlier that the process is commenced, the more likely that the implementation process will be completed well before 1 April 2015.

Some companies may, not unreasonably, be waiting for the passage of the GST legislation through Parliament. It is understood that the legislation, with amendments, is likely to be passed in March 2014 allowing 12 months before commencement. This timeline will be similar to that adopted by the Australian authorities. We recommend that, at the very least, companies undertake an Impact Study early to at least identify potential high risk issues particularly if one of these relates to IT or requires change to the underlying business model.

LESSONS LEARNED FROM AUSTRALIA

Some people will lodge their first income tax return. The introduction of GST in Australia introduced thousands of taxpayers to the income tax system. It is likely that something similar will occur in Malaysia.

Also in Australia, many businesses devoted considerable time and money to GST implementation getting professional advice, training staff and upgrading IT systems. They incorrectly thought that once GST was introduced, the system would automatically capture and report the necessary data. In a large majority of cases, the data capture was accurate and comprehensive but GST is a transaction tax and needs regular monitoring to ensure that the information provided to the revenue authorities is accurate. Greater automation with minimum manual intervention should result in lower error rate and easier monitoring.

In a post implementation Australia, many companies undertook a review of their GST system one, two or three years later. The longer the company took before conducting the review, the more likely that substantial errors were identified, from either an output tax or input tax perspective. One such review resulted in a refund to a company in excess of RM6m (equivalent) as a direct result of incorrect coding of the accounting system subsequent to ERP.

The knowledge gained by business must be retained in the business even if that means that a senior staff member, with GST implementation experience, has to take responsibility for GST matters. Ideally, the processes and policies developed over the course of the GST implementation project should be recorded in a GST Reference Manual. GST knowledge cannot be allowed to disappear just because implementation is completed.

CONCLUSION

Although GST is intended to be a simple tax, complexities for implementation may be caused by classification, apportionment, timing and transitional issues. It would be a mistake to assume that IT software with GST capability from other countries may be adopted wholesale in Malaysia, due to peculiarities embedded in the proposed Malaysian GST legislation. Consideration also needs to be given to the many Guidelines issued by the Royal Malaysian Customs which reveal their practices, procedures and interpretation of the GST legislation. Furthermore, having a GST compliant software does not mean that a company is "GST ready". Configuration of the IT system coupled with introduction of new processes to comply with the Malaysian GST law requires considerable time and attention. The total time, manpower commitment and cost required for successful GST implementation would ultimately depend on the size and complexity of the business organisation. Businesses should aim for greater automation with minimum manual intervention for easier post implementation monitoring and to focus on minimising risk of errors and exposure to GST penalties.

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E-COMMERCE AND TAX CHAOS

Dr. Nakha Ratnam Somasundaram

Abstract

This article looks at the emergence of the internet and e-commerce, and the chaos created in the process for revenue agencies. It also reviews the Guideline on Taxation of Electronic Commerce issued recently by the Inland Revenue Board of Malaysia (IRB)[1], as well as approaches to the tax treatment of e-commerce transactions in some selected countries and finally, the e-commerce scenario in Malaysia.

TAX LAWS HAD EXISTED LONG BEFORE THE INTERNET ARRIVED ON THE COMMERCIAL SCENE[2]. AS NOBODY HAD HEARD OF THE INTERNET THEN, IT DID NOT FIGURE IN THE TAX STATUTES.

REVENUE AGENCIES COULD THEREFORE BE FORGIVEN IF THEY ARE NOW CAUGHT UP WITH A NEW SCENARIO WHERE THE OLD RULES (OR THE TRADITIONAL PRINCIPLES) OF TAXATION DOES NOT FIT IN NEATLY WITH THE TRANS-JURISDICTIONAL CHAOS CREATED BY THE INTERNET.

Charge to tax in Malaysia

In Malaysia, the law governing the taxation of income is the Income Tax Act 1967 (as amended) [ITA]. Income must fall within the ambit of the scope of charge under Section 3[3], which essentially provides that income of a person accruing in or derived from Malaysia is subject to tax in Malaysia. Thus for business income, where the business operations is carried on in Malaysia, the income of the person attributable[4] to those business operations is deemed to be derived from Malaysia.

Factors one need to consider in the determination of whether a business operation is carried on within Malaysia, includes an examination of the contractual obligations, location where contracts and services are performed, where the goods are stored, and where the arrangement was made for the delivery of the goods[5].

Charge to tax in the United Kingdom

In the United Kingdom (UK) tax is imposed on the worldwide income of any person tax resident in the UK or on the income arising in the UK of any person not resident in the UK.

A company incorporated in the UK would be a tax resident; and a company incorporated outside the UK may be resident of the UK if it is centrally managed and controlled from the UK. The term ‘managed and controlled’ refers to the place the business is controlled (this is therefore different from where the business is transacted). Where a company is not resident in the UK, it may be subjected to tax in the UK if the company is trading in the UK through a branch or agency.

Whether a trade is being carried on within the UK is a fuzzy area and the statutes are not clear on this – and one needs to rely on case laws where the stress is on where the contract was formed (known as the traditional test).

Owing to the growing complexity of international trade, British courts now also apply a wider test: Do the profits in substance (as against the form) derive from operations in the UK?

To answer this question, reliance is placed on the traditional rules of contract i.e. a contract is made where the acceptance is communicated – but where the communication is instantaneous, it is treated as made where the acceptance is received. The British revenue authorities are, however, not certain as to whether internet communications should be regarded as instantaneous for these purposes[6].

Even if the profits are determined to be derived from a trade in the UK, it will have limited taxing powers in practice unless it can be established that the activities in the UK constitute that of a branch or agency through which the profits are earned. And if the provisions of the Double Taxation Agreement (DTA) apply, then the activity must fall within the limited definition of the 'permanent establishment'[7].

Charge to tax in Singapore

In Singapore, tax is imposed on income accruing in or derived from Singapore or income received in Singapore from outside Singapore (this provision is similar to the Malaysian provision under Section 3).

Essentially in the case of business income, it boils down to whether a merchant is trading in Singapore, or is trading with Singapore. As in the United Kingdom and Malaysia, the Singapore revenue authorities take into account several factors for this purpose – the place of contract, the place where the operations relating to the business took place, the place where capital is invested and labour is engaged, location of the goods manufactured, the location where the goods are stored after manufacture and before sale, among others.

Electronic commerce and electronic business

E-commerce is not a business transaction but merely a method of transaction. In other words, the content of the business done through e-commerce is no different from the business done in a brick and mortar set up.

But beyond that a divergence appears in two dimensions – the business method and the business concept.

Essentially in e-commerce, there are three distinctive business components - the presence of any one of them being sufficient to characterise the business as e-commerce. The components are electronic advertising, electronic sales and electronic delivery. This can be conducted on a business to customer basis (B2C), business to business (B2B), government to customer (G2C), government to business (G2B) and customer to customer (C2C) basis, the acronym for each type being determined by the customer component in the transaction.

The electronic transactions[8]

E-commerce in its widest sense refers to the consumer and business transactions conducted over an electronic network that uses computers, servers, websites and telecommunications. It involves the exchange of goods and services for a consideration on the internet – among which are online shopping, online trading of goods and services, electronic fund transfers, electronic data exchanges and trading of financial instruments online.

This new method of conducting business is totally different from the traditional business practice which was based on the physical presence and delivery of goods.

Until the internet came along, transactions, particularly international business transactions, had to cross a political barrier, a customs barrier, or a postal barrier. The transactions were operated in a physical world and in terms of tangible goods. Barring smuggling, there is a check and track on the physical goods at some point at the barriers.

In the case of e-commerce – all these changed overnight - physical presence of the goods in some cases is not required at all. The geographical boundaries between nations now hold no significance. Delivery of some goods in digital format such as computer

software, music and videos can be in bytes, and the speed with which a transaction can be completed i.e. instantaneously across nations, irrespective of time or day, adds another new dimension.

Business, DTA and PE

The income from a business arising from cross-border transactions in the traditional mode is subject to tax in both countries; and DTA offers some compensatory relief. In most DTA, a bilateral arrangement would be made under which a country seeking to tax income would do so if they can attribute it to a PE in the particular country. A PE would indicate that there is a place of business of some permanence.

In the internet context, these two features i.e. the identification of the income and the existence of a PE, so fundamental to the traditional scheme of things, is totally missing, leaving the revenue agency completely in the dark; and the transacting merchants uncertain as to their liability to income tax and their entitlement to DTA relief.

And to complicate matters, with the development of the wireless application protocol (WAP) which integrates mobile telephone with the internet, internet commerce can now be blurred up with mobile commerce – the result being the origin of the business is invisible, and brings about a frightful complication to the revenue agencies, challenging their domestic jurisprudence.

Characterisation of income

The character of the income is relevant as the different types of income are treated and taxed differently. Thus the income from the provision of professional services under a contract for services may fall to be treated as a business income while the same services provided under a contract of services would be treated as arising from the exercise of an employment[9].

An income could be characterised as royalty, or interest or dividend in which case irrespective of the existence of a PE the income would be subject to tax in the country of origin i.e. where the payer resides. Usually the payer would be required to deduct a specified sum from the payment and remit the same to the revenue agency – the recipient in the other tax jurisdiction receiving only the balance[10].

And if it is a business income, then the existence of a PE will determine how much of that business income is to be attributed to the said PE and the sum so determined would be taxed accordingly under the relevant tax rules.

Purchase of a product and right to the use of a product

Whether one is buying a product (payment for the purchase of goods) or the right to use the product (payment of royalty) can have significant impact on the treatment of the payment made by the buyer or user, to the seller. The difficulty is particularly met in transactions involving software.

For example, if an individual resident in Malaysia is buying a software package from a non-resident, this would be considered a purchase of a product, and payment made would not be subject to any withholding tax. But if it is a license for the software, then opening the package is an act equivalent to signing an agreement for the right to the use of the software[11], including the entitlement to any warranty that comes with the product[12]. The payment made would be a royalty derived from Malaysia, and would attract withholding tax.

Characterisation of the sale therefore becomes critical for income tax purposes.

Applicable law in cross-border transactions

In cross-border transactions, the parties to the contract would choose, in the case of a dispute, the law applicable to the contract, and in other instances, the principal place of business; or the law of the land where the buyer resides would be the law applicable; or it could even be that of a law applicable to a third party[13].

If the contract provides for a retention clause of title until the buyer performs some specified act, then the matter of which *lex situs* will govern the validity of the clause remains a doubtful question. To some extent this issue is resolved by the Rome Convention that provides that if the contract is in accord with the rule of any one of the states of the contracting parties, the validity of the clause and the contract is binding.

However with the emerging e-commerce, these issues will add on a new dimension of uncertainty on account of the inadequacy of the existing laws to deal with such matters.

Tax jurisdiction

Tax jurisdiction and their delineation is another major issue for the tax agencies as the internet provides numerous 'visits' across tax jurisdictions and is outside the geographical and immigration control mechanism.

The political delineation of Malaysia and the geographical delineation of Malaysia too, are vastly different from the definition of Malaysia in the ITA for income tax purposes, which includes territorial waters, contiguous zones, continental shelf and exclusive economic zones[14].

But geographical and legal definitions of a sovereign state becomes meaningless with e-commerce where the transaction takes place through satellites and the servers can be in any part of the globe, including a tax haven. Add to this the notion that one can tax a person if he or she is present in Malaysia for example for 182 days[15] or more, or is exempted from Malaysian income tax if he or she is a non-resident and exercises an employment for less than 60 days for a particular assessment year, also become meaningless with internet access – for example services can be performed outside Malaysia and delivered via the internet[16].

Singapore and e-commerce

Singapore's tax system hits the brick wall when it comes to e-commerce. Issues that one need to focus is then whether the income derived is from trading in Singapore or with Singapore. The issue can get more complicated with the two different taxes being imposed – the income tax and the goods and services tax (GST).

For income tax application in relation to e-commerce, one needs to look at the issue of source of the income, the residence of the buyer or payer and finally the issue of income characterisation or classification.

Singapore guideline on e-commerce

The Singapore revenue authorities issued the Income Tax Guide on E-commerce on 31 August 2000 (which was later updated in 2001)[17].

It was acknowledged that the rules and test to be applied to a brick and mortar set up cannot be fully applied to e-commerce particularly in cross-border transactions involving non-tangible goods.

The tax guide used five different scenarios to explain the features common to an e-commerce trade and the consequent liability to Singapore income tax. It includes a company with business operations in Singapore setting up a website in Singapore, or setting up a website outside Singapore; or setting up a website and a branch outside Singapore; a company with business operations outside Singapore setting up a website in Singapore or alternatively setting up a website and a branch in Singapore.

For example, if a company carries on business operations outside Singapore, manufacturing and supplying tangible products to a foreign country but does not operate a branch in Singapore, sets up a website in Singapore and that website is operated through a web-hosting service provider with the website merely enabling customers to place orders, receiving payments and delivering tangible goods physically – then any income received by the company is deemed to be not derived from Singapore.

A determination as to whether the income from the e-commerce is derived from Singapore or outside Singapore seems to rest on the manner in which the website is maintained – if various activities including supporting the technical aspects of the website to handling and completing e-commerce transactions is done in Singapore, then the income derived therefrom is deemed sourced in Singapore and would be liable to income tax in Singapore.

Hong Kong and e-commerce[18]

The treatment of electronic commerce for Hong Kong income tax purposes was explained by the Hong Kong Inland Revenue Department with the issuance of its Departmental Interpretation and Practice Notes No. 39 issued in July 2001 (DIPN). The position adopted is quite similar to that of Singapore.

