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## Applicability of Double Tax Agreements to REIT Distributions

Malaysian Institute Of Taxation

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**Inside:**

- Tax Avoidance and Section 140, Income Tax Act 1967
- 2009 National Budget Memorandum

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| Member's Firm Staff / Member of Supporting Body / Member of Sponsor | RM1,000 | RM1,200 |
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Please cross cheque made payable to MIT-NTC and mail payment together with the registration form to the address below. Admission will only be permitted and a Confirmation Letter will only be issued three (3) weeks before the Conference. (Please write NTC 2008, your name and contact number at the back of the cheque)

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## IMPORTANT NOTES

Reservation can be made by facsimile / post but will only be confirmed upon receipt of registration form and payment. Kindly contact the Secretariat for more info.

Conference Secretariat
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# Editorial Note

The Institute is gearing up for the National Tax Conference 2008 on 19 and 20 August 2008! MIT members and readers are strongly encouraged to be at this premier event of the year for all tax practitioners. The Conference will bring together both international and local professionals, under the auspices of the Inland Revenue Board Malaysia and the MIT, to discuss a broad range of tax issues and development in order to achieve the theme, "Together towards an Excellent Delivery System". So, sign up today to ensure your seat and to take advantage of the early bird fee!

As the body responsible for matters concerning taxation in this country, MIT works very closely with the IRB to continually enhance taxation as a tool for the nation's economic advancement. In this issue of the *Tax Guardian*, we are pleased to share the Institute's 2009 National Budget Memorandum. The Institute's proposals are broadly categorised under the following;

- Improving efficiency of tax administration
- Maintaining a competitive fiscal environment
- Continuous review in ensuring an equitable and business-friendly taxation system
- Stimulating the business environment
- Development of human capital
- Promoting a caring society

In this issue's cover story, we are pleased to bring you "Applicability of Double Tax Agreements to REIT Distributions". The tax treatment of distributions from a REIT in Malaysia is comparatively less attractive than that of other ASEAN countries and if Malaysia is to compete and attract foreign investors, the characterisation of REIT distributions from a DTA perspective is an important issue that needs to be addressed effectively — and quickly. Renuka Bhupalan in her article shares her thoughts on the issues of concern which must be addressed by the relevant authorities to allay investors' fears and uncertainties.

The feature article on "Tax Avoidance" looks into the legal aspects of the issue, i.e. is it legitimate for a taxpayer to arrange his affairs to avoid or reduce his tax payable; and how does such actions relate to Section 140 of the Income Tax Act 1967 and case law?

Under Practice Management, we look at "Organisational Cultures" in Asian businesses. Organisational cultures in Asian companies differ greatly due to the disparity in national as well as ethnic cultures. As globalisation and free trade make a common international culture more feasible, these distinctions will become less pronounced. But how long this process will take and whether it would be advantageous remains to be seen.

The other sections, i.e. Tax Cases, International Cases and Learning Curve, continue to focus on tax issues — both evergreen and new – which I hope you will find interesting and enlightening.

Happy reading!

**Harpal Singh Dhillon**
Chairman, Editorial Committee

# Table of Contents



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

## INVITATION TO WRITE

The Institute welcomes original contributions which are of interest to tax professionals, lawyers and academicians. It may cover local or international tax development. Article contributions should be written in UK English. All articles should be between 2,500 to 5,000 words submitted in a typed single spaced format using font 10 in Microsoft Word via email.

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

Contributions may be sent to:

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# CPD Events...

## Seminar on the Impact of Financial Reporting Standards (FRSs) on Taxation


Section of audience

On 2 April 2008, the Institute successfully conducted a seminar on the Impact of Financial Reporting Standards (FRSs) on Taxation at Best Western Premier Seri Pacific, Kuala Lumpur to over 150 participants. Mr Peter Lim chaired the session in the morning. The speakers for the morning session included Ms M. Silverranie who spoke on shared-based payment (FRS 2) and leases (FRS 117), followed by Mr Tan Hooi Beng who highlighted on property, plant and equipment (FRS 116) and investment property (FRS 140) leases. The session continued with Ms Kalarani Nagalingam who spoke on FRS 108 highlighting accounting policies, changes in accounting estimates and errors whilst Mr Nicolas Crist explained further views on taxation.

The afternoon session was chaired by Mr Lew Nee Fook where Mr Neoh Chin Wah spoke on property development activities (FRS 201) followed by Ms Phan Wai Kuan who spoke on non-current assets held for sale and discontinued (FRS 5) and the effect of changes in foreign exchange rates (FRS 121).

During the panel discussion after each session, many interesting and challenging questions were raised and participants were generally satisfied with the responses. Many participants felt the seminar had achieved its objectives and cleared some of their doubts and provided a greater understanding of the various FRSs.

## Workshop on Income Reconstruction

The workshop on income reconstruction was held in two sessions, on 29 March 2008 at PNB Darby Park, Kuala Lumpur and at the MIT Training Room, Kuala Lumpur on 17 April 2008.

The speaker, Tuan Haji Ab. Rahim Abdullah conducted both the workshops and discussed the method of income reconstruction. He also provided some insights on how the IRB reconstructs the income of taxpayers who failed to keep proper records.


Seminar on Income Reconstruction held at MIT


Participants listening to the speaker


Participants at FRS seminar


Mr Lew and Mr Neoh at FRS seminar


Registering for seminar.

# Special Ceremony at the IRB in conjunction with the National Tax Conference


APM & MIT members with Datuk Hasmah Abdullah


Dr Veerinderjeet presenting cheque to Datuk Hasmah Abdullah, DG of IRB

Representatives from the Malaysian Institute of Taxation attended a special ceremony at the office of the Director General of Inland Revenue Board (IRB), Datuk Hasmah Abdullah on 17 April 2008. The event was to present a cheque to the IRB in respect of the joint collaboration between the MIT and the IRB in organising the National Tax Conference (NTC) in 2007.

Present at the meeting were Dr Veerinderjeet Singh (President of MIT), Mr Khoo Chin Guan (Vice President of MIT and Co-organising Chairman of the NTC), Pn Noor Azian bt Abdul Hamid, En Saibun, Mdm Esther Koisin and Ms Ranjeet Kaur (from Akademi Percukaian Malaysia) as well as Ms Kulwant Kaur and Cik Nursalmi Haslina (from the MIT Secretariat).

The meeting also deliberated on and exchanged views on the draft programme for the National Tax Conference 2008 which is scheduled to be held on 19 and 20 August 2008.

# Branch Affairs Meeting


From left: Lam Weng Keat, Andrew Ewe, Fan Kah Seong, Dato' Raymond Liew, Dr. S Sivamoorthy, Lim Kah Fan, Venkiteswaran Sankar, Wong Seng Chong, Micheal Tong, Koh Kay Cham, Lew Nee Fook.

The second Branch Affairs meeting was held on 4 April 2008 at the MIT Secretariat where all branch chairmen were present. Dr Veerinderjeet, MIT President chaired the meeting. Also present were some MIT Council members and Secretariat staff.

Amongst the matters discussed during the meeting were the receipt of branch reports and discussions on the various issues including challenges faced by branch chairmen and how the Secretariat could assist and support them. The MIT President spoke on the progress of the Strategic Initiatives of MIT which had been adopted in July 2007.