The DIPN explains that the mere presence of a server in a particular jurisdiction without the involvement of human activities in the same jurisdiction would not generally amount to the carrying on of a business in Hong Kong.

The Hong Kong revenue authorities prefer to look beyond the server and into the extent of the person's other operations in Hong Kong. The central issue is whether there is a PE in Hong Kong, and certainly the presence of a mere server will not suffice for tax purposes. The server is also not equated to an agent (whether real or legal).

The bottom line for the Hong Kong approach is that if the principal place of business engaged in e-commerce operations is in Hong Kong, then the profits earned will be liable to Hong Kong income tax. The DIPN provides several examples, quite similar to that of Singapore.

United States and e-commerce[19]

In the United States of America (USA) sales tax is applicable for sale of goods and services over the internet within their own state.

The current hot issue is whether such taxes should be imposed and collected from out of state customers[20]. A nexus[21] determines whether an online retailer is also required to collect sales tax from an out of state customer.

Assuming that there is a nexus, the next issue is to establish the rate of charge – and at this stage it could get really complicated.[22]

Taxation of online transactions would require that the vendor identify all relevant taxing jurisdictions, calculate how much to charge, file forms, and remit payments to hundreds or even thousands of different taxing authorities. Given the dislike for taxes (remember the Americans went to war against Britain because the British monarch, King George III wanted to impose tax on tea!), most merchants simply do not bother to comply and the Quill case decision[23] fit in beautifully as a very convenient excuse.

As online shoppers do not have to pay state sales tax especially for purchases made out of state online, the online trade is increasing, some say at the expense of the brick and mortar set ups, as the goods bought online are cheaper without the sales tax.

The scenario of tax free purchases may change with the coming of the Market Fairness Act to be introduced soon[24]. The Act requires online retailers irrespective of where they are located to collect local taxes on retail sales – this will be done after some modification and simplification to the existing tax rules.

The Malaysian e-commerce guideline

With all these global and domestic developments taking place, Malaysia has come up with its own 18-page guideline on taxation of electronic commerce[25]. The salient features of the guideline are examined in the next few paragraphs[26].

The guideline defines e-commerce as "any commercial transaction conducted through electronic networks including the provision of information, promotion, marketing, supply, order

or delivery of goods or services though payment and delivery relating to such transactions may be conducted off-line." The location of the server/website is not a determinant in whether an individual is taxed or not. In paragraph 5.1 the guideline states that although the server and website facilitate the performance of business activities, a server/ website by itself does "not carry any meaning in determining derivation of income." Income from e-commerce is regarded as derived from Malaysia only if the business operations test shows that the business is carried on in Malaysia.

Paragraph 5.2 provides three examples of situations where income from e-commerce would be deemed to be derived from Malaysia if the company conducts business through a website which is hosted on a server located outside the country.

A commendable major concern for the IRB is tax neutrality where both e-commerce and conventional business are subject to the same tax treatment. In other words, taxpayers in similar situations and carrying out similar transactions should be subject to the same tax treatment.

Paragraph 4 of the guideline discusses the scope of tax liability for a business under the law. The main points are:

- In general, income of a person accruing in or derived from Malaysia is subject to income tax in Malaysia.
- Where business operations are carried on in Malaysia, the income attributable to those business operations is deemed to be derived from Malaysia. The scope and extent of business operations in Malaysia, including a PE is a determinant factor in considering whether income is derived from Malaysia.
- In respect of e-commerce, particular determinant business activities that may be considered include sourcing of content, procurement of goods, promotions, advertisements, selling, updating and maintaining of website, uploading and downloading of contents and such similar activities.
- Where a DTA is applicable, determination of Malaysia's taxing right over the business income is based on the PE concept under which the business income would be attributed.

In paragraph 6 the guideline examines various business models of e-commerce with varying assumptions, in each case, explaining the IRB's position on whether or not business income is deemed to be derived from Malaysia or outside Malaysia. The IRB's position on the various scenarios is summarised conveniently in the table attached to the guideline.

The Malaysian e-commerce scenario

One of the first Malaysian portals was established in 1995 – the *www.klonline.com.my* - when the internet concept was as vague as ever in the country. But it did not pick up and the company went back to its brick and mortar set up and stayed there, now distributing baby clothing and shoes. On the other hand, Rakuten Online Shopping launched its portal in November 2012 offering more than 10,000 goods from different retailers with a promise of a new online experience that is entertaining and interactive[27].

While Gwei Tze, the managing director of retail distributor Kinderjijk Sdn Bhd thinks that Malaysians are not ready for e-commerce, others like Richard Tan, founder of *Lelong.my* and a prominent expert in the field of e-commerce think that offering fair prices and packing it up with excellent services would increase e-commerce customers[28].

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Conclusion

Taxation, which by any standard is complicated, is made worse with e-commerce and multijurisdictional operations (as illustrated by the position in the US viz a viz its sales tax).

E-commerce makes political boundaries meaningless and the application of traditional rules like PE and income classification extremely difficult.

Contrary to popular belief that tax on e-commerce will kill internet trading, one should take comfort in the idea that the tax as imposed is not a new tax but only an existing income tax now applied to profits derived from a new method of trading, in a more definitive way. And the guideline seeks to delineate the liability to tax in line with the OECD principles and rules, adding an element of certainty. In this context the OECD's ongoing work on tax issues stirred up by e-commerce goes a long way.

There is now an urgent need to ensure efficient and effective administration of tax in the context of e-commerce. The application of international tax rules to e-commerce needs to be fine-tuned, particularly the concept of PE and the classification of income.

A problem can also be a challenge (notwithstanding that some cynics think they are both the same!) and hence e-commerce can be viewed as presenting an opportunity to modify existing tax systems to address today's business model and taxation system. Considering the global nature of e-commerce, much work is needed on international tax reform as well (the concept of PE, for example, maybe out-dated). This is no small task, but one that needs to be pursued in a collaborative fashion by businesses and governments, both at the domestic and international level.

Obviously, there is a long, long way to go – but every step taken in the right direction would be one step out of the tax chaos.

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1 The Guideline on Taxation of Electronic Commerce was issued on 1 January 2013.

2 The Bible records that nearly 2,000 years ago at about the time of the birth of Jesus Christ, a decree was issued by Ceaser that a census be taken so that all citizens of Rome be accounted for and be taxed. In India, around 300 B.C. the famous sage, Kautilya wrote the Arthasastra, a comprehensive treatise dealing with the system of taxation implemented in the Mauriyan empire in India – which among other things laid down that merchants pay tax at the rate of 20% on their business profits (about the same rate as currently imposed in Malaysia under the Income Tax Act 1967 (as amended) on small and medium enterprises on the first RM500,000!). Ref: http://incometaxindia.gov.in/HISTORY/PRE-1922.ASP.

3 All reference to sections in this article will be to the Malaysian Income Tax Act 1967 (as amended) unless and otherwise specified. Section 3 provides that 'Subject to and in accordance with this Act, a tax known as the income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia'.

4 The word 'attributable' has a number of cognate meanings, and is wider in meanings than 'derived from'. See Central Asbestos Co Ltd v Dodd [1972] 2 All ER 1135 (HL).

5 Under Section 12, so much of the gross income of a person from the business as is not attributable to operations of the business carried on outside Malaysia shall be deemed to be derived from Malaysia.

6 Taxation of e-commerce-UK. Ref: http://www.out-law.com/page-7512

7 Starting an Online Business in Singapore –Taxation. Ref: http://www.guidemesingapore.com/industryguides/ ecommerce.

8 The Institute of Chartered Accountants of India, 'The Taxation of E-commerce Transactions'. Ref: http://thefirm.moneycontrol.com/story_page.php?autono=814205.

9 Under Section 4, income is broadly classified as business, employment, dividends, interest, rent, royalties, pensions, annuities, and other gains or profits. And when issues arose as to whether a particular income is business income or royalty , a new Section 4A was introduced that focuses on the income of non-residents being income received for services rendered or provision of technical advice and assistance or for rent of movable property.

10 The withholding tax rate may vary based on the domestic legislation and the tax treaty in force with the relevant country.

11 In the case of a shrink-wrapped software (or pre-packed software), the contract would only grant the customer a license to use the software to a limited extent i.e. to use the software either on a single computer, or on a specified number of the customer's computers or network servers. The customer would not have the right to reproduce, make derivative programmes, modify or adapt the software programme or otherwise exploit the copyright in the software or make copies for distribution or display to the public. The payment for such shrink-wrapped software being a payment for a simple use, and being incidental to the process of acquiring, capturing and storing the digital signals (for which the payment is made) is regarded as a business income (and not subject to withholding tax). It would be different if the payment is for an acquisition of the right to use the copyright (in which case the payment would be treated as royalty and withholding tax would apply). Ref: Veerinder on Taxation (2nd Ed) CCH. pp. 1334-1335.

12 Some products for example, have a sealed back and if that is opened, any warranty that comes with the product may be void.

13 In the case of Indofood International Finance Ltd v JP Morgan Chase Bank [(2006) STC 1195] for example, Indofood International Finance Ltd was incorporated as a special purpose vehicle (SPV) in Mauritius as a subsidiary of an Indonesian public company to raise finance via JP Morgan in London in order to take advantage of the low withholding tax rate (10%) under the Indonesia-Mauritius DTA. The agreement for the finance provided for the British law to apply in case any disputes should arise. The Indonesia-Mauritius DTA was subsequently revoked, and a new SPV was then incorporated in the Netherlands to channel the finance to the Indonesian company through this new SPV. And when things went sour, the dispute was litigated in the UK court (and not in Indonesia, Mauritius or the Netherlands).

14 'Malaysia' is defined in Section 2 and the definition as existed before the year of assessment 1998 was amended in that year to be in line with the Exclusive Economic Zone Act of 1984 to include the offshore areas up to 200 nautical miles from the Malaysian coast and excludes Singapore from any reference to Malaysia.

15 Under Section 7(1)(a) for example, an individual can be resident in Malaysia if he is in Malaysia in the basis year for a period or periods amounting in all to 182 days or more.

16 Under the proviso to Section 15A (iii) gross income attributable to services which are performed outside Malaysia is not deemed to be derived from Malaysia, and therefore not liable to Malaysian income tax.

17 Income Tax Guide on E-commerce, Inland Revenue Authority of Singapore, 31 August 2000.

18 For a coverage of e-commerce in Hong Kong, see Veerinder on Taxation (2nd Ed) CCH. pp. 1333-1335.

19 Allison Hoven, E-commerce Sales Taxes in Focus.

20 ibid.

21 'Nexus' is the term used in relation to the American revenue law to determine if you have a "link" in a particular State. This nexus, unfortunately, is not clearly defined, and where defined, the definition is inconsistent and varied as among the different States of the United States. It can be brought into existence if a business employs anyone within a State or someone who physically enters a State to conduct business, if the business leases or owns any property in the State, or if the business participates in any trade shows that promote its products or service in the State. If an entity is determined to have a link or nexus to a State, then that entity would be subject to that State's Sales Tax and Use Tax Rules, and must collect and remit sales tax to the particular State. To make it even more complex, the definition of 'nexus' as far as sales tax is concerned is different from the definition of 'nexus' for State Income Tax or Franchise Tax purposes. Thus you may owe sales tax in a State in which you do not have to file a State Income Return, or a Franchise Tax Return. Ref: E-commerce Sales Tax 101. http://www.startupnation.com/business-articles/9080/1/ecommerce-salestax.htm.

22 The current tax system in the United States recognises over 30,000 tax jurisdictions. If purchases outside the borders of the United States are made, one has to factor international tax jurisdictions into the mix. Within the 30,000 tax jurisdictions, there are more than 7,000 separate state and local taxes that cover all goods and services. The sales tax burden from multiple tax jurisdictions could be very tedious and costly, and most merchants simply do not comply (merchants not complying is rarely prosecuted as prosecuting non-compliance is equally tedious and costly for the revenue authorities). In the State of California for example only 1.4% of online transactions in 2012 included the required sales tax.

23 The US Supreme Court ruling in Quill Corp v North Dakota [No. 91–194. Argued 22 January 1992—Decided 26 May 1992] required an online retailer to collect sales tax only if the retailer has a physical presence within that customer's state. Such physical presence would include a temporary or a permanent presence, property or people working in the state. The case also ruled that the imposition of the tax places an unconstitutional burden on interstate commerce of remote retailers. This part of the decision now forms the basis of an excuse conveniently used by merchants to avoid online tax. The case involves the respondent, North Dakota (one of the States in the US), through its Tax Commissioner, who filed an action in state court to require the petitioner Quill Corporation—an out-of-state mail-order house with neither outlets nor sales representatives in the North Dakota State—to collect and pay a use tax on goods purchased for use in the State. The trial court ruled in Quill's favour. Ref: http://venturebeat.com/2013/04/22/marketplace-fairness-act/.

24 Ibid.

25 See footnote 1.

26 For details of the guidelines, see IRB's Guidelines on Taxation of Electronic Commerce issued on 1 January 2013.

27 Karamjit Singh, Are Malaysians ready for e-commerce? Digital News Asia. 2 November 2012 : http://www.digitalnewsasia.com/sizzle-fizzle-slow-burn/are-malaysians-ready-for-e-commerce.

28 Karamjit Singh, Lelong Tan sees opportunity. http://www.digitalnewsasia.com/node/262.

International Issues

The column only covers selected developments from countries identified by the CTIM and relates to the period 16 November 2013 to 15 February 2014.

CHINA (PEOPLE'S REP.)

Place of effective management – amendment to the notice of 2009

The State Administration of Taxation (SAT) issued Gong Gao [2014] No. 9 on 29 January 2014 to amend the procedure for application of resident status on the basis of place of effective management by a foreign company established by a Chinese enterprise as provided for by Guo Shui Fa [2009] No. 82. Gong Gao [2014] No. 9 applies from 2013 onwards. Art. 2 of Guo Shui Fa [2009] No. 82 provides that a foreign company established by a Chinese enterprise is subject to enterprise income tax on its worldwide income in China and entitled to a tax exemption on dividends received from a resident enterprise if it is considered to have a place of effective management in China.

It further provides that a foreign company applying for resident status (based on the place of effective management) must apply to the competent tax authority of the place where the main investor of the foreign company is situated. After the primary examination and approval, the application must be submitted directly to the tax authority at the provincial level for approval. Once it is approved at the provincial level, the decision must be communicated to the SAT for publication on its website. Thus approvals are only required at the local competent tax authority and provincial levels and no longer at each tax authority level as was previously required. The announcement also clarifies that the dividends and other income from equity investment received from other resident enterprises after 1 January 2008 are exempt from EIT (Art. 26 of the Enterprise Income Tax Law (EITL)).

Large transfer pricing adjustment on service fee payments reported

A large transfer pricing adjustment on service fee payments was made by the state tax bureau of Xiamen city.

(a) Facts. A Fortune 500 company set up two subsidiaries in Xiamen city in 1998 and 2004 respectively. Since the implementation of the current EITL in 2008, the profit rates of both companies have been declining despite increasing sales proceeds. Accounting records showed that the decrease in profits was due to the huge cross-border service fees (amounting to CNY3.8 billion) paid to a related company in Singapore. According to its business structure, this Fortune 500 company allocated the global service costs to the Singapore company which operates as a global operating centre of the company, and the Singapore company in turn allocated the costs to the two Chinese companies. The Singapore company was eligible for the exemption of enterprise income tax.

(b) Investigation and ruling of the tax authority. The State Tax Bureau suspected that the profits have been shifted from China to Singapore and started investigation on the two Chinese companies in May 2010. During the investigation, the tax officials discovered:

- a note on a contract concluded between the headquarter of the Fortune 500 company and the related Singapore company. From the note, it could be concluded that the cost calculation in the cost allocation was based on the number of employees;
- the cost calculation in the cost allocation between the Singapore company and the two Chinese companies was based on the sale proceeds;
- the Singapore company has economic ownership of intangibles in respect of information technology system, research and development (R&D) and marketing while sharing the costs with the headquarter. However, the Chinese companies do not posses any ownership or enjoy any benefits while sharing higher costs with the Singapore company; and
- the Chinese companies paid the fees on the basis of the global costs allocated by the headquarter to the Singapore company, not the portion of the global costs to the Singapore company.

The tax authority took the view that there were inconsistencies in the transfer pricing method and policy, and adjustments of expenses on the business proposal, support of information technology system, R&D and marketing support must be made.

(c) Settlement. After four years of discussion and negotiation between tax intermediaries and the tax authorities, the companies have accepted the settlement of CNY800 million (including interest) and the tax bureau closed the case in December 2013. The international tax division of the SAT was involved in the settlement of the case and considered it as having set an example in combating tax avoidance schemes of multinational companies.

Indirect tax policy on export of retail products via e-commerce clarified

The Ministry of Finance (MoF) and the SAT issued Cai Shui [2013] No. 96

on 30 December 2013 concerning the indirect tax policy on export of retail products through e-commerce, which is effective from 1 January 2014 .

E-commerce export enterprises (EEE) are entitled to a refund of VAT and consumption tax on export (except goods expressly) provided that the following conditions are satisfied:

- an EEE must be a general taxpayer of VAT and recognised by the competent tax authority as an enterprise qualifying for export tax exemption or refund;
- the EEE has the export customs declaration form which is specially issued for tax refund for export, and the information stated in that form is consistent with the electronic information of the customs service;
- the payments for exported goods have been settled prior to the expiring date of filing the application for tax exemption or refund for that export transaction; and
- if the EEE is an enterprise with import and export rights (foreign trade enterprise), the enterprise has to present the special VAT invoices on the purchased goods, the consumption tax payment certificate, the certificate of VAT and consumption tax payments on imported goods, and the information contained in these documents must match with that contained in the export customs declaration form.

Where an EEE does not meet the conditions described above and is thus not entitled to a tax refund, a tax exemption may apply if the following conditions are satisfied:

- the EEE is registered with the competent tax authority as a taxpayer;
- the EEE has received the customs declaration form for exported goods issued by the customs service; and
- the EEE has in possession the lawful receipts on the purchase of exported goods.

The standard procedure for the application of tax exemption and refund for export equally applies to EEE.

Note. The notice merely applies to EEEs that carry on business through their own cross-border sale platforms or the cross-border sale platforms of third parties. Enterprises providing the cross-border sale platforms as a third party do not fall within the applicable scope of this notice.

◆◆ Special tax treatment of share transfer by non-resident enterprise

The SAT issued SAT Gong Gao [2013] No. 72 on 11 December 2013 concerning the special tax treatment of share transfer by a non-resident enterprise (NRE) and became effective on the same date.

The announcement deals with the special tax treatment referred to in the notice on restructuring of enterprises, Cai Shui [2009] No. 59, and the cases, as described in article 1 paragraphs 1 and 2 of Cai Shui [2009] No. 59 (including the transfers caused by a division or merger occurred outside China), in cases where:

- the shares in a resident enterprise (RE) are transferred by a NRE to a 100% owned non-resident subsidiary which do not alter the withholding tax implications, and the transferor guarantees not to dispose of these shares within three years; or
- the shares in a RE are transferred by a NRE to a 100% owned resident subsidiary.
- A NRE which intends to apply for the special tax treatment of its share transfer has to file the case with the tax authority by submitting the following information:
- filing form of the special tax treatment of share transfer by a NRE;
- general information on the share transfer including the commercial purposes of the transfer, evidence of fulfilment of the conditions of the special tax treatment, and the charts of the shareholdings before and after the transfer etc.;
- contract or agreement on share transfers;
- the approval documents of the industrial, commercial and other relevant department on the share transfer;
- information on undistributed profits of the transferred (Chinese) enterprise which are accumulated in each past year before the time of the share transfer; and
- other information requested by the tax authority.

In cases where the shares in a (Chinese) RE are transferred by a NRE to its 100% non-resident subsidiary, the tax authority is required to issue its opinion within 30 days of the filing by the taxpayer. The special tax treatment will not apply if the transfer may alter the withholding tax burden and the shares are transferred from a country with tax to a no tax or low tax country or jurisdiction. If the special tax treatment is denied by the tax authority, the share transfer will be taxable according to the normal provisions of the EITL.

In cases where the transfer is eligible for the special tax treatment, the transferor and transferee are not located in the same country or jurisdiction and, after the transfer, the undistributed profits of the transferred enterprise are distributed to the transferee, the treaty benefits on dividends contained in the tax treaty (or tax arrangement) between China and the country of the transferee do not apply. In this case, the transferred (Chinese) enterprise must withhold the enterprise income tax on the transfer. Finally, the announcement states that

Article 9 of Guo Shui Han [2009] No. 698 on indirect transfer ceases to apply.

Individual income tax on enterprise's annuity and occupational annuity clarified

The MoF, the Ministry of Human Resources and Social Security, and the SAT jointly issued a notice on taxation of enterprise's annuity and occupational annuity on 6 December 2013 (Cai Shui [2013] No. 103). The content of the notice is summarised below.

(i) ***Individual income tax exemption of the employer's contribution.*** Individuals are exempt from individual income tax in respect of employer's contributions to the enterprise's annuity scheme which are made to the individual account in accordance with the relevant regulations and standards of the state.

(ii) ***Deductibility of the contributions made by the employee.*** The contributions made by an individual employee in accordance with the relevant regulation and standard of the state are deductible from his or her taxable income in the current period if such contributions do not exceed 4% of the average wage or salary on the basis of which the contribution is calculated.

(iii) ***Investment income from enterprise's annuity.*** Investment income derived from enterprise's annuity is not subject to individual income tax when it is transferred to the individual account of the scheme.

(iv) ***Taxation of annuity.*** When the pension age is reached and the employee receives the annuity payment (after the effective date of this announcement), the lump-sum payment may be divided into monthly payments and taxed as wage or salary income on a monthly basis. The tax rates for the monthly taxable income and the monthly standard deduction for wages and salaries of individual income tax will apply.

In the case of emigration or death, the annuity can be withdrawn from the individual account at a time, divided into 12 and taxed on a monthly basis. In other cases, a lump-sum withdrawal is considered to be one monthly payment and will be taxed accordingly.

(v) ***Administration.*** The individual income tax must be withheld by the entity or person that manages the annuity fund. The enterprises establishing the enterprise's or occupational annuity must file it with the tax authority and the human resource/social security bureau within 15 days of the establishment.The notice is effective from 1 January 2014 and the notices Gao Shui Han [2009] No. 694 and SAT Gong Gao [2011] No. 9 will cease to apply on the same date.

INDIA

Transfer pricing safe harbour rules – Additional Directions issued

Pursuant to the Safe Harbour (SH) rules notified by the Central Board of Direct Taxes (CBDT) on 18 September 2013, the CBDT vide letter F.No.500/139/2012-FTD-I dated 20 December 2013 has issued directions for proper implementation of the SH Rules. The directions and clarifications are summarised below.

- All SH options in Form 3CEFA should be filed by 30 November 2013 and the Assessing Officers (AOs) should provide in writing to the CBDT the details of all the Form 3CEFA received by them.
- The AO should minutely examine the Form 3CEFA filed (including the eligibility of the taxpayer and the international transactions) and decide within two months from the end of the month in which the Form 3CEFA is filed, whether to accept the SH option or make a reference to the Transfer Pricing Officer (TPO).
- If the AO fails to make a decision within two months from the end of the month in which the Form 3CEFA is filed, the SH option will be considered as accepted and would remain valid for five years.
- For minor defects in the Form 3CEFA filed by the taxpayer, the AO will provide an opportunity to the taxpayer for rectification of any mistakes, however, under no circumstances may the statutory time limit of two months as explained above be extended.
- SH rules will not apply to eligible international transactions entered into with an Associated Enterprise located in notified jurisdiction (e.g. Cyprus)..
- Where the taxpayer has opted for the SH option but has reported rates or margins less than the SH rates or margins, the income is to be computed on the basis of SH rates or margins only.
- The AO or the TPO should not consider the SH rates or margins as benchmarks.
- Where the taxpayer has not opted for SH or the option is found to be invalid, and a regular transfer pricing audit is considered necessary, such transfer pricing audit should be carried out without regard to the SH rates or margins.

INDONESIA

Extension of 5% final tax on bonds interest income received by mutual funds

The government has decided to extend the implementation of the 5% final tax on interest from bonds received by mutual funds registered on Otoritas Jasa Keuangan (Financial Services Authority), following the issuance of Government Regulation No. 100 of 31

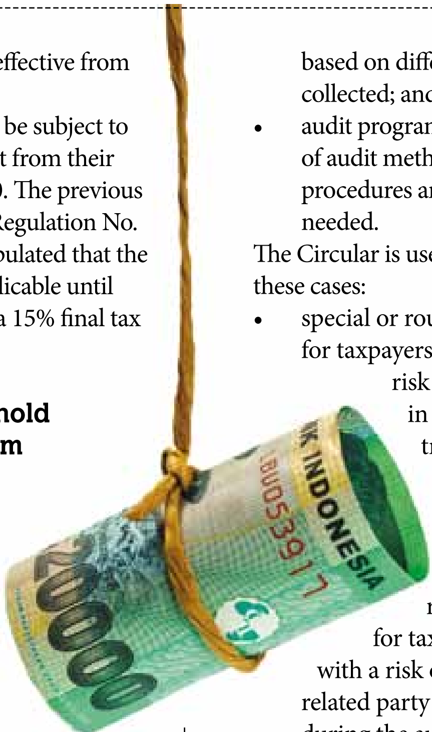
December 2013 which is effective from the issuance date.

The mutual funds will be subject to the 5% final tax on interest from their bonds portfolio until 2020. The previous regulation, Government Regulation No. 16 of 9 February 2009, stipulated that the 5% final tax would be applicable until 2013 and continued with a 15% final tax from 2014 onwards.

Higher VAT threshold for small and medium enterprises

MoF Regulation No. 197/PMK.03/2013, issued on 20 December 2013 and effective from 1 January 2014, increases the VAT threshold for small and medium enterprises to IDR4.8 billion (from IDR600 million), i.e. small and medium enterprises with annual turnover of below IDR4.8 billion are not taxable entrepreneurs for VAT purposes.

The increased threshold was issued in relation to a 1% final income tax on gross income below IDR4.8 billion.



Circular on Transfer Pricing Audit

The Directorate General of Taxation (DGT) has issued Circular No. SE-50/PJ/2013 (SE-50) dated 24 October 2013 as a technical audit guide for transfer pricing. The Circular is effective from the issuance date and revokes the previous Circular No. SE-04/PJ.7/1993 dated 9 March 1993.

Circular SE-50 corresponds to the previously issued DGT Regulation No. PER-23/PJ/2013 (PER-23) dated 11 June 2013 on the tax audit standard which stipulates the following before the tax audit:

- collecting and studying the taxpayer's data, e.g. taxpayer's profile, financial data, and other relevant data;
- audit plan designed by the supervisor of the audit team based on different issues already collected; and
- audit programme which consists of audit methods, techniques, procedures and documents needed.

The Circular is used for an audit in these cases:

- special or routine tax audit for taxpayers identified with a risk of tax avoidance in related party transactions found before the audit request was issued; and
- special or routine tax audit for taxpayers identified with a risk of tax avoidance in related party transactions found during the audit.