# Continuing Professional Development (CPD)

# CALENDAR OF EVENTS 3RD QUARTER 2008

## july

| Date | Training Programme | CPD Points | Venue | Fee (RM) Member | Fee (RM) Member Firm's Staff | Fee (RM) Non Member | Speaker |
|---|---|---|---|---|---|---|---|
| 1 Jul 2008<br>9.00am - 5.00pm | Workshop: Tax Planning on Current Tax Issues | 8 | Penang | 315 | 365 | 415 | Chow Chee Yen |
| 2 Jul 2008<br>9.00am - 5.00pm | Workshop: Tax Planning on Current Tax Issues | 8 | Johor Bahru | 315 | 365 | 415 | Chow Chee Yen |
| 9 Jul 2008<br>9.00am - 5.00pm | Workshop: Tax Planning on Current Tax Issues | 8 | Kota Kinabalu | 315 | 365 | 415 | Chow Chee Yen |
| 10 Jul 2008<br>9.00am - 5.00pm | Workshop: Tax Planning on Current Tax Issues | 8 | Kuching | 315 | 365 | 415 | Chow Chee Yen |
| 17 Jul 2008<br>9.00am - 5.00pm | Workshop: Tax Audit Under Self Assessment: Issues & Lessons Learnt | 8 | Kuala Lumpur | 295 | 345 | 395 | Abdul Rahim |

## august

| Date | Training Programme | CPD Points | Venue | Fee (RM) Member | Fee (RM) Member Firm's Staff | Fee (RM) Non Member | Speaker |
|---|---|---|---|---|---|---|---|
| 12-13 Aug 2008<br>9.00am - 5.00pm | Workshop: Basic Tax Practice & Principles | 16 | Ipoh | 630 | 730 | 830 | Chow Chee Yen |
| 19-20 Aug 2008<br>9.00am - 5.00pm | **NATIONAL TAX CONFERENCE 2008** | 25 | Kuala Lumpur Convention Centre | 900<br>1,000 | 1,000<br>1,200 | 1,200<br>1,300 | Local & Foreign Speakers |
| 30 Aug 2008<br>10.00am - 5.00pm | 2009 Budget Seminar: Selangor | 10 | Selangor | 330 | 380 | 440 | Chow Chee Yen |

## september

| Date | Training Programme | CPD Points | Venue | Fee (RM) Member | Fee (RM) Member Firm's Staff | Fee (RM) Non Member | Speaker |
|---|---|---|---|---|---|---|---|
| 2 Sept 2008<br>2.30pm - 5.00pm | 2009 Budget: Hi-Tea with YBhg Datuk Azlyah binti Bahauddin | 10 | Kuala Lumpur | 200 | 230 | 250 | Chairman: Dr Veerinderjeet Singh<br>Representative from IRB, Customs & Tax Practitioner |
| 5 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Ipoh | 330 | 380 | 440 | Chow Chee Yen |
| 8 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Malacca | 330 | 380 | 440 | Chow Chee Yen |
| 9 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Seremban | 330 | 380 | 440 | Chow Chee Yen |
| 10 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Johor Bahru | 330 | 380 | 440 | Chow Chee Yen |
| 15 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Kuantan | 330 | 380 | 440 | Chow Chee Yen |
| 16 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Kuching | 330 | 380 | 440 | Chow Chee Yen |
| 17 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Sibu | 330 | 380 | 440 | Chow Chee Yen |
| 18 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Kota Kinabalu | 330 | 380 | 440 | Chow Chee Yen |
| 19 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Penang | 330 | 380 | 440 | Chow Chee Yen |
| 20 Sept 2008<br>9.00am - 5.00pm | 2009 Budget Seminar | 10 | Kuala Lumpur | 330 | 380 | 440 | Chow Chee Yen |

**DISCLAIMER:** MIT reserves the right to change the speaker (s)/date (s), venue and/or cancel the events without notice at their discretion.

**ENQUIRIES:** Please call Ms Latha, Cik Aliy or Cik Nur at 03-2162 8989 ext 108, 113 and 106 respectively or refer to MIT's website www.mit.org.my for more information on the CPD programmes.

# Applicability of Double Tax Agreements to REIT Distributions

By Renuka Bhupalan

*The Malaysian tax law in relation to REITs has evolved considerably over the past few years, ostensibly with the view of promoting the REIT industry in Malaysia. Malaysian REITs compete in the region with their counterparts in Singapore and Hong Kong. The ability to attract foreign investors is important in growing the Malaysian REIT industry and in this regard, the tax treatment of distributions from Malaysian REITs is certainly not as attractive as in some jurisdictions. This article aims to examine the tax treatment of REIT distributions to non-resident investors by addressing the relevant legislative provisions in relation to REITs and REIT distributions to non-residents, as well as the issue of whether non-resident investors have recourse to double tax agreements (DTAs) for relief.*

**The Law**

The tax provisions affecting REITs are found in the Income Tax Act, 1967 (ITA), more particularly in Sections 61A, Section 109D and Schedule 1. This is set out below:

- Section 61A:

  "(1) Where in the basis period for a year of assessment ninety per cent or more of the total income of the unit trust is distributed to the unit holder, the total income of the unit trust for that year of assessment shall be exempt from tax"

  (2) In this section, "unit trust' means a unit trust which is approved by the Securities Commission as a Real Estate Investment Trust or Property Trust Fund"

- Section 109D – this section only applies to unit trusts in the form of REITS which distribute 90% or more of their total income, i.e. REITs which are exempt from tax pursuant to Section 61A. Section 109D(2) provides as follows:

  *"Where a unit trust (in this section referred to as the payer) distributes income to a unit holder other than a unit holder which is a resident company which is deemed to be derived from Malaysia, the payer shall upon distributing the income, deduct therefrom tax at the rate applicable to such income and shall within one month after distributing such income, render an account and pay the amount of that tax to the Director General:*

  Provided that the Director General may –

  *(a) give notice in writing to the payer requiring him to deduct and pay tax at any other rates or to distribute the income without deduction of tax; or*

  *(b) under special circumstances, allow an extension of timefor the amount of tax deducted to be paid over."*

- Schedule 1, Part X provides as follows:

*"1. Notwithstanding Part I –*

*(a) and subject to paragraphs (b) and (c), income tax shall be charged for a year of assessment on the income of a unit holder other than a unit holder which is a resident company consisting of income distributed to the unit holder referred to in section 109D which is derived from Malaysia at the rate of 15% of gross:*

*(b) and subject to paragraph (c), income tax shall be charged for a year of assessment on the income of a unit holder which is a non-resident company consisting of income distributed to the unit holder referred to in section 109D which is derived from Malaysia at the rate of 26% of gross; and*

*(c) income tax shall be charged for a year of assessment on the income of a unit holder which is a foreign institutional investor consisting of income distributed to the unit holder referred to in section 109D which is derived from Malaysia at the rate of 20% of gross:*

*2. In this Part, "institutional investor" means a pension fund, collective investment scheme or such other person approved by the Minister"*

Based on the above, it is clear that under the ITA, REIT distributions to non-residents, both companies and individuals will be subject to withholding tax. The rate of withholding tax on distributions to non-resident companies is 26%, while the rate applicable to non-resident individuals is 15%. It is also clear that distributions to residents, aside from resident companies, will also attract withholding tax.

The imposition of withholding tax on REIT distributions was only introduced in Malaysia with effect from 1 January 2007 and the issues arising from this are in their infancy. One such issue is the question of whether non-resident investors who receive distributions from REITs would be entitled to relief (if any) pursuant to the relevant DTA between Malaysia and their country of residence.[1]

## DTAs

### *Broad Principles underlying a DTA*

A DTA is applicable to residents of contracting states and seeks to ensure that taxpayers do not endure the unnecessary burden of being taxed in two countries. For instance, a company which is resident in Country X and derives income from Country Y may potentially be taxed in both countries. Country X, as the country of residence may tax the income under its domestic laws (either on a remittance basis or on a world-wide scope of taxation basis) and Country Y, may seek to tax the income on a source basis. In most instances, Country Y would impose a withholding tax on the income, the rates of which would vary depending on the nature of the income, e.g. dividends, royalties, technical fees, etc. Where Countries X and Y have entered into a DTA, relief would be afforded under the DTA in the following potential ways:

> "In view of Section 132 of the ITA, the DTA would take precedence and would override the provisions of the ITA."

- The DTA may offer a reduced rate of withholding tax in Country Y
- The DTA may provide for double tax relief in Country X in the form of a credit for tax suffered on the income in Country Y
- To the extent that the income comprises business profits of the resident of Country X, the DTA would generally provide that the income should only be taxed in Country X, unless the recipient of the income (resident of Country X) has a permanent establishment (PE)[2] in Country Y.

### *DTA v. ITA*

Where domestic laws (in the present case, this refers to the ITA) and the DTA differ, which takes precedence? In view of Section 132 of the ITA, the DTA would take precedence and would override the provisions of the ITA. However, this would only happen where it is clear that the income in question falls within the scope of the DTA.

### *Character of REIT Distributions*

The question of whether REIT distributions fall within the scope of Malaysian DTAs is a relatively new concept for Malaysia. Indeed, this issue has not been resolved in many countries. The Organisation for Economic Cooperation and Development (OECD) has also been considering the issue of the character of REIT distributions to investors in the context of DTAs to assess whether these comprise dividends, income from immovable property, etc. The OECD released in October 2007, a Public Draft Discussion paper for comments on "Tax Treaty Issues Related to REITS" and has also recently released the draft contents of the 2008 update to the OECD Model Tax Convention. The draft amendments to the Commentary on Article 10 (Dividends) of the Model Tax Convention include the following:

*"The importance and the globalisation of investments in and through REITs have led the Committee on Fiscal Affairs to examine the tax treaty issues that arise from such investments"*

It is timely therefore that we address this issue from a Malaysian perspective.

DTAs cover several different categories of income including dividends, income from immovable property, interest, royalties, business profits, employment income, etc. DTAs would also generally include a broad category known as "Other Income". Under which of these categories would REIT distributions fall?

1 Malaysia has a wide network of DTAs with over 60 countries.

2 A PE is essentially a taxable business presence that a resident of one country is deemed to have in another country as a result of several possible factors, e.g. a branch office, a factory, a construction, installation or assembly project for 6 months (or other such period as may be prescribed in the relevant DTA) ,etc.

In considering this question, it is helpful to understand how REITs derive their income. A Malaysian REIT is required to invest a large proportion of its total assets in real estate, and real-estate related assets. However, REITs are also permitted to make other forms of investment in liquid assets, non-real estate related assets (such as listed shares, Government issued or Government guaranteed debt securities, asset-backed securities, etc). Therefore, the earnings of a REIT would comprise rental income, interest income, dividend income, capital gains, etc. Accordingly, the distributions would be made out of a 'mixed bag' of income, although a large part of this would be rental income.

If Malaysian REITS were strictly 'pass-through' vehicles, whereby the REIT itself is never taxable and the tax is imposed only on the unit-holders, then there are grounds to take the view that the character of the distributed income would arguably remain unchanged, provided the REIT is able to identify and segregate the distributed income accordingly. However, Malaysian REITS are not strictly 'pass through' vehicles as there is always a likelihood of the REIT being taxed if it does not distribute 90% or more of its income. This accords with Section 61(1) Income Tax Act, 1967 (the Act) which taxes income from trust property as income of the trustees or trust body which in turn is treated as a 'person' under the Act. Therefore, it would not be correct to argue that the character of income distributed by the REIT is the same as that received by the REIT. Accordingly, Malaysian REIT distributions would not fall within the following categories of income seen in most Malaysian DTAs:

– Income from Immovable Property
– Interest
– Capital Gains

Would a REIT distribution fall within the category of 'Dividend'? The typical 'Dividend Article' as provided in most of the Malaysian DTAs applies in respect of "*dividends paid by a company which is a resident of one of the States to a resident of the other State*". A REIT is clearly not a company and therefore, this Article cannot apply to the REIT distribution. A company is defined in the DTA as "*any body corporate or any entity which is treated as a body corporate for tax purposes*". The draft contents of the 2008 update to the OECD Model Tax Convention suggests that the Commentary on Article 10 (Dividends) be amended for contracting states where REITs are not companies. The suggestion is that Article 10 should be amended as follows:

*"1. Dividends paid by a company which is a resident, or a REIT organised under the laws, of a Contracting State to a resident of the other Contracting State may be taxed in that other State.*

*2. However, such dividends may also be taxed… in the Contracting State of which the company paying the dividend is resident or, in the case of a REIT, under the laws of which it has been organised, but if the beneficial owner of the dividends is a resident of the other Contracting State (other than a beneficial owner of dividends paid by a company which is a REIT in which the person holds, directly or*

*indirectly, capital that represents at least 10 per cent of the value of all the capital in that company), the tax so charged shall not exceed ….".*

The proposed change above would seek to limit the rate of tax charged in the country of source. It will be interesting to follow the OECD proposals, which also suggest that a distinction needs to be made between a small investor in a REIT who has no control over the REIT's investment decisions as opposed to a larger investor who would have more influence in the REIT's investment decisions.

Until such time that Malaysian DTAs include specific references to REITs, REIT distributions would generally not fall within the Article on 'Dividends'. This therefore leaves the 'Business Profits Article' or the 'Other Income' Article. There would be limited circumstances under which REIT distributions would comprise business profits of the recipient. One such situation might be where the investor (recipient) is a non-resident financial institution (Bank X) which acquires units in REITs in the course of managing its banking funds. The REIT distributions would clearly form part and parcel of its business income from its banking activities. If Bank X does not have a PE in Malaysia, then based on the 'Business Profits Article' of the relevant DTA, Bank X should not be taxable in Malaysia on the REIT distribution.

Where the non-resident investor in the REIT derives distributions from a Malaysian REIT which do not constitute business profits of the investor nor fall within any of the other classes of income covered by the other articles in the respective DTA with Malaysia, then the "Other Income"[3] Article found in most DTAs would potentially apply. It is important to review the provisions of this Article in each relevant DTA. Generally, this article provides that income is taxable in the country of residence of the recipient unless there is a source in the other country. Where there is a source in the other country, the income may be taxable there too. Therefore, in such situations, it is clear that Malaysia would continue to have the right to tax the non-resident investors on their REIT distributions as the source of the REIT distribution would clearly be Malaysian. Certain DTAs however do not follow this typical pattern – for instance, in the DTA between Malaysia and Germany, the 'Other Income' Article provides as follows:

*"1. Items of income of a resident of a Contracting State which are not expressly mentioned in the foregoing Articles of this Agreement shall be taxable only in that Contracting State.*

*2. The provisions of paragraph 1 of this Article shall not affect the taxation of the income of any person derived from a trust or estate under administration as provided for under the laws of Malaysia".*

While paragraph 1 clearly grants the taxing rights in respect of such income to Germany, paragraph 2 expressly excludes this right where the income is derived from a trust. Therefore, distributions from a Malaysian REIT to a German investor would continue to be subject to the Malaysian withholding tax provisions.

In the DTA between Malaysia and the Netherlands, the tax rate on 'Other Income' is limited to 10%. Therefore, where a resident of the Netherlands invests in a Malaysian REIT, the withholding tax on the REIT distribution should be limited to 10%. In such an instance, the custodian of the REIT would typically be responsible for withholding the requisite tax deductions on the REIT distribution. The non-resident investor should provide the custodian with a certificate of its tax residence in the Netherlands to support the reduced withholding tax rate. In the event of a tax audit, the Malaysian tax authorities are likely to require such documentation to satisfy themselves that the reduced rate of withholding tax should apply.

> "…it is clear that Malaysia would continue to have the right to tax the non-resident investors on their REIT distributions as the source of the REIT distribution would clearly be Malaysian. Certain DTAs however do not follow this typical pattern…"

In the case of Japan, the 'Other Income' Article of the DTA provides as follows:

*"1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Agreement shall be taxable only in that Contracting State.*

*2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other Contracting State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply."*

Based on the above, arguably Malaysian REIT distributions paid to a resident of Japan should not be subject to tax in Malaysia, unless the Japanese investor has a PE in Malaysia and the distribution is connected with that PE.

Where a DTA does not have the equivalent of the 'Other Income' article, for instance, the Malaysia-France DTA and the Malaysia-Denmark DTA, then the domestic withholding tax provisions should apply where the REIT distributions do not comprise business income of the recipient.