SE-50, in principle, is similar to the DGT Regulation No. PER-22/PJ/2013 dated 30 May 2013 regarding the guidance for transfer pricing audit .

The Circular provides further guidance on how the transfer pricing audit should be conducted:

Audit preparation

The tax auditor is required to perform the following steps:

- Review the disclosure of related party transactions from the annual corporate income tax return.
- Review the disclosure of related party transactions from the company's financial report.
- Further research on special relationships if there is any indication of tax avoidance. When the tax auditor finds that a special relationship exists, an analysis for the risk of tax avoidance has to be done, taking the following into consideration:
  - * significance of related party transactions, including interest expenses or gains/losses from the sales of assets and foreign exchange, to the overall sales or profit;
  - * related party transactions with entities located in low-tax jurisdictions;
  - * specific related party transactions, e.g. transfer of intangibles, royalty payment, intra-group services and interest payments;
  - * lower net profits compared to other companies in similar industries;
  - * non-routine related party transactions, e.g. business restructuring involving or not involving intangible property, and sales of intangible property; and
  - * taxpayer has suffered losses for several years.

Conducting the audit

During the audit, the tax auditor has to perform the following:

(a) Determination of taxpayer's business characteristics

- For industrial analysis, the tax auditor may use external reports from industry research reports, financial reports of main public companies in the industry, statistics reports and also transfer pricing documentation. Reports of industry performance can be used to check any increase or reduction of the overall market.
- Schemes of related party transactions and supply chain analyses have to be made since it is needed to understand the risk of tax avoidance and how the multinational company performs its business and functions.
- An analysis of functions, assets and risks (FAR) is needed. The tax auditor has to consider the significant functions of the taxpayer, prepare the list of

interview questions, make field observations and ensure that the functions given by related parties have been performed.

- The tax auditor needs to check the existing manufacturing intangibles and marketing intangibles.
- A FAR analysis is used to determine the taxpayer's business characteristics, e.g. as a fully fledged entity or a limited risk entity.

(b) Choosing the transfer pricing method

- The availability of comparables should be identified for both internal and external comparables.
- In choosing the most appropriate transfer pricing method, the following should be considered:
  * the strength and weakness of each method;
  * the compatibility of the transfer pricing method based on the FAR analysis;
  * the availability of reliable information; and
  * comparability factors including comparability adjustment.

(c) Applying the arm's length principle

For sales or purchases of goods or services, it is compulsory for the tax auditor to perform a comparability analysis and consider a reasonably accurate adjustment to determine the most appropriate transfer pricing method.

- In regards to the Transactional Net Margin Method (TNMM), the profit level indicator used should be the most suitable based on facts and conditions which may include the commonly used profit level indicators,i.e. net margin, net mark-up and return on assets (ROA) in which the total operating assets for ROA

includes fixed assets, intangible assets and working capital assets but excludes investments and cash for a non-financial company.

- For intra-group services, the tax auditor has to check if the service has been provided and gives economic benefits, e.g. ensuring that the services are not shareholder activities, duplicative services, incidental benefits, passive association or on-call services. The arm's length charge of the service must also be calculated and how the charge is calculated should be indicated, e.g. basis of the calculation and charging method (direct or indirect).
- Concerning interest payments to related parties, among other things, the tax auditor has to calculate the interest coverage ratio which is needed to understand the taxpayer's ability to pay interest.
- Other than the above, the following should be taken into account by the tax auditor when performing an audit:
- The taxpayer may use transfer pricing documentation to show the arm's length principle and further requests of information can be adjusted based on the information already delivered accordingly.
- For information clarification for international related party transactions, the tax auditor may request for an exchange of information from the tax treaty partner.
- Regarding domestic related party transactions, e.g. domestic companies and permanent establishments, it is compulsory to confirm the type and value of the related party transaction from the other tax office where the related party is registered.
- Several tests have to be performed and disclosed in the working paper using the attached format from the circular, i.e. the test of arm's length principle, related parties,industrial analysis, related party transactions, supply chain analyses, analysis of FAR, business characteristics of the taxpayer, identification of the availability of comparables, transfer pricing method, comparability analysis and calculation of arm's length price/profit.
- Documents required from the taxpayer will include not only tax returns, financial reports, contracts of purchase/sales, taxpayer's organisational chart, royalty agreements, export/import documents or transfer pricing documentation etc., but also may include the global pricing policy, segmented financial reports and organisational charts or financial reports from the trader/ supplier/ agent/ intermediary party that sold the raw material to the taxpayer or from the one who purchased the taxpayer's product.

THAILAND

Individual tax rates for 2013 and 2014

On 23 December 2013, Royal Decree No. 575 was published and thereby enacted the proposed reduction of individual tax rates for the fiscal years

2013 and 2014. The progressive rates now range 5% to 35%.

VIETNAM

Advanced Pricing Agreement Guidelines – details

Following the introduction of the Advanced Pricing Agreement (APA) regime under the Amended Tax Administration Law, Amended Corporate Income Tax Law and Decree 83/2013/ND-CP dated 22 July 2013, the MoF has issued Circular 201/2013/TT-BTC dated 20 December 2013 providing detailed guidance on APAs (Circular 201) which will be effective from 5 February 2014.

Scope of application

An APA is available to Vietnamese corporate income taxpayers with related-party business transactions. There is no restriction on the taxpayer in terms of the size of business (such as minimum revenue or capital thresholds) and it appears that an APA may apply to both domestic and international transactions.

The APA may be unilateral/bilateral/multilateral in nature and is based on the following principles: (i) voluntary request by taxpayer; (ii) cooperative discussion and conclusion between the tax authority, taxpayers and/or relevant treaty partners; (iii) the prospective application; and (iv) is focused on predetermined related-party transactions only.

APA process

The APA process consists of five main steps as follows: pre-filing consultation, formal application, evaluation, discussion and negotiation and conclusion and circulation. The GDT is responsible for the overall process with assistance from the provincial tax departments in negotiating, organising and implementing the APA application, whilst the MoF is responsible for the APA framework itself. There is no fee for an APA application.

Post-approval

An APA will be effective for no more than five years with the date of submission of the APA request being the earliest date possible. An APA can be renewed but for no more than another five years and if there are no material changes to the transaction(s) to which the APA applied.

Throughout the tenure of the APA, the taxpayer is required to submit an annual report together with its CIT return. If there are any material changes which may impact the APA, the taxpayer is required to submit an ad-hoc report within 30 days of the changing event. The taxpayer is also responsible for making the necessary adjustments, in line with the agreed APA, throughout the APA period.

Others

- Information confidentiality is to be observed by all parties and any information/documentation provided during the APA application process shall not be used for other purposes, such as audits, investigations, etc.
- Taxpayers seeking application of a bilateral or multilateral MAP can submit a MAP request. The GDT will contact the competent tax authority within 30 days of the request and will inform the taxpayer of the corresponding response within 15 days of the receipt of the same.

Decree on tax penalties

Decree 129/2013/ND-CP, which is effective from 15 December 2013, revises the tax administrative rules on penalties for administrative violations. The key amendments are summarised below.

(i) Statute of limitations (SOL). The SOLs for procedural offences and for underpayment of tax remain unchanged at two years and five years respectively. Decree 129, however, clarifies that the SOL runs from the date the offence is committed which (for the two preceding situations) is defined as the day after the applicable tax filing date or the date the tax refund is issued.

Further, Decree 120 provides that the SOL applicable for the collection of outstanding taxes is 10 years from the date the violation is detected. There is no SOL in respect of unregistered taxpayers with outstanding tax liabilities due.

(ii) Penalties. The maximum penalty for procedural violations has doubled as follows: (i) VND 200 million if the taxpayer is a business entity; or (ii) VND 100 million if the taxpayer is an individual.

Underpayment of taxes or excessive tax refund claims will be subject to a tax penalty of 20% of the actual tax due. The penalty for tax evasion (100%-300% of tax evaded) remains unchanged.

The penalty on late payment of taxes is replaced by a late payment interest of 0.05% per day for the first 90 days and 0.07% thereafter. The SOL on the interest due is 10 years.

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

Technical Updates

The technical updates published here are summarised from the selected government gazette notifications published between 16 November 2013 and 15 February 2014 including Public Rulings and guidelines issued by the Inland Revenue Board (IRB), the Royal Customs Department and other regulatory authorities.

INCOME TAX

Income Tax (Deduction for Cash Contribution to Bantuan Pelajar Miskin 1Malaysia Fund) Rules 2013

Income Tax (Deduction for Cash Contribution to Bantuan Pelajar Miskin 1Malaysia Fund) Rules 2013 [P.U.(A) 340] gazetted on 15 November 2013, are deemed to have come into effect from the year of assessment (YA) 2012 until YA 2017. The Rules provide a double deduction to a qualifying person on cash contributions paid to the Bantuan Pelajar Miskin 1Malaysia Fund, a fund under the Tabung Pendidikan Tinggi Nasional, administratively created by the Perbadanan Tabung Pendidikan Tinggi Nasional.

Income Tax (Deduction from Remuneration) (Amendment) Rules 2014

Income Tax (Deduction from Remuneration) (Amendment) Rules 2014 [P.U. (A) 35] gazetted on 30 January 2014 amended the Income Tax (Deduction from Remuneration) Rules 1994 and took effect from 1 January 2014. The Income Tax (Deduction from Remuneration) Rules 1994 were issued pursuant to Section 107(2) of the Income Tax Act 1967 (ITA). The Rules provide that the employer must determine and make monthly tax deductions (MTD) from the employees' salaries based on either the schedule or the computerised calculation method. The schedule is issued to employers who do not use computerised payroll software. Employers who use computerised software, on the other hand, can adopt the computerised calculation method.

Income Tax (Exemption) (No. 14) Order 2013

Income Tax (Exemption) (No. 14) Order 2013 [P.U.(A) 361] gazetted on 19 December 2013, legislates the 2014 Budget proposal to provide a special relief to middle-income taxpayers. The Exemption Order exempts from tax chargeable income of RM2,000 of resident individual taxpayers earning an aggregate income of up to RM96,000 for YA 2013. This is a one-off special relief in recognition of the financial burden faced by the middle-income taxpayers.

Finance Act 2014

The Finance Act 2014, incorporating changes proposed in 2014 Budget , was gazetted on 23 January 2014. This Act adopts all the changes proposed in the Finance (No. 2) Bill 2013.

Public Ruling No. 11/2013: Pre-operational business expenditure

Public Ruling (PR) No. 11/2013 issued on 18 November 2013 replaces PR No. 2/2010 dated 3 June 2010 and provides an explanation on the deductibility of certain expenditure incurred prior to the commencement of a business.

Public Ruling No.12/2013: Rescuing contractors and developers

PR No. 12/2013 issued on 17 December 2013 provides an explanation on the tax treatment of a rescuing contractor or developer appointed to revive an abandoned project certified by the Minister of Urban Wellbeing, Housing and Local Government.

Public Ruling No. 1/2014 - WHT on special classes of income

PR No. 1/2014, issued on 23

January 2014, provides guidance on the special classes of income that are chargeable to tax under Section 4A of the ITA, deduction of WHT on the special classes of income and the consequences of non-compliance with the WHT rules. The PR consolidates and replaces PR No. 4/2005 dated 12 September 2005 and its accompanying addendums i.e. addendum dated 30 November 2007 and second addendum dated 4 January 2010.

2014 income tax return filing programme

The IRB has recently made available on its website, the 2014 income tax return filing programme (ITRF). Where a grace period is given, submissions shall be deemed to have been received by the stipulated due date if received within the grace period. Settlement of balance of tax payable under Section 103(1) also applies to the grace period. Where the ITRF/balance of tax payable is not furnished within the grace period, penalty can be imposed based on the due date i.e. the original due date.

REAL PROPERTY GAINS TAX

Real Property Gains Tax (Exemption) (Revocation) Order 2013

Real Property Gains Tax (Exemption) (Revocation) Order 2013 [P.U.(A) 369] gazetted on 24 December 2013 revoked the Real Property Gains Tax (Exemption) Order 2012, which effectively provided the real property gains tax (RPGT) rates with effect from 1 January 2013 for all taxpayers. The Revocation Order takes effect from 1 January 2014 and new RPGT rates as proposed in 2014 Budget , are effective from 1 January 2014.

STAMP DUTY

Stamp Duty (Exemption) Order 2014

Stamp Duty (Exemption) Order 2014 [P.U.(A) 16], gazetted on 13 January 2014, provides a stamp duty exemption on any loan agreement or financing under *Syariah* principles, which is chargeable with duty under item 27(a)(i) of the First Schedule of the Stamp Act 1949. The instrument must, however, be executed on or after 1 January 2013 but not later than 31 December 2014. Further, the instrument must be executed between small and medium enterprises (SMEs) approved under the "Green Lane Policy" and the specified financial institutions in the exemption order, i.e. Bank Pertanian Malaysia Berhad, Malaysian Industrial Development Finance Berhad (MIDF) or Malaysia Debt Ventures Berhad (MDV).

LABUAN

Guidelines on the Establishment of Labuan Protected Cell Companies (Labuan PCC)

The Labuan Financial Services Authority (Labuan FSA), vide a letter dated 11 December 2013 addressed to the Chairman of the Association of Labuan Trust Companies, Labuan Banks, Labuan International Insurance Association and Labuan Investment Banks Group, has issued guidelines on the Labuan PCC that came into effect on 1 January 2014. The guidelines were issued to clarify the procedures and regulatory requirements for the establishment of a Labuan PCC in the Labuan International Business and Financial Centre (Labuan IBFC).