## Conclusion

The characterisation of REIT distributions from a DTA perspective is an important issue that needs to be addressed. The Inland Revenue Board (IRB) is well aware of this issue and is following the progress of the OECD draft changes. The treatment of REIT distributions under DTAs needs to be agreed upon quickly to give investors the certainty required to enable them to make appropriate investment decisions. TG

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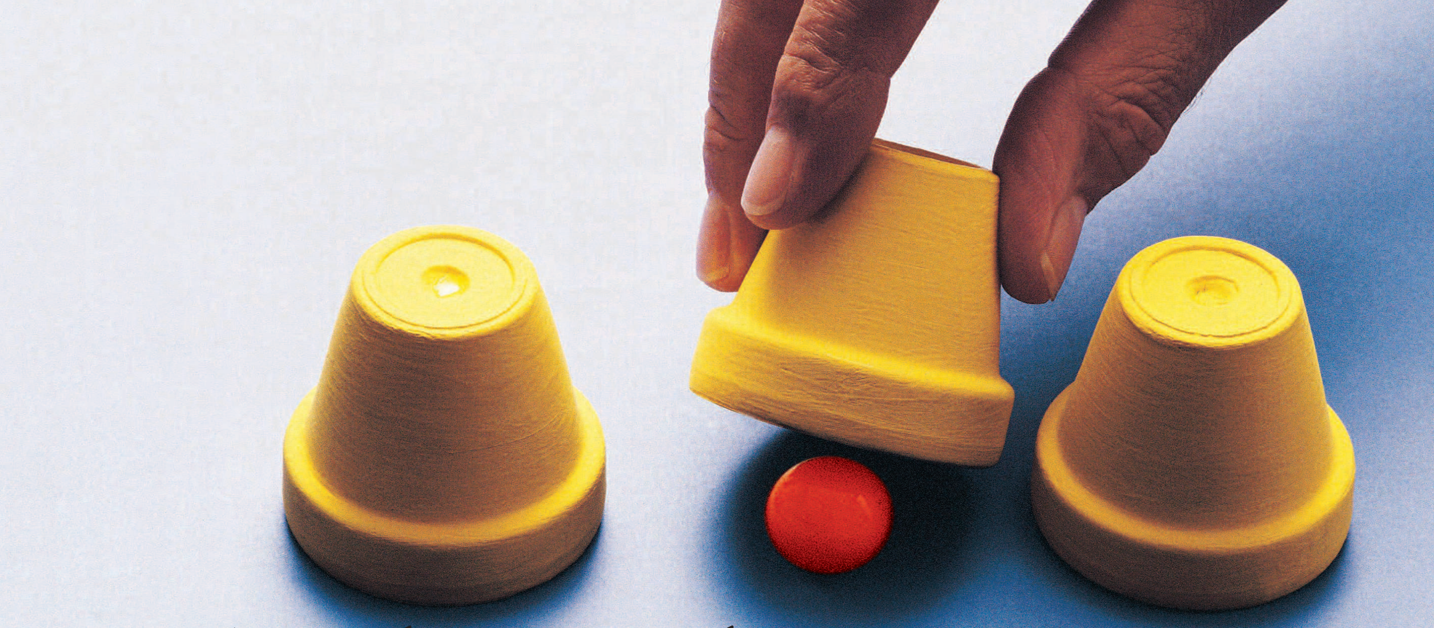
3 This is also referred to in many DTAs as the "Income Not Expressly Referred To" Article and is generally Article 21 or 22 in most of the Malaysian DTAs.



# Tax Avoidance and Section 140, Income Tax Act 1967

## Tax Avoidance Provisions

*"Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."*

That classic statement was made in 1936 by Lord *Tomlin* in *I.R. Commrs* v. *Duke of Westminster* in support of the principle that it is perfectly legitimate for a taxpayer to arrange his affairs to avoid or reduce the incidence of tax.

Tax avoidance is the reduction of one's tax liability by means which are, in themselves, legal. It is to be distinguished from tax evasion, which involves the same result but by means which result in the commission of an offence. Examples of tax evasion are understating income/sales, overstating purchases/expenses or failing to submit tax returns.

In *Sabah Berjaya Sdn Bhd* v *Ketua Pengarah Jabatan Hasil Dalam Negeri* [1999] 3 CLJ 587, the Commissioners held that certain donations made by the appellant could be disregarded by reason of Section 140(1) of the ITA as it amounted to tax avoidance. The appellant appealed on the ground that the Commissioners were wrong in law in holding that the respondent was entitled to disregard the donations as a means of tax avoidance under Section 140 of the Act. *Gopal Sri Ram* JCA in the Court of Appeal held that Section 140 of the Act is a comprehensive provision that enables the respondent to disregard any transaction which directly or indirectly has the effect of avoiding the incidence of tax. His Lordship opined as follows:

> "... The section is not *sui generis*. It has parallels in other jurisdictions where it has received judicial consideration. Of the cases that have dealt with its equipollent, *Commissioner of Inland Revenue v. Challenge Corporation Ltd.* [1986] STC 548 is the most notable. It is a decision of the Privy Council on an appeal from New Zealand. The Special Commissioners referred to it in their Deciding Order. The Judicial Committee had before it, in that case, s. 99 of the Income Tax Act 1976 of New Zealand. It is a provision that is in *pari materia* with s. 140 of the Act.

On the facts of the *Sabah Berjaya* case, his Lordship found that:

> "... there was a payment that reduced the appellant's income in circumstances in which the Act by way of Section 44(6) clearly affords a reduction in tax liability. The appellant here was not engaging in tax avoidance. For, it did not do anything which did not reduce its income or suffer a loss, nevertheless resulting in it obtaining a reduction in its liability to tax as if it had. Accordingly in my judgment this is not a case to which s. 140 of the Act applies..."

Tax avoidance has also been distinguished from tax mitigation. Tax mitigation was defined by Lord *Templeman* in *C.I.R.* v. *Challenge Corporation Ltd* as the case when a taxpayer obtains a tax saving or advantage by reducing income or incurring an expenditure which the tax statute permits. Tax mitigation, unlike tax avoidance, involves an actual expenditure which results in a tax advantage. An example would be conducting a business by way of an incorporated company rather than a sole proprietorship so as to take advantage of the lower corporate tax rate and tax incentives available to companies. An extreme example would be adopting a child (or having a natural child) in order to benefit from child relief.

To counter tax avoidance the Income Tax Act contains a variety of provisions of an anti-avoidance nature. They can be divided into two categories, specific anti-avoidance provisions and the general anti-avoidance contained in Section 140. Some of the more important specific anti-avoidance provisions are as follows:

- Schedule 3 – sales between associated persons;
- Section 35(5) – transfer or sale of stocks on discontinuance of business;
- Section 65 – settlements;
- Section 139 – controlled companies; and
- Section 141 – transactions with non-residents.

*General anti-avoidance provision*
Section 140 is the general anti-avoidance provision. It purports to void, for tax purposes, arrangements entered into with a purpose of tax avoidance.

In addition to the anti-avoidance provisions there are other principles which might negate the effect of a tax avoidance arrangement. These are the fiscal nullity doctrine (which is of doubtful application in Malaysia) and the rules relating to sham transactions.

There is another issue which often arises in the tax avoidance context. This is the question of whether a transaction should be analysed according to its legal form or its economic substance. Principles relating to that issue are set out below.

## Substance or Form

The exercise of defining the true legal nature of any transaction might involve the question of whether the matter should be analysed according to its stated form or according to its broad substance. The first approach requires that regard may be had only to the legal form of the transaction while the second approach emphasises that regard should also be had to the economic consequences that attend the transaction. Under the second approach attention is focused on whether economic objectives are accomplished by means of some manipulation of the tax laws. If that is found to be the case the efficacy of that manipulation is denied for tax purposes.

The latter approach should be distinguished from the fiscal nullity doctrine (discussed below). Under the latter a preconceived series of transactions may be disregarded for tax purposes where their purpose is only one of tax avoidance. Another related body of law is the principles which should be followed in determining precisely what facts should be considered when analysing the true legal nature of a transaction.

What is important is that it must be seen whether the arrangement in question is intended or meant to defeat the revenue laws of the country. In *B-Trak Sdn Bhd* v. *Bingkul Timber Agencies Sdn Bhd & Anor* [1989] 1 MLJ 124, the first defendant rented from the plaintiffs nine units of equipment, and the second defendant was the guarantor. The first defendant paid only part of the rental due and owing. The plaintiffs claimed that they were entitled to retake possession of the equipment and claimed against the defendants the total rent and all moneys payable under the agreements. The defendants contended that the lease agreements were a subterfuge for sale and purchase agreements. They further contended that the lease agreements were illegal in that they were intended or meant to defeat the revenue laws of the country or alternatively that they were contrary to public policy. The High Court held that if the defendants could prove that the agreements had the effect of misleading the Revenue, such agreements would be unenforceable on the ground of public policy. The court observed that as far as tax avoidance is concerned, the revenue law is Section 140 of the *Income Tax Act 1967* which follows the Australian provision. It is in *pari materia* with Section 260 of the Australian Income Tax Act 1936.

An example of the substance approach may be found in *Ray* v. *C. of I.R.* The taxpayer in that case carried on a business of dealing in land, and in two instances he sold some of his land to companies which he owned. Immediately after these sales the taxpayer sold his shares in the companies at figures which produced a profit. The Commissioner treated the profits as assessable income from a business of dealing in land. *Hutchison* J. confirmed the lower Court finding that the profit taken on the sale of the shares was a profit made in the ordinary course of the taxpayer's business of dealing in land. His Honour seemed to disregard the fact that the profits were realised by the companies, neither of which was carrying on a land dealing business. It is evident that his Honour paid regard to the economic objectives of the taxpayer's strategem.

As a general rule, however, the courts do not adopt the substance approach when dealing with tax problems. Authority for rejection of that approach is normally taken from *I.R. Commrs* v. *Duke of Westminster*.

*The Duke of Westminster approach*
In *I.R. Commrs* v. *Duke of Westminster* (1936) A.C. 1 the House of Lords emphasised that attention must focus on the actual transaction entered into by the taxpayer. Their Lordships also enunciated the principle that every person is entitled to organise his affairs so that he pays less tax than he otherwise might. Briefly the facts were that the Duke had covenanted to pay an annuity to his gardener. The Revenue said that this form of the transaction should be ignored and taxed the Duke on the basis of the substance of the transaction, which was that the annuity represented a payment of salary or wages. The House of Lords unequivocally rejected the Crown's reliance upon the substance doctrine. Lord *Tomlin* noted the existence of the substance doctrine and then continued, at pp. 19-20:

> "This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting 'the uncertain and crooked cord of discretion' for 'the golden and straight met wand of the law', 4 Inst 41. Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable."

His Lordship went on to add the qualification that the documentation embodying the transaction may be disregarded in cases where the documents are neither *bona fide* nor intended to be acted upon but are used only as a cloak to conceal a different transaction.

## Doctrine of Fiscal Nullity

Under the fiscal nullity doctrine a transaction will not be regarded as effective for tax purposes where its only purpose is to obtain a tax advantage. Broadly, there are two requirements to satisfy if the doctrine is to apply. First, there must be a preconceived series of transactions. Secondly, there must be steps which have no commercial or business purpose apart from attainment of a tax advantage. The fiscal nullity doctrine denies that tax advantage without the need to refer to anti avoidance-provisions.

The fiscal nullity doctrine developed in reaction to paper schemes. These are elaborate and intricate arrangements whereby the taxpayer, for payment of a fee to a promoter, shifts assets around in a circular manner with the result that only a tax advantage is generated. Without the tax benefits the arrangements usually are artificial and of an accounting nature only.

The fiscal nullity doctrine is a significant limitation on the *Duke of Westminster* principle that every person is entitled to organise his affairs to pay less tax than he otherwise might. A taxpayer who enters into an arrangement to obtain a tax benefit may be denied that benefit. It has not been authoritatively determined whether the fiscal nullity doctrine applies in Malaysia. The doctrine has been rejected in both Australia and Canada. In the United Kingdom, unlike in Australia, Canada, New Zealand and Malaysia, there are no general anti-avoidance provisions, hence the importance of the fiscal nullity doctrine. In view of the existence of Section 140, it is doubtful whether the doctrine is applicable in Malaysia.

## Sham Transactions

A sham is a transaction set up to conceal the true intention of the parties. It is inherently ineffective at law so it does not require provisions such as Section 140 to strike it down (*Jaques* v. *F.C. of T.* (1924) 34 C.L.R. 328).

The concept of a sham transaction was considered by *Diplock* L.J. in *Snook* v. *London & West Riding Investments Ltd* (1967) 2 Q.B. 786 at p. 802:

> "As regards the contention of the plaintiff that the transactions between himself, Auto Finance and the defendants were a 'sham', it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. But one thing, I think, is clear in legal principle, morality and authorities (see *Yorkshire Railway Wagon Co.* v. *Maclure* (1882) 21 Ch. D. 309 and *Stoneleigh Finance Ltd* v. *Phillips* (1965) 2 Q.B. 537), that for acts or documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a 'shammer' affect the rights of a party whom he deceived."

In *Miles* v. *Bull* (1969) 1 Q.B. 258 at p. 264, *Megarry* J. added these comments about a sham:

> "On the other hand, a transaction is no sham merely because it is carried out with a particular purpose or object. If what is done is genuinely done, it does not remain undone merely because there was an ulterior purpose in doing it."

In *Drummond* v. *Revenue and Customs Commissioners* SpC 617; [2007] STC (SCD) 682, where a taxpayer purchased second-hand life assurance policies and surrendered them at lower value as part of a tax avoidance scheme, the Special Commissioner held that to determine the relevant transaction for tax purposes, the approach was first, to determine the transaction that answered the statutory description and second, to decide whether the transaction in question did so whilst adopting an unblinkered approach to the analysis of the facts.

There may be different kinds of transactions which would fall into the category of sham transactions. For example, there may be acts or arrangements which ostensibly were intended to create or modify legal rights or obligations but which were not in truth intended to do so. There may have been a purported disposal of property to which the disponor and disponee did not intend to give effect, i.e. there was an understanding that the legal or beneficial ownership was not to change. If there is a contract, agreement or arrangement which is inoperative to create or vary legal rights and obligations, the contract, agreement or arrangement is itself devoid of legal effect. It should be noted, however, that a payment by cheque is not a sham simply because at the time of payment it was arranged that there should be a repayment of a similar amount in the near future. Thus, although there may be some cases where, as steps in a sham transaction, the exchange of cheques will not be given the effect of actual payments, an exchange of cheques cannot usually be attacked as a sham merely because each party knows that the cheques will cancel each other out or that neither party has funds to meet them — *Re Barnett (Deceased)*; *Perpetual Trustee Co. Ltd* v. *Barnett*; see also *Joseph* v. *Campbell* and *Burbury* v. *Commr of Stamps*.

It should also be observed that a contract, agreement or arrangement may be void and perhaps fall within the category of sham transactions, not because it was not intended to have legal effect, but by reason of some misunderstanding of the law it fails to effect what was intended by the parties. This appears to have been the view taken by *Windeyer* J. of the trusts which were purported to be established in *Arbuckle* v. *F.C. of T.* Furthermore, a gift of property would not be a sham merely because the donor expected some compensating benefit.

## Application to Innocent Party

It has been established in Australian cases that the tax avoidance section cannot be used against a taxpayer who is an innocent party and who is a stranger to the tax avoidance scheme. This point was established in *Stamp* v. *F.C. of T.* 88 ATC 4,803, the question to be decided in the case being whether the voidness of arrangements caught by Section 260 of the Australian Act could be used by the Commissioner against taxpayers not involved in the arrangements. The tax avoidance scheme was not for the taxpayer's benefit, nor did it in fact benefit her. The income was purely notional: she did not receive it, nor was she entitled to it. Nevertheless, the Commissioner contended that, as the taxpayer had the right to share in the income of trust in so far as that income was not distributed, the taxpayer was deemed to have received a share of the income when arrangements adopted to achieve the distribution were nullified by Section 260. *Pincus* J. of the Federal Court said that Section 260 could not have the effect argued by the Commissioner. His Honour said at p. 4,805:

> "If, of two parties to a contract caught by the section, one can say there is a tax-avoiding 'purpose or effect' as to one but not the other, the section works only so far as the contract has or purports to have that purpose or effect — i.e. only so far as it relates to the party avoidance of whose tax is in question."