Guidelines on the Establishment of Labuan

Securities Licensee including Islamic Securities Licensee

The Labuan FSA has issued guidelines on the Labuan securities licensee including Islamic securities licensee that came into effect on 1 January 2014. The guidelines have been issued to clarify the application procedure and the operational and regulatory requirements for a Labuan securities licensee, including Islamic securities, in the Labuan IBFC.

CUSTOMS AND EXCISE DUTIES

◆◆ 2013 RMC Compliance Audit Framework

The Royal Malaysian Customs (RMC) has issued a compliance audit framework dated November 2013. The framework explains the nature and reasons for a compliance audit by the RMC as well as the scope, duration and conduct of the audit. The framework also highlights the relevant legislations to which the audit framework applies: the Customs Act 1967, the Sales Tax Act 1972, the Service Tax Act 1975, the Excise Act 1976, the Windfall Profit Levy Act 1998 and the Free Zones Act 1990.

◆◆ Customs (Prohibition of Imports) (Amendment) (No.3) Order 2013 Customs Act 1967 [P.U. (A) 341/2013]

Effective 31 January 2014, "Construction products" is listed as Item 10 in Part II of the Fourth Schedule to the Customs (Prohibition of Imports) Order 2012 [P.U. (A) 490/2012]. Importation of such goods must be accompanied by a certificate of approval or a letter of exemption issued by or on behalf of the Chief Executive Officer of the Construction Industry Development Board (CIDB).

Please refer to P.U (A) 341/2013 for details.

◆◆ Customs (Prohibition of Imports) (Amendment) (No. 4) Order 2013 Customs Act 1967 [P.U. (A) 353/2013]

Effective 15 January 2014, "Ceramic tableware and kitchenware" is listed in Part I of the Third Schedule to the Customs (Prohibition of Imports) Order 2012 [P.U. (A) 490/2012]. Importation of such goods is subject to the approval of the Food and Safety and Quality Division of the Ministry of Health.

Please refer to P.U (A) 353/2013 for details.

◆◆ Customs (Values of Imported Completely Built-Up Motor Vehicles) (New) (Amendment) (No. 2) Order 2013 Customs Act 1967 [P.U. (A) 355/2013]

The Customs (Values of Imported Completely Built-Up Motor Vehicles) (New) (Amendment) (No. 2) Order 2013 was gazetted on 12 December 2013 and came into effect on the same day. The Order amended the Schedule to the Customs (Values of Imported Completely Built-Up Motor Vehicles) (New) Order 2006 [P.U. (A) 108/2006].

Please refer to P.U (A) 355/2013 for details.

◆◆ Customs (Values of Imported Completely Built-Up Motor Vehicles) (Used) Order 2013 Customs Act 1967 [P.U. (A) 356/2013]

Effective 12 December 2013, the Customs (Values of Imported Completely Built-Up Motor Vehicles) (Used) Order 2013 revoked the Customs (Values of Imported Completely Built-Up Motor Vehicles) (Used) Order 2011 [P.U. (A) 315/2011]. For the purpose of levying and payment of customs duties, the Order listed out the value of dutiable imported completely built-up motor vehicles (used) as specified in the Schedule. The Order is applicable to completely built-up motor vehicles (used) (not inclusive of motorcycles) imported by open AP holders.

Please refer to P.U (A) 356/2013 for details.

◆◆ Customs (Prohibition of Imports) (Amendment) (No. 5) Order 2013 Customs Act 1967 [P.U. (A)

360/2013]

Effective 1 January 2014, "Bars and rods, hot rolled, in irregularly wound coils, of other alloy steels" is listed in Part I of the Second Schedule to the Customs (Prohibition of Imports) Order 2012 [P.U. (A) 490/2012]. Importation of such goods must be accompanied by an import licence from the Ministry of International Trade and Industry.

Please refer to P.U (A) 360/2013 for details.

Customs Duties (Exemption) Order 2013 Customs Act 1967 [P.U. (A) 371/2013]

Effective 1 January 2014, the Customs Duties (Exemption) Order 2013 revoked the Customs Duties (Exemption) Order 1988 [P.U. (A) 410/1987]. The Order provides that specified persons are exempted from the payment of customs duty on certain goods subject to conditions specified in the Schedule.

Please refer to P.U (A) 371/2013 for details.

Customs Duties (Goods under the Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area) Order 2013 Customs Act 1967 [P.U. (A) 378/2013]

Effective 1 January 2014, the Customs Duties (Goods under the Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area) Order 2013 revoked the Customs Duties (Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area) Order 2009 [P.U. (A) 484/2009]. The Order provides that instead of paying full import duty imposed under the Customs Duties Order 2012 [P.U. (A) 275/2012], the importer can pay import duty at the rate specified in the Second Schedule in respect of a particular class of goods provided that the Director-General is satisfied that the goods have originated from ASEAN Member States, Australia or New Zealand. The Order also provides that goods imported for non-commercial use will be taxed at a flat rate of 30%.

Please refer to P.U (A) 378/2013 for details.

Customs Duties (Goods of ASEAN Countries Origin) (ASEAN Harmonised Tariff Nomenclature and ASEAN Trade in Goods Agreement) (Amendment) Order 2013 Customs Act 1967 [P.U. (A) 380/2013]

The Customs Duties (Goods of ASEAN Countries Origin) (ASEAN Harmonised Tariff Nomenclature and ASEAN Trade in Goods Agreement) (Amendment) Order 2013 came into operation on 1 January 2014. The Order amended the Customs Duties (Goods of ASEAN Countries Origin) (ASEAN Harmonised Tariff Nomenclature and ASEAN Trade in Goods Agreement) Order 2012 [P.U. (A) 277/2012].

Please refer to P.U (A) 380/2013 for details.

Customs Duties (Goods under the Framework Agreement on Comprehensive Economic Co-operation among the Government of the Member Countries of the Association of Southeast Asian Nations and the Republic of Korea)

(Amendment) Order 2013 Customs Act 1967 [P.U. (A) 381/2013]

The Customs Duties (Goods under the Framework Agreement on Comprehensive Economic Co-operation among the Government of the Member Countries of the Association of Southeast Asian Nations and the Republic of Korea) (Amendment) Order 2013 came into operation on 1 January 2014. The Order amended the Schedule to the Customs Duties (Goods under the Framework Agreement on Comprehensive Economic Co-operation among the Government of the Member Countries of the Association of Southeast Asian Nations and the Republic of Korea Order 2007 [P.U. (A) 209/2007].

Please refer to P.U (A) 381/2013 for details.

Customs (Prohibition of Exports) (Amendment) (No. 3) Order 2013 Customs Act 1967 [P.U. (A) 386/2013]

Effective 1 January 2014, "Hydrochlorofluorocarbons gas" is listed in the Second Schedule to the Customs (Prohibition of Exports) Order 2012 [P.U. (A) 491/2012].

Exportation of such goods must be accompanied by an export licence from the Department of Environment.

Please refer to P.U (A) 386/2013 for details

Customs (Prohibition of Imports) (Amendment) Order 2014 Customs Act 1967 [P.U. (A) 18/2014]

Effective 27 January 2014, "All kinds of special tables for casinos including their apparatus, whether or not mechanical or electronic, and their components, accessories and parts thereof and casino chips" and "Equipment for keno games including its components, accessories and part thereof" are listed in the Third Schedule to the Customs (Prohibition of Imports) Order 2012 [P.U. (A) 490/2012]. Importation of such goods must be accompanied by a letter of approval from the Ministry of Finance.

Please refer to P.U (A) 18/2014 for details.

Customs (Prohibition of Removal) Order 2014 Customs Act 1967 [P.U. (A) 20/2014]

Effective 27 January 2014, the Customs (Prohibition of Removal) Order 2014 revoked the Customs (Restriction of Movements) Order 2000 [P.U. (A) 476/2000]. The Order provides that the removal of goods specified in the First Schedule and Second Schedule between Peninsular Malaysia, Sabah and Sarawak is prohibited unless permitted by the Director-General of Customs or the relevant authority.

Please refer to P.U (A) 20/2014 for details.

Customs (Anti-Dumping Duties) (No. 3) Order 2013 Countervailing and Anti-Dumping Duties Act 1993 and Customs Act 1967 [P.U. (A) 339/2013]

Effective 16 November 2013 to 15 November 2018, importers are required to pay anti-dumping duties in respect of "Electrolytic Tinplate" specified in the Schedule exported from the Republic of Korea and the People's Republic of China into Malaysia by the exporters or producers specified in the Schedule. The imposition of anti-dumping duties shall be without prejudice to the imposition and collection of import duties under the Customs Act 1967 and sales tax under the Sales Tax Act 1972 [Act 64].

Please refer to P.U (A) 339/2013 for details.

Customs (Provisional Anti-Dumping Duties) (No. 2) Order 2013
Countervailing and Anti-Dumping Duties Act 1993 and

Customs Act 1967 [P.U. (A) 349/2013]

Effective 30 November 2013 to 29 March 2014, importers are required to pay provisional anti-dumping duties in respect of "Cellulose fibre reinforced cement flat and pattern sheets" specified in the Schedule exported from Thailand into Malaysia by the exporters or producers specified in the Schedule. The provisional anti-dumping duties levied under the Order shall be guaranteed by a security equal to the amount of duties levied.

Please refer to P.U (A) 349/2013 for details.

Customs (Anti-Dumping Duties) (No. 4) Order 2013 Countervailing and Anti-Dumping Duties Act 1993 and Customs Act 1967 [P.U. (A) 390/2013]

Effective 5 January 2014 to 4 January 2019, importers are required to pay anti-dumping duties in cash in respect of "Seven wires pre-stressed concrete strand and specifically excluding Polyethylene Grease Coated PC Strand, Galvanised Steel Wire, Galvanised PC Strand, Indented PC Strand, PC Strand with Spiral Ribs, ropes and cables" specified in the Schedule exported from the People's Republic of China into Malaysia by the specified exporters or producers. The imposition of anti-dumping duties shall be without prejudice to the imposition and collection of import duties under the Customs Act 1967 and sales tax under the Sales Tax Act 1972 [Act 64].

Please refer to P.U (A) 390/2013 for details.

Sales Tax (Exemption) Order 2013 Sales Tax Act 1972 [P.U. (A) 376/2013]

Effective 1 January 2014, the Sales Tax (Exemption) Order 2013 revoked the Sales Tax (Exemption) Order 2008 [P.U. (A) 91/2008]. The Order listed out the goods exempted from sales tax in Schedule A and also provides a list of persons who are exempted from payment of sales tax on goods specified in Schedule B and C subject to conditions specified.

Please refer to P.U (A) 376/2013 for details.

Sales Tax (Rates of Tax No. 2) (Amendment) Order 2013 Sales Tax Act 1972 [P.U. (A) 377/2013]

Effective 1 January 2014, the Sales Tax (Rates of Tax No. 2) (Amendment) Order 2013 amended paragraph 2 of the Sales Tax (Rates of Tax No. 2) Order 2012 [P.U. (A) 355/2012] by deleting subparagraph 2(a) and the particulars relating to it. The Order also amended Sales Tax (Rates of Tax No. 2) Order 2012 by deleting the First Schedule and the particulars relating to it.

Please refer to P.U (A) 377/2013 for details.

Excise Duties (Exemption) Order 2013 Excise Act 1976 [P.U. (A) 379/2013]

Effective 1 January 2014, the Excise Duties (Exemption) Order 2013 revoked the Excise Duties (Exemption) Order 1977 [P.U. (A) 151/1977]. The Order provides that specified persons are exempted from the payment of excise duty on certain goods subject to conditions specified in the Schedule.

Please refer to P.U (A) 379/2013 for details.

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

UK VAT TRIBUNAL / COURT DECISIONS

CASE

GST RETURNS PREPARED WITH DUE CARE - APPROPRIATE TECHNOLOGY LTD [1991] BVC 571 ***(VAT Tribunal, United Kingdom)***

FACTS

The taxpayer company distributed approximately one-third of its computer hardware abroad. In April 1990, an unusually large repayment claim was made by the taxpayer company. Following an audit, a Customs officer discovered that a large number of invoices for supplies made to the taxpayer company in May had been included in the April return in the claim for input tax. As a result of the misdeclaration, the Customs assessed the taxpayer company to a penalty. The taxpayer company appealed, contending that it had a reasonable excuse.

Two years prior to the assessment, the taxpayer company had installed a computerised accounting system to record its sales. The system operated effectively and had no record of inaccuracies in its returns. The sales system included a 'date check' facility, so that invoices relating to supplies made in the later month were separated and recorded in a different file.

Subsequently, a similar system was incorporated for the taxpayer company's purchases. This was brought into service on 1 April 1990. At the beginning of May 1990, the accounts manager went on study leave, returning on 16 May 1990. At around the same time, his assistant was unexpectedly taken ill and returned on 23 May 1990. This resulted in a big backlog of work which needed to be done as the accounts department had been operating without the manager and his assistant. The VAT return for April was prepared and sent off using printouts from the computer. The manager and his assistant assumed that there was a 'date check' incorporated in the new purchase module as in the sales module, therefore, the 80 pages of figures were not checked. Unfortunately, the computer did not have a 'date check' facility for purchases, which resulted in some of the May figures being included in the April return.

ISSUE

Whether the taxpayer company had a reasonable excuse for a serious misdeclaration caused by a computer error which led to the overstatement of its entitlement to input tax in its return form?

DECISION

The taxpayer company submitted that the fault in the computer was unforeseen and its detection was inhibited by the absence of the manager and the illness of his assistant.