In *Davis & Anor* v. *F.C. of T.* 89 ATC 4,377, *Hill* J. of the Federal Court noted that *Pincus* J. did not say that for Section 260 to apply it was necessary for the taxpayer personally to be a party to the tax avoidance scheme: "what his Honour did say was that it was necessary for the scheme to have the purpose or effect of avoiding the tax of the taxpayer" (at p. 4,408). *Hill* J. went on to say that there were two reasons why, on the reasoning of *Pincus* J., the applicant in *Stamp's case* should have succeeded:

1. The arrangement entered into was *not* entered into to avoid the applicant's tax.
2. The case involved a trustee and beneficiary and the purpose of the arrangement, in part at least, was to avoid the liability of the beneficiary although the beneficiary was *unaware* of the scheme.

In *Davis' case*, the applicant was not a party to the transaction in the sense that she participated in it, but, because she was the sole beneficiary, it was clear that the purpose of the arrangement was to avoid *her* tax. Nevertheless, there remained the question, *Hill* J. said, whether it is necessary for the operation of Section 260 that the taxpayer knew of or participated in the scheme. His Honour said at p. 4,409:

> "In many cases it may well be critical that a taxpayer either alone or through an agent participate in the scheme as a whole albeit that it will quite often be the case that a taxpayer is not conscious of each and every step in the scheme. In one sense, such a distinction may well underline the differing results in *Slutzkin* on the one hand and *F.C. of T.*v. *Gregrhon Investments Pty. Ltd.* 87 ATC 4,988 ... However, with respect to *Pincus* J., I would be of the view that Section 260 of the Act could apply in a case such as the present ... There is, in the language of Section 260, no requirement that a taxpayer necessarily be a party to the scheme provided that it is correct to characterise the scheme as a whole as one having a purpose or effect of avoiding the tax of the taxpayer."

## Meaning of "transaction"

"Transaction" is defined to include "any trust, grant, covenant, agreement, arrangement or other disposition..." In *Newton* v. *F.C. of T.* (1958) A.C. 450 at p. 465 the following comments were made by the Privy Council:

> "Their Lordships are of opinion that the word 'arrangement' is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons — a plan arranged between them which may not be enforceable at law. But it must in this section comprehend, not only the initial plan, but also all the transactions by which it is carried into effect — all the transactions, that is, which have the effect of avoiding taxation, be they conveyances, transfers or anything else. It would be useless for the Commissioner to avoid the arrangement and leave the transactions still standing."

Do unilateral acts fall within the meaning of Section 140? In a New Zealand case (*Case G43*), the Review Authority confirmed that the tax avoidance section cannot apply if there is no "arrangement" with another person. The taxpayer in that case made a voluntary payment of interest in order to increase his entitlement under the rebate for mortgage interest paid in relation to a first home. The Authority held that there was no plan or arrangement. There was just a single, simple unilateral act and so Section 99 (of the New Zeland Act, which is comparative to Section 140, ITA) could not apply.

Section 140 is expressed to apply to any transaction which has the "direct or indirect effect" of doing any of the things specified in the section. Unlike the Australian and New Zealand provisions, Section 140 does not refer to "purpose" . Therefore, a transaction which is entered into for the purpose (in the ordinary meaning of the word) of avoiding tax, but which does not achieve that purpose, will not be void under Section 140. It is therefore important to analyse the effect of the transaction.

## The Choice Principle

Essentially the choice principle entails the proposition that particular sections of the *Income Tax Act* present a choice of alternative courses of action and that the deliberate exercise of a choice so as to generate a tax advantage is not invalidated by a general provision such as Section 140. The justification for the principle is that, in the light of the policies underlying the particular section, those policies would be frustrated if the general provision could be invoked to take them away. The choice principle is one of statutory construction, that a general provision cannot be allowed to override a specific provision (expressed in the Latin maxim, *generalia specialibus non derogant*).

## Cases Involving Section 140

The Malaysian courts have not yet considered the scope of Section 140 in detail.

In *LD Timber Sdn Bhd* v. *D.G. of I.R.* (1978) 1 MLJ 203 one of the issues that came before the High Court for a decision was whether Section 140 applied to the transaction entered into by the taxpayer. The taxpayer signed two agreements, one for timber extraction and the other for the sale of timber and the execution of certain works. As both the agreements were executed on the same day by the same parties, the Revenue maintained that this was solely for the purpose of avoiding income tax and therefore Section 140 is applicable. Justice *Yosoff* in his judgment said:

> "In my opinion, in order to see that the transaction in this case had the effect of altering the incidence of tax, it must be shown that the transaction is not capable of explanation by reference to ordinary business dealing without necessarily being labelled as a means to avoid tax.
>
> In applying these principles to the present case and by looking at the two agreements, in my opinion, it cannot be said that the transaction was done to avoid tax.
>
> The question to be asked is, what was the purpose of the arrangement for the appellant to enter into two agreements with the Society, instead of one? It is not difficult to see that the appellant company's purpose was to separate their income derived from the extraction of timber and their income from the sales of timbers on behalf of the Society. Their income from timber extraction fees as contracted in the first agreement for the year was $686,775.70; and their income from the sales of those timbers, namely, the agency fee, was $303,313.66 according to the terms of the second agreement. This arrangement brings about the result that the appellant company escapes liability for timber profit tax on their income derived from the sales of those timbers; but not their income from timber extraction fees."
>
> This is more so when the substantial income from this arrangement had already been conceded to be taxable. In my view, the principal purpose of the scheme or transaction designed by the appellant company was to facilitate the development of the land and the execution of works of building houses, school and other facilities relating to such development. The tax saved by the appellant company in this respect was not substantial. With due respect I do not think that in this case, Section 140 of Act 53 can properly be invoked."

Section 140 was invoked by the Revenue in *SBP Sdn Bhd* v. *D.G. of I.R.* (1988) 1 MSTC 243, 2,053. In this case, Mine Sdn Bhd was incorporated on 8 December 1966 and ceased mining on 12 December 1972. The company (TC) disposed of its mining assets and ceased operations on 31 May 1975. An option was granted by a sole-proprietor (C) of a tin mine to acquire his business. The offer was signed by the husband (Mr C, the sole-proprietor of the mining business) and the acceptance was signed by his wife (Mrs C) (as director of Mine Sdn Bhd). On 20 June 1975 the option was exercised and the sole-proprietorship business (T) was acquired for Mine Sdn Bhd (TC). On 20 June 1975, the old board of directors approved the transfer of all the shares to the husband and wife at a price of 20 cents per share. On 1 August 1975, all the shares were transferred to the husband and wife. The agreed unabsorbed losses of Mine Sdn Bhd up to and including year of assessment 1975 was $411,197. The Revenue disallowed the losses against business income. The Special Commissioners held that the Revenue was correct in invoking Section 140 so as to disregard the acquisition of T by TC and the transfer of all shares of TC to Mr and Mrs C.

The Special Commissioners said thus:

> "In the instant case we have found that the purpose of the taxpayer was to set off the losses of TC against that of T so as to alter the incidence of income tax which would otherwise be payable by C or to relieve C of any liability to pay income tax which would otherwise be payable if the acquisition had not taken place."

The Special Commissioners found as a fact that the transaction was not capable of explanation as a family arrangement or commercial purpose. The only conclusion to be drawn was that the transaction was to avoid income tax. The Commissioners said:

> "If the Director-General had not acted in applying Section 140, the unabsorbed losses of TC amounting to $411,197 would of course be a very significant set-off against what were effectively the profits of T to the benefit of Mr and Mrs C ..."

*SBP Sdn Bhd* is a classic example of an attempt to use unabsorbed losses of one enterprise against income of another enterprise. The effect and purpose of the transaction could not be explained as family arrangements or for purposes of commercial reasons; the plain purpose emerging from the transaction was to avail the tax losses against income of another enterprise. Therefore, the case failed before the Special Commissioners.

In *UHG* v. *D.G. of I.R.* (1950-1985) MSTC 145, Section 140 was considered but not in detail. In that case the facts, in brief, were that a taxpayer owned 16 taxis and the books of account were in many respects fictitious and had no relation to facts. The audited accounts were inaccurate and did not reveal the true financial position. Wages and salaries were charged in the accounts but were not paid. The payments charged for petrol were also found not to be paid. One of the arguments advanced by the company was that the Revenue did not give particulars of adjustments required by subsection (5) of Section 140 and this rendered the assessments issued invalid.

*Raja Azlan Shah* F.J. (as he then was) spoke of Section 140 in the following terms at p. 147:

> "The genesis and purpose of Section 140 is clear. It gives the Director-General an unfettered discretion in certain matters of tax evasion. The powers under it are wide but they are not plenary. He may, under the section, disregard or vary the transaction of controlled companies and make such adjustments as he thinks fit with a view to counteracting the whole or a part of any direct or indirect effect of the transaction. To carry out these adjustments, he may make such assessments or additional assessments as he deems necessary to nullify a right to repayment of tax or to require a return of any tax which has been repaid."

In that case his Lordship was of the view that the assessments were outside Section 140 and therefore, the rendering of particulars under Section 140(5) was not required. In other words the Revenue did not invoke Section 140.

Section 140 was again considered by the Special Commissioners in *SB Sdn Bhd* v. *Ketua Pengarah Hasil Dalam Negeri* (1995) 2 MSTC 2,417. In this case, the taxpayer company was a wholly-owned subsidiary and the trading arm of the S Foundation, an approved non-profit making institution. The Chief Minister of Sabah was the chairman of both the taxpayer and the S Foundation. Pursuant to the State Government's request that subsidiaries of the S Foundation donate their surplus funds to the Foundation, the taxpayer decided that it would be more tax-effective to donate its profits than declare them as dividends. The taxpayer made substantial donations to the Foundation, sometimes exceeding its profits. The donations were allowed as a deduction for the years of assessment 1980 to 1987. However, in 1987, the Revenue invoked Section 140 to disallow deductions originally claimed and allowed as deductions, and raised additional assessments to the taxpayer. The taxpayer appealed to the Special Commissioners.

The Special Commissioners found that the payments did not constitute a gift within the meaning of Section 44(6) of the Act, and consequently, did not qualify for deduction.

On the burden of proof in activating Section 140, the Special Commissioners said at p. 2,428:

> "In cases of this nature the burden of proof is on the [Director-General of Inland Revenue] to show that a transaction falls within one of the limbs of section 140(1) except in instances where section 140(6) applies. Section 140(6) is a deeming provision."

At p. 2,429:

> "Thus once it is established that a transaction between persons specified in the subsection is not one which would have been made by independent persons in the same or similar activities dealing with one another at arm's length then it shall be deemed to be transactions of the kind to which subsection (1) applies. In that event there is no onus on the [Director-General] to establish that the transaction falls under one of the four limbs of Section 140(1). It must be taken as concluded that the transaction falls within Section 140(1) of the Act. He may proceed to disregard or vary the transaction as specified in the section upon proof of the basic facts needed to activate the deeming consequence flowing from the deemed state of affairs ...
>
> In this regard what requires consideration is whether the manner in which the payments were made in this case is one that would be made by independent persons dealing with one another at arm's length."

The Special Commissioners were of the view that the transactions between the taxpayer and the S Foundation were not made at arm's length and the payments fell squarely within the meaning of tax avoidance. The Revenue had discharged the burden of proof in activating Section 140, and was empowered to disregard the payments made as donations and to make such adjustments as it thought fit to counteract the effect of the transactions.

The Commissioners agreed with his Lordship, *Raja Azlan Shah* F.J. (as he then was), in *UHG* v. *D.G. of I.R.* on the scope of Section 140, at p. 2,436:

> "The judgment of the Federal Court ... makes it pellucid that where the Director-General of Inland Revenue has invoked Section 140 the other relevant sections of the *Income Tax Act* are rendered inapplicable. This shows in crystalline terms that the powers conferred by the section are in addition to those conferred by the other provisions of the Act. As his Lordship said '... section 140 merely superadds a discretion of the Director-General's power.' Thus it is illogical to suggest that section 140 has to be read subject to the other provisions of the Act."

On the application of the "choice principle" developed by the Australian courts, the Special Commissioners had this to say at p. 2,435:

> "The 'choice principle' conflicts with the unambiguous language of Section 140 and, if adopted, would render the existence of the section nugatory. In our opinion Section 140 must be nursed and nurtured in its original form without being adulterated by any alien interpretation. The doctrine's entry into the smooth working of our fiscal system would undermine the purpose of the creation of Section 140 as a provision designed to combat tax avoidance." TG

*This article is summarised from* Malaysian Tax Reporter, Volume 2 *published by CCH Asia Pte Limited and has been adapted for publication in this issue of the* Tax Guardian.

# 2009 National Budget Memorandum

*The Malaysian Institute of Taxation submitted its memorandum recently to the Ministry of Finance on issues relating to the forthcoming 2009 National Budget. The proposals were broadly categorised under the following:-*

- *Improving the efficiency of tax administration*
- *Maintaining a competitive fiscal environment*
- *Continuous review in ensuring an equitable and business-friendly taxation system*
- *Stimulating the business environment*
- *Development of Human Capital*
- *Promoting a caring society*

*A summary of the main issues and proposals are outlined below:*

## A. IMPROVING THE EFFICIENCY OF TAX ADMINISTRATION

### 1. Public Rulings/Guidelines/Legislative Amendments

The Institute proposed that :

(a) The effective date for laws or any guidelines/public rulings should be prospective from the date such rules are made and announced to the public instead of retrospective.
(b) Appropriate lead-time should be given to taxpayers to comprehend and understand the legislation or amendments made thereto.
(c) Any guidelines/public rulings issued, etc should be announced and notified in advance to the professional bodies. Alternatively, the IRB website must have an "Updates" or "Latest Developments" link on the website so that taxpayers can be alerted on the latest announcements. The same applies to the Customs Department website.
(d) The requirement to disclose compliance with public rulings by a taxpayer in the tax return form should be removed as it vests the rulings with some degree of "power" to compel compliance. Rulings are only intended as a guide and represents the tax authorities' interpretation of the law. The Institute is of the view that taxpayers should not be penalised if they have a different interpretation of the law as long as it is supported by a valid basis.
(e) Specific guidelines/rulings should be issued on a timely basis to provide clarity on the tax treatment of new emerging business developments.
(f) The Inland Revenue Board may outsource of some of the technical research work to solve its human resource shortfall. The IRB maly also consider forming an Advisory Panel made up of prominent and respected practitioners so that timely changes can be implemented.

### 2. Assessment of Employment Income

#### 2.1 Bonuses

Proposal

The Institute has proposed that bonuses be taxed on the receipt basis and be declared in the Form EA for the year in which it was received to eliminate administrative hassles such as the issuance of an additional notices of assessment, etc.

#### 2.2 Benefits and Perquisites

There are various categories of benefits (including allowances) and perquisites which are provided by employers, and although considered to be essential in carrying out the employment duties, these have to be reported no matter how small the quantum is. These benefits are also subject to Schedular Tax Deductions (STD).

Proposal

The Institute proposes that the IRB discuss/consult with the relevant parties including professional bodies to determine a list of common benefits wherein the amount/value can be considered as fully utilised in the carrying out of the employees' duties thereby relieving the employees/employers from monitoring such benefits and perquisites.

#### 2.3 Consolidation of Personal Reliefs

Proposal

The Institute proposed that personal reliefs be consolidated into a few broad categories (for example, single individual and married individual) and the global personal relief amount will then be automatically (in some cases there could be a minimum and maximum amount stipulated subject to conditions) granted to the taxpayer. This will simplify the completion of tax returns and reduce the tendency for errors and overclaiming reliefs due to confusion in determining eligibility for such reliefs

### 3. Consolidation of Incentives Legislation

Currently various types of tax incentives are provided under the Promotion of Investments Act 1986 (PIA), Income Tax Act 1967(the Act), various gazette orders, etc. Additions and amendments to the law over the years have made the legislation more complex. Furthermore these legislations are under the purview of different authorities e.g. MIDA, MDeC, IRB, MOF, etc.

#### Proposal

It is proposed that a relevant authority be appointed to consolidate the various incentives under one legislation for ease of reference and application by taxpayers and tax practitioners.