The Customs contended that reliance on the computer was no excuse and that the absence of the manager and his assistant was for only part of the month of May. The manager should have tested the equipment before using it.

The VAT Tribunal, in allowing the taxpayer company's appeal, held as follows:

(a) The question was whether the grounds on which the taxpayer company said it should be excused can be accepted as 'reasonable grounds'? In determining what amounts to 'reasonable grounds', the VAT Tribunal observed that the test is an objective one where:

"Reasonableness is not an absolute concept, and there is no scientific way of saying whether any excuse is reasonable or not. It must in the end be a matter of human judgement, having regard to, and weighing all the circumstances of each particular case ..."

(b) The VAT Tribunal found that there was a difference in degree between what amounted to a reasonable excuse in default surcharge cases and what amounted to reasonable excuse in serious misdeclaration cases. In the former, the act or omission which triggers the surcharge is one which the taxpayer must be aware he has committed. In the latter, the act which triggers the penalty may be committed without the taxpayer being aware that it has occurred.

(c) In asking the question *'would a reasonably conscientious businessman who knew all the facts consider that the appellant had acted with due care in the preparation of its return?'*, the VAT Tribunal found that it was reasonable that the accounts manager and his assistant should assume that the new part of the computer system would also have a 'date check'.

(d) The VAT Tribunal recognised that there was a great deal of work for the manager, who had just returned from study leave, and his assistant, who had had a period of sickness. The repayment claim was large, but this did not appear to be out of the ordinary for the manager as the taxpayer company had been making a large number of export sales at the material time.

(e) The VAT Tribunal further found that it would have been easy to check through the printout, but the manager had no reason to suspect the error that had occurred, nor was it unreasonable not to have done so, as the manager and his assistant were under pressure as a result of their absence.

(f) It was thus held that this, being an unforeseen error being made entirely innocently and the circumstances were such that the detection of the error was inhibited, the taxpayer company had acted with due care and had a reasonable excuse.

CASE

CLERICAL ERROR - THE CLEAN CAR CO LTD [1991] BVC 568
(VAT Tribunal, United Kingdom)

FACTS

The taxpayer company owned two sites on which it carried on the business of cleaning and washing cars, one of which had recently been constructed at a cost of £250,000. It was a term of the taxpayer company's contract with the builder that payment for the building work was to be made in stages, more specifically within 14 days of the receipt of each architect's certificate.

The second interim certificate issued by the architect was dated 29 June 1990 in the sum of £105,100 and received by the taxpayer company on 3 July 1990. No invoice had been received from the contractor but the managing director of the taxpayer company paid to the contractor on 6 July 1990 the amount shown on the architect's certificate. The managing director worked out the amount of VAT chargeable and paid the total plus VAT to the contractors on 6 July 1990. The actual invoice issued by the contractor was only received by the taxpayer company on 8 July. On 6 July 1990, the managing director completed the taxpayer company's VAT return for the period to 30 June 1990 and included in that return £15,765 as input tax for which credit was claimed. As the contractors were not in fact paid by 30 June 1990, the supply on which input tax had been charged could not be treated as having taken place by the end of June. The tax on those supplies only became chargeable on 2 July 1990 when the contractors issued the tax invoice. It followed from the relevant VAT regulation that the taxpayer company should have claimed credit for the input tax in its return for the period that included July. By claiming in the return for the period to the end of June, the taxpayer company had overstated its entitlement to credit for input tax for that period. A Customs officer noticed the error and assessed the taxpayer company to a penalty, being 30 per cent of the overstatement of input tax.

ISSUE

Whether the taxpayer company had a reasonable excuse for claiming credit for input tax in the period before the invoice was received?

DECISION

The managing director accepted the facts, but submitted that he had a reasonable excuse for the mistake. In March 1990, his daughter had had a bone marrow transplant and came out of hospital in July 1990. As a result, the managing director could not give the time he usually gave to office business. He knew that all the work for which he had to pay had been completed before the end of June, was anxious to pay promptly and did so before the tax invoice arrived. The VAT Tribunal found that the invoice was dated 2 July 1990 but could easily have borne a date in June. The managing director realised that normally a tax invoice was required when claiming input tax, but was not sure whether that applied when payment was required on an architect's certificate.

The Customs contended that it was not reasonable for the taxpayer company to have believed that when the managing director filled in the return he was not doing something he was not entitled to do. This is because he knew that to claim input tax, he had to possess a tax invoice for the appropriate period. However, he did not have a tax invoice at that point in time.

The VAT Tribunal observed Section 14(6) of the Finance Act 1985 which stated that a conduct:

"Shall not give rise to liability to a penalty … if

(a) the person concerned satisfies the Commissioners or, on appeal, a value added tax tribunal that there is a reasonable excuse for the conduct"

The VAT Tribunal further observed that Parliament in passing this legislation must have intended that the question of whether a particular trader had a reasonable excuse should be judged by the standards of reasonableness exhibited by a taxpayer who has a responsible attitude to his duties as a taxpayer and relevant to the situation being considered. Thus, though such a taxpayer would give a reasonable priority to complying with his duties in regard to tax and would conscientiously seek to ensure that his returns were accurate and made timeously, the VAT Tribunal held that a taxpayer's age and experience, his health or the incidence of some particular difficulty or misfortune may all have a bearing on whether, in acting as he did, he acted reasonably and so had a reasonable excuse.

Bearing in mind the strain of the managing director's daughter's illness and the limitation on the time he was able to devote to his business duties, and the fact that he was not in the building industry and was unfamiliar with building contracts and the special rules that applied to these contracts by the relevant VAT Regulations (which had the effect of altering the normal rule that the time when a supply was said to take place was when it was performed), the VAT Tribunal found that it was not unreasonable for the managing director to include the claim for input tax in the taxpayer company's return for the period to the end of June. The taxpayer's appeal was thus allowed.

CASE

PAYMENT OF TAX PRIOR TO AN APPEAL - HAPPER V COMMISSIONERS OF CUSTOMS AND EXCISE (1982) 1 BVC 497
(High Court, United Kingdom)

FACTS

The taxpayer was a self-employed driving instructor who had been registered for VAT purposes between 1973 and 1978. He had made returns during that period showing VAT liability of £4,542.79. Subsequently, he discovered that it was possible that he was not required to be registered for VAT purposes. He then cancelled his VAT registration and did not pay the outstanding VAT of £1,341.16. The taxpayer was of the view that none of the £4,542.79 shown on the returns was in fact payable.

When the appeal went before the VAT Tribunal, the VAT Tribunal concluded that it did not have jurisdiction to hear the matter because Section 40(2) of the Finance Act 1972 provided that *no appeal shall be entertained unless the appellant has made all the returns which he was required to make and has paid the amounts shown in those returns as payable by him.* In this case, all the tax shown as payable had not been paid.

Section 40(3) of the Finance Act 1972 allowed the VAT Tribunal to hear an appeal, notwithstanding that the tax has not been paid, if the appeal relates to an assessment to tax or to the tax chargeable on the supply of any goods or services. The VAT Tribunal indicated that it would be willing to hold that the decision in issue related to the tax chargeable on the supply of goods and services and to consider favourably the question of hardship, except that it considered it was prevented from doing so by the operation of Section 40(2) of the Finance Act 1972.

ISSUE

The issue is essentially a point of construction on whether an appeal before the VAT Tribunal could not be heard because all the tax shown on the returns made by the taxpayer had not been paid?

DECISION

In a judicial review application before the High Court, the Customs contended that there was no specific indication that Section 40(2) of the Finance Act 1972 was to be read as being subsidiary to Section 40(3) of the Finance Act 1972. Read literally, Section 40(2) prevented the VAT Tribunal from entertaining the appeal.

It was contended by the taxpayer that such a result led to a hardship, and it was submitted that Section 40(3) should be given priority to overcome the ambiguity which arises when the section is read as a whole.

The High Court, in allowing the application in favour of the taxpayer, held that when reading the section as a whole, the two sub-sections as drafted created an intrinsic ambiguity. The High Court held that sense can be made of the section if the two sub-sections were read together, with priority being given to Section 40(3). The High Court further held that the Chairman of the VAT Tribunal erred in ruling that that VAT Tribunal was barred by Section 40(2) from entertaining the taxpayer's appeal, as the taxpayer would have suffered hardship had the appeal not been entertained.

CASE

PERSONS WHO MAY APPEAL - WILLIAMS & GLYN'S BANK LTD (1974) 1 BVC 1021
(VAT Tribunal, United Kingdom)

FACTS

The taxpayer company carried on its business as a bank and entered into a contract with a carrier providing for the carriage of 'secured packaged' containing money or documents of monetary value from one branch of the bank to another.

The Customs decided that the supply of such services by the carrier to the taxpayer company was chargeable to tax at the standard rate. The taxpayer company contended that the supply of this service was exempt from tax as a 'dealing with money' within the Finance Act 1972, Sch. 5, Grp. 5, item 1, or alternatively, under Grp. 5, item 3, as 'the making of arrangements for any transaction comprised in item 1 or 2 of that Group'.

ISSUE

At the hearing of the appeal, one of the issues which arose was whether the taxpayer company, being the recipient of a supply, had sufficient legal interest to maintain the appeal having regard to the fact that the carrier and not the taxpayer company accounts to the Customs for any tax on the supply?

DECISION

In *Processed Vegetable Growers Association Ltd.* (1973) VATTR 87, it was held in that case that Section 40 of the Finance Act 1972 did not expressly or impliedly prevent a VAT Tribunal from hearing an appeal at the instance of a recipient of a supply who was not accountable for the tax in dispute, but that such an appellant must establish a sufficient legal interest in obtaining a decision of the VAT Tribunal thereon.

In *Payton* (1974) 1 BVC 1,017, the appellant had received and paid for a supply of goods which she claimed was exempt from tax. The VAT Tribunal, on the authority of *Twyford v. Manchester Corporation* [1946] Ch. 236 and *Sebel Products Ltd. v. C. & E. Commrs.* [1949] Ch. 409; [1949] 1 All E.R. 729 held that, as the appellant appeared to have no right to recover from the supplier or the Customs any sum paid as tax, if no tax was properly chargeable, she had no sufficient interest in maintaining the appeal.

In this instance, the VAT Tribunal held that by Section 40 of the Finance Act 1972, the legislature has conferred upon VAT Tribunals the jurisdiction to hear appeals against decisions of the Customs with respect to the tax chargeable on supplies of goods and services. If, on the hearing of such an appeal, a VAT Tribunal comes to the conclusion that a decision of the Customs was wrong, and that tax alleged by them to be chargeable was not properly chargeable, the Customs are bound by necessary implication, subject to any decision of a higher court, to give effect thereto. It was held that, on any appeal, the Customs can only give effect to a decision allowing an appeal by repaying the tax to the supplier or instructing him to take a credit therefor in his next tax return. This they can do whether the decision arises on an appeal by the supplier or by the recipient of the supply. The supplier would in either case hold any such repayment or the benefit of any such credit as constructive trustee for the recipient of the supply. Accordingly, the taxpayer's interest laid in its right to obtain the repayment of the tax paid by it on the supply from the carrier.

CASE

FAILURE TO NOTIFY CUSTOMS - ELECTRIC TOOL REPAIR LTD (1986) (2 BVC 205478)
(VAT Tribunal, United Kingdom)

FACTS

A director of a company purchased an 'off-the-shelf' company (i.e. the taxpayer company) to take over a part of the business activities of another company. The invoice of the agency which supplied the taxpayer company cited a VAT number which the director erroneously assumed to be its pre-existing VAT registration number. The taxpayer company continued its business using that number. The error came to light when an audit was carried out on the books of the taxpayer company. The taxpayer company applied for late registration, which was granted. The Customs also imposed penalty for late registration. The taxpayer company appealed to the VAT Tribunal.

The Customs contended that the taxpayer company's excuse was ignorance of the law which was no excuse. The director should have known about the non-VAT registration as the necessary form of notification had to be signed by a director or secretary. The Customs further contended that reliance on the agency to effect registration was excluded from being a reasonable excuse by legislation.

ISSUE

Whether the taxpayer company had a reasonable excuse for the late registration?

DECISION

The taxpayer company described the penalty as an unfair imposition on a small company. The taxpayer company accepted that ignorance of the law is no excuse, and contended that they were well aware of the need to register. The taxpayer company had at all times sent out tax invoices, and it had collected and accounted for the tax payable by it. The taxpayer company argued that it would be a travesty of justice to require it to pay the penalty of £405.51.

The Customs argued that the taxpayer company was liable to be registered as a taxable person and was required to notify the Customs on the due date by Form VAT 1 signed by a director or the secretary. The taxpayer company should have realised that a form of notification had to be signed by a director or a secretary and could not have been made on their behalf by an agency. The Customs added that an excuse founded on ignorance of the law could not be a reasonable excuse for a failure to comply with the law.

The VAT Tribunal held as follows:

(a) The excuse by the taxpayer company is not that they had entrusted the registration to the agency or any other person, but that they were misled by the invoice submitted by the agency into believing that they had been registered and allocated the registered number therein set out.

(b) This excuse is not that the taxpayer company was ignorant of the law, but that they thought that the legal requirements had been met by the agency.

(c) The VAT Tribunal accepted fully the evidence of the director that the taxpayer company was misled by the said invoice and had genuinely considered that the number set out therein was the VAT registration number assigned to the taxpayer company.

(d) The taxpayer company could reasonably have assumed that they had been registered as a taxable person by the agency with the number given on the said invoice.

(e) There was no provision of the law which requires Form VAT 1 to be signed only by a director or the secretary. Form VAT 1 as distributed by the Customs contains a note to that effect, but such note is not contained on form numbered 1 in the Schedule to the Regulations. The VAT Tribunal was not prepared to extend the doctrine that ignorance of the law is no excuse to such a note.

(f) The taxpayer company established a reasonable excuse for its conduct and no tax whatsoever has been lost. Invoices have at all times been sent out correctly except for the mistaken number printed thereon. It would be most harsh to enforce the penalty.

CASE

LIABILITY TO REGISTER - ADDIE (1986) (2 BVC 208095)
(VAT Tribunal, United Kingdom)

FACTS

The taxpayer was an actor who did not register for VAT registration. At the end of each year, the taxpayer's agent was instructed to pass the relevant documents to the accountant, who upon preparing draft accounts discovered the taxpayer's liability to register. It was accepted that the taxpayer had a liability to register.

Consequently, the Customs imposed penalty on the taxpayer and the taxpayer appealed to the VAT Tribunal.

ISSUE

Whether the taxpayer had a reasonable excuse for the non-registration of VAT?

DECISION

At the hearing, the taxpayer was not present and neither was the taxpayer represented by a lawyer. The VAT Tribunal dismissed the taxpayer's appeal and held that where one intends to advance reasonable use of excuse as a defence, it is essential for the taxpayer or his representative to attend the hearing. Even if such explanations as advanced by the taxpayer's accountant's letter had been proved before the hearing, they did not establish a 'reasonable excuse' for failure to comply with the requirements.

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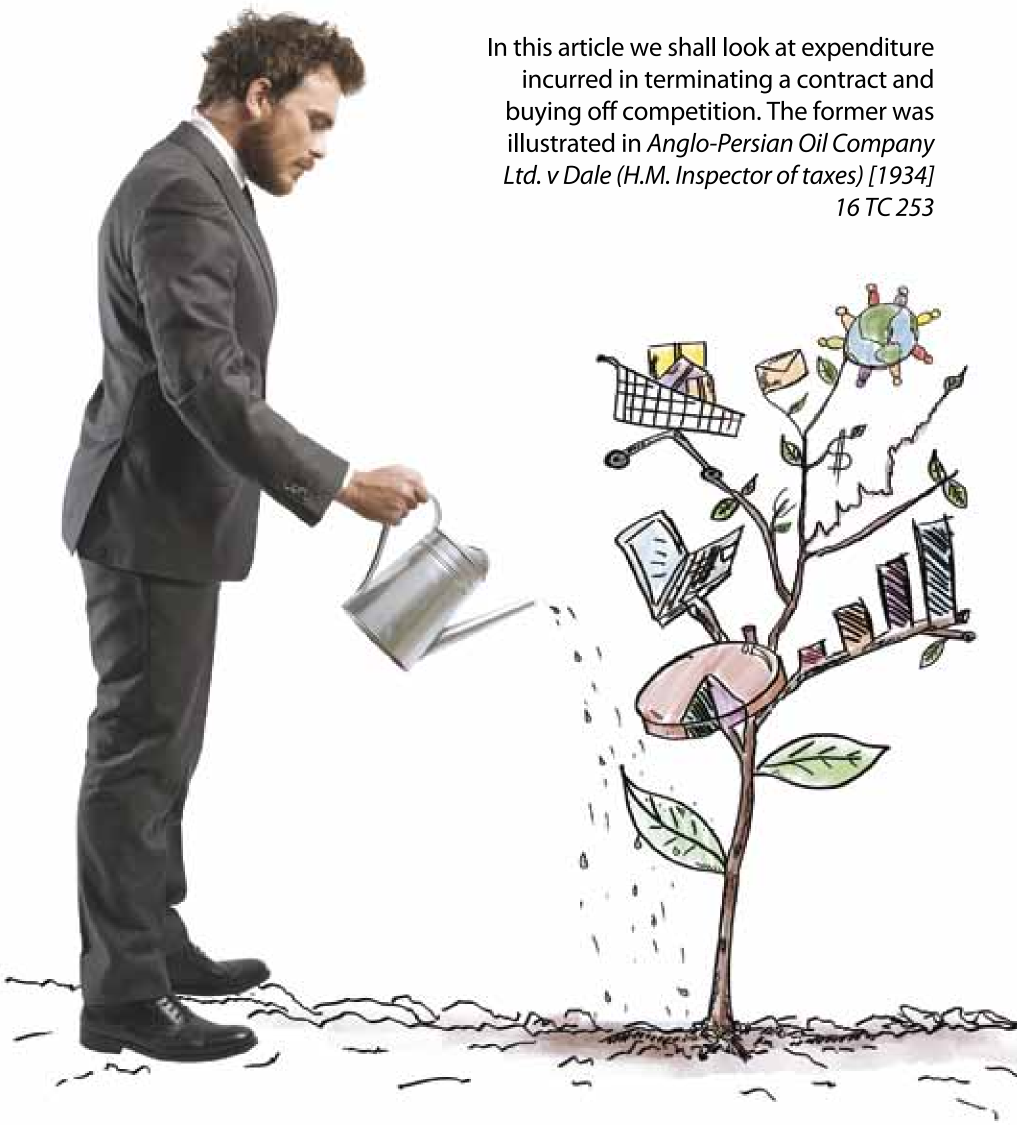
OTHER BUSINESS DEDUCTIONS

Siva Subramanian Nair

Compensation – Part 3

In this article we shall look at expenditure incurred in terminating a contract and buying off competition. The former was illustrated in *Anglo-Persian Oil Company Ltd. v Dale (H.M. Inspector of taxes) [1934] 16 TC 253*



FACTS OF THE CASE

The appellant company had through agreements made in 1910 and 1914 appointed other limited companies as its agents in Persia and the East for a number of years and the terms included that they would be remunerated by way of commission at specific rates.

With the passage of time, the amounts payable to the agents by way of commission increased far beyond the amounts contemplated by the company and after negotiations between the parties, the agreements were cancelled in 1922, the agent company agreeing to go into voluntary liquidation and the company agreeing to pay to the agents £300,000 in cash. The amount was paid and the company claimed a deduction for the expenditure incurred.

DECISION OF THE COURT

The Special Commissioners rejected the contention of the taxpayer on grounds that it was capital in nature but upon appeal to the High Court, the eminent tax judge Rowlatt J. held that the payment to the agents in respect of the cancellation of the agency contract was an admissible deduction. He explains:

> *"As far as I can understand by the Case stated by the Commissioners, it simply was the case of a lump sum payment in lieu of all these payments of commission in future, payable now of course, and payable with very heavy discount on what the total commission would be, and on the other hand without getting the benefit of the services for which the commission would be paid."*

Candidates will note that he is saying that this lump sum is merely a net present value of all the commission payable in future to the agents and therefore, since the commission is deductible, so should this payment.

He further equates this to termination payments to employees when he states:

> *"It is simply nothing more than a lump sum payment to the servant to leave a lucrative employment, and I cannot see that it is anything else."*

In deliberating on the decision of the Commissioners he opines:

> *"….what they say is that this was expenditure of a capital nature to secure an enduring benefit for the company's trade by getting rid of an onerous contract. In my judgement that is a finding that is perfectly inconclusive. It does not deal with the question…[of]…an onerous contract for what? If it is an onerous contract for the payment of wages or commission which are chargeable to revenue account in the plainest possible way, and that is the onerous contract that you are getting rid of, it is impossible to suggest that that is a reason for saying that this a capital expenditure UNLESS (emphasis is mine) you get rid of that onerous contract by erecting in its place a capital asset in the nature of - of course I am only using this as an illustrative example – a labour saving machine which gives you an asset and so dispenses with the expense of labour.*

The judgement of the High Court was confirmed by the Court of Appeal.

Our second area is on buying off competition. In deliberating on expenditure incurred for elimination of competition attention should be given to the nature of the transaction i.e. is it affecting the business structure itself or is it an activity which enhances the profits for the company as the former will be regarded as capital whilst the latter, revenue. Let us look at some cases which serve to exemplify the above contention.

In *United Steel Companies Ltd. v Cullington (No. 1)* the expenditure was held to be capital as explained below.

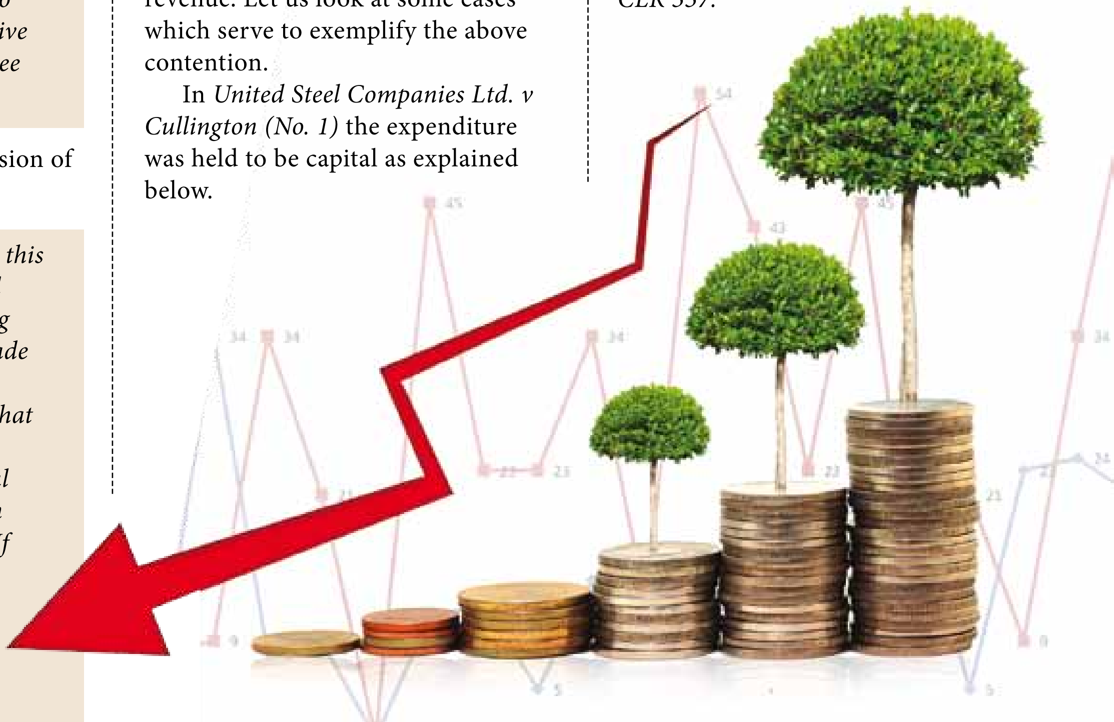
FACTS OF THE CASE

An agreement was reached between a railway company and two steel companies whereby the former will close down its steel works for a period of 10 years and purchase its requirements for specific steel products from the latter in return for £180,000 to be paid over that period. The taxpayer argued that the payment was made in order to secure a trade customer and would therefore constitute a revenue expenditure ranking for a deduction.

DECISION OF THE COURT

The learned judge at the Court of Appeal in finding for the Revenue opined that the termination of the steel works by the railway company itself furnished a capital advantage to the steel companies. He also commented that the periodic disbursement of the payments over the 10 years did change the "fundamental character of the expenditure".

A similarly situation arose in *Sun Newspapers Ltd. v FC of T [1938] 61 CLR 337.*



FACTS OF THE CASE

Sun Newspapers was the publisher of a number of journals. Associated Newspapers, which held nearly all the shares in Sun, entered into an agreement to pay a rival publisher £86,500 if it agreed not to publish an evening paper [The Star] within 300 miles of Sydney for three years and to pass over control of plant and equipment. As a result, the rival went out of business. The payment was claimed as a deduction allowable to either Sun or Associated.

DECISION OF THE COURT

Dixon J. in deciding that the expenditure was of a capital nature drew the following conclusions:

- The expenditure was of a large sum incurred to finally remove the competition feared from the Star (competitor).
- It could be regarded as recurrent only in the sense that the risk of a competitor arising must always be theoretically present, and that the reality of the imminence of the risk depends upon circumstances which can never clearly be foreseen.
- The chief object of the expenditure was to preserve from immediate impairment and dislocation the existing business organisation of the taxpayer.
- The impairment or dislocation feared involved a lowering of selling price, a loss of circulation, a change in advertising rates, and a reorganisation of selling and production arrangements all of a lasting character; that is, the changes would be of an indefinite duration and their effects would continue until they disappeared under influences brought by the future the exact nature of which could not be foreseen.
- The transaction involved the acquisition for cash consideration of the right to enjoy for three years all the property tangible and intangible of an existing undertaking, that is the acquisition of a going concern for a period, a thing recognised as a capital asset. The advantage in terms of profit was not to be obtained by the use of the undertaking but by putting it out of use; but in itself it remained a capital asset.
- In the circumstances the transactions were regarded as strengthening and preserving the business organisation or entity, the profit-yielding subject, and affecting the capital structure.

However, unlike the above cases in *C of T v Nchanga Consolidated Copper Mines Ltd [1964] 1 All ER 208* a compensatory payment for ceasing production for a year was held to be revenue in nature and not an enduring benefit.

FACTS OF THE CASE

Following a plunge in copper prices, the producers of copper decided to voluntarily reduce production by 10%. The respondent company in this case was one of three companies in the Anglo-American Group whereby one of the other two had agreed to cease production for 12 months and this company paid a compensation of £1,384,569 to that company.

DECISION OF THE COURT

The Privy Council dismissed the Revenue's contention that it was a capital payment and allowed a deduction for the payment. The salient point noted was that the cost was incidental to the production and sale of the output of the company's mine and as such, was analogous to an operating cost. Some of the distinguished authors of the books in the reading list have opined that this is probably because the right acquired exhausted itself in the year within which profits were ascertained and as such does not constitute an enduring benefit nor is it an accretion of capital or income-earning structure of the business. The period of refraining from competing was seen as being of a relatively short term in the particular circumstances.

So also in *Hallstroms Pty Ltd v FCT (1946) 72 CLR 634.*

FACTS OF THE CASE

The taxpayer incurred expenditure relating to preventing a competitor, Electrolux Pty Ltd, from extending for ten years its patent over a greatly improved domestic refrigerator, so that they could manufacture similar ones.

DECISION OF THE COURT

This expenditure was held to be of a revenue nature and deductible. Latham CJ in his judgement pointed out that the expenditure,

- did not provide the taxpayer with any advantage of an enduring nature
- it merely succeeded in maintaining an existing position in relation to

a common right that arose on the expiry of the patent.

However, it is interesting to note the dissenting judgement of Dixon J who argued that:

> *"The legal expenses incurred in the final removal of this obstacle [the patent], or in preventing its continuance, ought not, therefore, to be regarded as an outgoing in the course of and as an incident to the carrying on of the profit earning operations of the business, that is working the plant and organisation according to an existing form and arrangement ... I am, therefore, of the opinion that the expenditure was an outgoing of a capital."*

Again, in *BP Australia Ltd v FCT (1965) 112 CLR 386;* the Privy Council held that payments made to petrol service station dealers to sell only one brand of product were revenue in nature.

FACTS OF THE CASE

The company claimed deductions for amounts paid as trade ties to service station proprietors so that those proprietors would deal exclusively in its products for a fixed period. The payments were calculated by reference to expected sales by the service stations.

DECISION OF THE COURT

The Privy Council held that:

- the real object of the outgoing was not the tied network but the orders that would flow from it. The tie agreements were a temporary solution that were of a recurrent nature.
- The advantage sought was the promotion of sales by up to date marketing methods which had become necessary and the expenditure was therefore deductible as being on revenue, rather than capital account.

The learned judge in distinguishing this case from the Sun Newspapers case stated:

> *But in the present case BP was not achieving a monopoly nor buying off competition nor obtaining any substantial area for its own domain. Although one retailer was tied to BP, the retailer next door could still buy some other brand and the passing motorist could do likewise. [And later] ... For those reasons the cases where competition had been stifled for a substantial period or a monopoly has been acquired have little bearing*

Some other salient cases include the following.

- Costs incurred by a broadcasting company which held a monopoly on AM radio license, in seeking to obtain an FM license, was held to be capital not because the FM license was an asset or advantage but rather if it was gained by a competitor, it would interfere with the broadcasting activities of AM *[Sunraysia Broadcasters Pty Ltd v FCT 91 ATC 4350].*
- However, for a company whose business involved the acquisition and development of valuable information and that the taxpayer was under constant pressure to defend its interests, expenditure on protecting patents and confidential information were held to be revenue in nature. *[C of T v Consolidated Fertilizers Ltd (1991) 22 ATR 281].*
- Similarly in the case of a bank which wanted to be the exclusive lender under a Commonwealth loan scheme for members of the defence forces, the payment of $42 million to achieve this objective was held to be deductible because the payment was in the nature of a marketing expense *[National Australia Bank Ltd (1997) 37 ATR 378; 97].*

Therefore, candidates should carefully evaluate the scenarios presented in the question paper to determine whether the expenditure is incurred to maintain the status quo of the business quite similar to the situations in the earlier article whereby getting rid of an onerous character was held to be deductible, or is it one which enhances the profit-yielding structure of the business. A payment to protect the business from an isolated threat will be capital but if it involves prudent management of business interests, then its revenue.

That concludes our discussion on compensatory payments for termination of contracts and buying off competition.

Siva Subramanian Nair is a freelance lecturer. He can be contacted at sivasubramaniannair@gmail.com

FURTHER READING

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

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: April – June 2014

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
APRIL 2014								
IRB-CTIM TAX FORUM 2014								
IRB-CTIM Tax Forum	3 Apr	9a.m. – 1p.m.	Kota Bharu	IRB & CTIM	250	300	350	4 RS/003
IRB-CTIM Tax Forum	7 Apr	9a.m. – 1p.m.	Penang	IRB & CTIM	250	300	350	4 RS/004
IRB-CTIM Tax Forum	8 Apr	9a.m. – 1p.m.	Johor Bahru	IRB & CTIM	250	300	350	4 RS/002
IRB-CTIM Tax Forum	9 Apr	9a.m. – 1p.m.	Kota Kinabalu	IRB & CTIM	250	300	350	4 RS/005
IRB-CTIM Tax Forum	10 Apr	9a.m. – 1p.m.	Kuching	IRB & CTIM	250	300	350	4 RS/006
GOODS AND SERVICES TAX (GST)								
GST Training Course (10 days) GST Examination Day *(subject to RMC confirmation)*	April: 9, 10, 11, 17, 18, 19, 23, 24, 25, 26 6 May	9a.m. - 5p.m.	Kuala Lumpur	Royal Malaysian Customs	3,000 *(fee for 10 days course)*	3,400 *(fee for 10 days course)*	3,700 *(fee for 10 days course)*	JV/006
Workshop: Latest Tax Developments on Employers' Statutory Requirements in 2014	1 Apr	9a.m. - 5p.m.	CTIM Training Room, KL	Sivaram Nagappan	300	350	400	8 WS/020
Workshop: Latest Tax Developments on Employers' Statutory Requirements in 2014	3 Apr	9a.m. - 5p.m.	Kuching	Sivaram Nagappan	335	385	435	8 WS/021
Workshop: Tax Planning for Companies (in collaboration with MAICSA)	3 Apr	9a.m. - 5p.m.	MAICSA Training Room, KL	Vincent Josef	350	400	450	8 JV/005
Workshop: Latest Tax Developments on Employers' Statutory Requirements in 2014	7 Apr	9a.m. - 5p.m.	Melaka	Sivaram Nagappan	335	385	435	8 WS/022
Seminar: Selected Common Tax Issues	8 Apr	9a.m. - 5p.m.	Kuala Lumpur	Various Speakers	*120 Subsidised fee	475	545	8 SE/004
Workshop: Capital Allowances on Plant, Machinery & Buildings	17 Apr	9a.m. - 5p.m.	Penang	Thenesh Kannaa	335	385	435	8 WS/032
Workshop: Capital Allowances on Plant, Machinery & Buildings	21 Apr	9a.m. - 5p.m.	Ipoh	Thenesh Kannaa	335	385	435	8 WS/033
Workshop: Latest Tax Developments on Employers' Statutory Requirements in 2014	22 Apr	9a.m. - 5p.m.	Johor Bahru	Sivaram Nagappan	335	385	435	8 WS/023
Workshop: Capital Allowances on Plant, Machinery & Buildings	24 Apr	9a.m. - 5p.m.	Melaka	Thenesh Kannaa	335	385	435	8 WS/034
Workshop: Latest Developments on Real Property Gains Tax	30 Apr	9a.m. - 5p.m.	CTIM Training Room	Sivaram Nagappan	300	350	400	8 WS/027

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

CPD Events: April – June 2014

Month /Event	Details				Registration Fee (RM)			CPD Points
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non - Member	
MAY 2014								
Workshop: Latest Tax Developments on Employers' Statutory Requirements in 2014	5 May	9a.m. - 5p.m.	Ipoh	Sivaram Nagappan	335	385	435	8 WS/024
Workshop: Latest Tax Developments on Employers' Statutory Requirements in 2014	8 May	9a.m. - 5p.m.	Penang	Sivaram Nagappan	335	385	435	8 WS/025
Workshop: Capital Allowances on Plant, Machinery & Buildings	8 May	9a.m. - 5p.m.	Johor Bahru	Thenesh Kannaa	335	385	435	8 WS/035
Workshop: Latest Tax Developments on Employers' Statutory Requirements in 2014	15 May	9a.m. - 5p.m.	Kota Kinabalu	Sivaram Nagappan	335	385	435	8 WS/026
Workshop: Latest Developments on Real Property Gains Tax	23 May	9a.m. - 5p.m.	Johor Bahru	Sivaram Nagappan	335	385	435	8 WS/029
Workshop: Latest Developments on Real Property Gains Tax	27 May	9a.m. - 5p.m.	Kuching	Sivaram Nagappan	335	385	435	8 WS/028
Public Holiday *(Labour day: 1 May, Wesak Day: 13 May)*								
JUNE 2014								
Workshop: Latest Developments on Real Property Gains Tax	11 Jun	9a.m. - 5p.m.	Penang	Sivaram Nagappan	335	385	435	8 WS/031
Workshop: Latest Developments on Real Property Gains Tax	18 Jun	9a.m. - 5p.m.	Kota Kinabalu	Sivaram Nagappan	335	385	435	8 WS/030
GST Training Course (10 days) GST Examination Day *(subject to RMC confirmation)*	Jun: 2, 3, 4, 9, 10, 11, 16, 17, 18, 19 23 Jun	9a.m. - 5p.m.	Penang	Royal Malaysian Customs	3,000 *(fee for 10 days course)*	3,400 *(fee for 10 days course)*	3,700 *(fee for 10 days course)*	JV/007

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* Certificate of Attendance will be issued upon full attendance and receipt of full payment.
* Normal rate will be applicable for unpaid early bird registrations after 18 July 2014.

	Early Bird Fee (with payment before or on 18 July 2014)	Normal Fee (after 18 July 2014)
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Member's Firm Staff Member of Supporting Body Member / Staff of Supporting Sponsor	RM 1400	RM 1600
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Impiana Hotel
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F: 03-2147 1028
E: joash.denics@impiana.com

Maya Hotel
Contact Person : Jamie Cheah
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E: reservation@hotelmaya.com.my

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

Reminder
Certificate of Attendance will only be released to registered participants (must register before 11.00am on day 1), full attendance and after completion of the event

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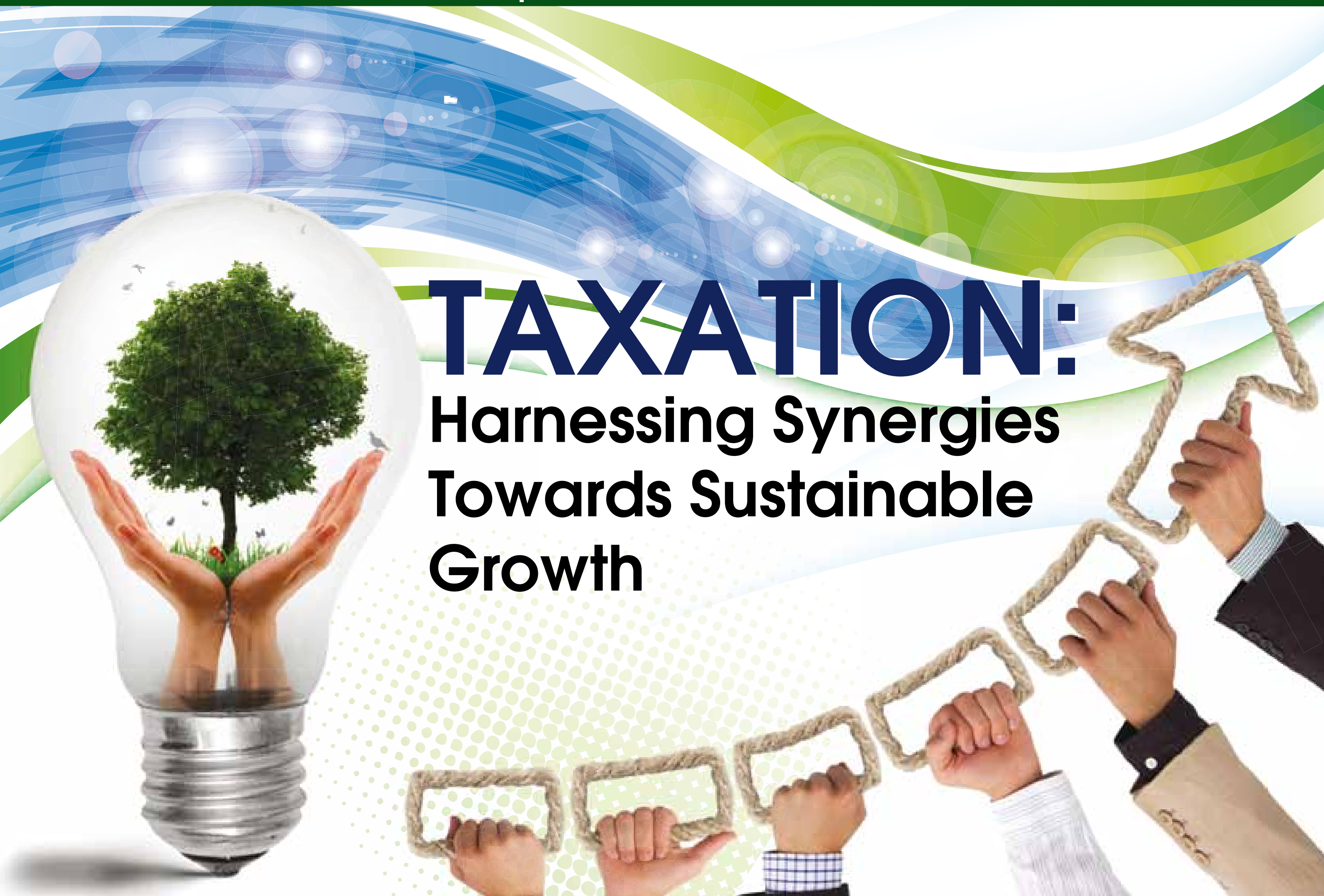

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