### 4. Self Assessment System

Malaysia has now fully implemented the self assessment regime, which relies on taxpayers determining their income tax liability. Continual review of the current tax regulations and administration environment is necessary to make it friendly so as to ensure compliance. The Institute would like to commend the Government and the IRB for their initiative in reviewing the current tax system, with a view to improving its efficiency, transparency and effectiveness.

In this respect, the Institute has proposed the following for the Government's consideration.

#### 4.1 Basis Periods

To simplify the determination of the basis periods, the basis of determination for the various entities should be reviewed. Our proposals are as follows:-

##### (a) Sole-Proprietors and Partnerships

Proposal

The Institute is of the view that taxpayers should be using the financial year ends of their businesses for income tax purposes. Thus an individual who has a sole proprietorship business with a 30 September year end should be reporting the statutory business income for the year ended 30 September 2007 in the Form B to be filed by the end of June 2008 rather than having to report the business income for the year ended 31 December 2007.

##### (b) Company, Trust Body or Co-operative Society (Section 21A)

Section 21A provides that where a company, trust body or co-operative has made up the accounts of its operations for a period of 12 months ending on a day other than 31 December in the basis year, that period shall constitute the basis period for that year of assessment.

Proposal

It is proposed that even if a company, etc has made up its accounts for a period of less than 2 months ending on other than 31 December, that period should constitute the basis period for that year of assessment.

##### (c) Non-Corporate Bodies

Pursuant to Section 56 of the Trade Unions Act, 1959, the secretary of the trade union shall submit the audited financial statement of a registered trade union in respect of the period of twelve months ending on 31st March in each year before 1st October in every year. However, as stated in Section 21 of the Act, the basis year for a year of assessment in relation to a source of a person other than a company, trust body or co-operative society shall constitute the basis period for that year of assessment.

Proposal

It is proposed that a trade union and any other non-corporate body be allowed to prepare their tax computations based on their financial year being taken to be the basis period for a year of assessment rather than on a calendar year basis. This will assist these taxpayers to comply fully with the filing requirements under the self assessment system.

#### 4.2 Submission of Revised Income Tax Returns

Under the self-assessment system, there is no specific provision in the Income Tax Act to allow for the submission of a revised or amended tax return. The Institute proposed the introduction of a specific time period, for example a 6 month period, within which taxpayers are allowed to submit a revised tax return (which could include the correction of errors) without the imposition of penalty. It is inevitable that human errors do occur especially when there is a time constraint.

#### 4.3 Revision of Tax Estimates

Under the self assessment system, every company is required to submit an estimate of tax payable of not less than 85% of the tax estimate or revised tax estimate for the immediately preceding year of assessment, 30 days before the beginning of the basis period for that year of assessment. In practice, the IRB has, based on the merit of each case, considered applications (via Form CP204) which are submitted with a lower tax estimate than the permitted amount and with an appeal letter stating valid reasons and supporting documents.

Proposal

The Institute proposes that Section 107C of the Act be amended to specifically allow a company with valid reasons to file a tax estimate which is lower than the permitted amount.

#### 4.4 Refund of Tax Overpayment

A company may revise the estimate of tax payable in the 6th and 9th month of the basis period and in

National Budget Memorandum

the event that actual tax payable exceeds the estimated tax by an amount of more than 30% of the actual tax payable, the company shall be liable to a penalty of 10% on the difference. Some taxpayers tend to furnish a higher estimate of tax payable to avoid a penalty being imposed.

### Proposal

It is proposed that any tax overpayment due to a taxpayer should automatically be used to set off the taxpayer's current year tax liability unless a refund application has been made. A penalty should not be imposed if sufficient tax credits are available. Where a tax overpayment is not refunded within a period of 60 days, there should be an increase in the total amount of tax to be refunded, perhaps at the same rate of increase as that imposed on taxpayers for a delay in the payment of tax.

## 4.5 Submission of Income Tax Return for Employees

Every employer is required to deduct (where required), the monthly tax deductions from the remuneration of each of his employees based on the Income Tax (Deduction from Remuneration) Rules 1994.

### Proposal

To further simplify the self-assessment system, the Institute proposed that all individual taxpayers who are currently employed and subjected to schedular tax deductions, be waived from the requirement to submit personal tax returns unless there is an overpayment of tax or if the individual has other income to report. At the same time, the STD tables should be reviewed to ensure that the deductions to be made are accurate.

## 4.6 Tax Audits and Investigations

### Proposal

The Institute proposed that a clear mechanism be set in place for any appeal against the manner in which an audit/investigation is carried out and such appeals could be settled on a timely basis by an independent party, for example, an Administrative Appeals Tribunal (AAT).

In respect of the framework for tax investigation, Paragraph 12.6 reads as follows:-

*"Where a taxpayer seeks a longer installment payment scheme than usually permitted, the penalties exigible will be much higher compared with a taxpayer who opts to settle in one lump sum payment or requests for an installment payment scheme of a shorter duration"*

### Proposal

A penalty should not be increased due to a longer installment scheme. Instead the merit of a case should be looked into. The Institute therefore proposed that the said paragraph 12.6 be deleted.

## 4.7 Appeals

Where it is unlikely that the IRB and the taxpayer will reach an agreement on an area of dispute, either party can appeal to the Special Commissioners (SC). Either party to the proceedings before the SC may appeal on a question of law against the decision of the SC to the High Court.

### Proposal

To improve the appeal process, the following measures were proposed by the Institute:-

(a) the Courts of Judicature Act be amended to allow cases first heard by the Special Commissioners to be eventually heard at the Federal Court.
(b) Review the time frame for disposal of appeals by the Director General of Inland Revenue (currently, a maximum period of 18 months is far too long and does not motivate efficient handling of appeals).
(c) Consider the setting up of an Administrative Appeals Tribunal (AAT) for taxpayers aggrieved by decisions of an administrative nature including the imposition of penalties.
(d) Provide an avenue for appeals against penalties which are imposed through the exercise of the discretionary power of the IRB. This could be through the AAT stated above.

## 5. Taxpayers' Rights

With the implementation of the self-assessment system, the IRB is able to place emphasis on enforcing compliance via tax audits and investigations. Compliance with the tax legislation must be strictly enforced and tax offences such as non-compliance and tax evasion should be penalised.

### Proposal

The following suggestions are proposed-

a) The introduction of the office of a Taxation Ombudsman as an avenue for taxpayers to forward complaints in relation to non-technical matters.
b) The introduction of an Administrative Appeals Tribunal (mentioned earlier) for taxpayers aggrieved by decisions of an administrative nature (including the imposition of penalties).
c) The establishment of a more effective Taxpayer's Charter or Client's Charter which not only sets out the rights and obligations of taxpayers and certain timelines for the IRB to follow but is also effectively monitored as far as the adherence to the Charter is concerned.
d) Criminal proceedings should only be initiated on repetitive or recalcitrant offenders and not as a first recourse of action.

## 6. Advance Rulings

Paragraph 17 of the Guidelines on Advance Ruling, issued at December 2007, provides that advance rulings issued will not be published.

### Proposal

The Institute proposed that the advance rulings be published for general reference with the confidentiality of the taxpayers maintained to promote transparency in the tax administration

## 7. Application of Decided Tax Cases

### 7.1 Publication of Decided Tax Cases

It is not always possible for a piece of legislation to be perfectly clear resulting in certain provisions in the Act to be the subject of dispute with the tax authorities. It is here that case law provides the opinions of the courts on the interpretation of the legislation which are relied upon by practitioners and tax officers.

#### Proposal

The following were proposed-

a) Tax cases decided by the Special Commissioners, Customs Appeal Tribunal and courts should be made available to the public for better transparency through timely dissemination via the IRB's and Customs websites or other means. The Special Commissioners of Income Tax and Customs Appeal Tribunal should also establish their own websites and place their judgements on these websites.

b) Both the IRB and the taxpayers should be allowed to adopt the decisions passed by the courts (irrespective of the stage of appeal of the case) in the preparation of their tax computation in respect of the interpretation of the legislation.

### 7.2 Scope of Controlled Transfer

The IRB appears to hold the view that the controlled transfer provisions under Schedule 3 of the Income Tax Act apply only to transfers between Malaysian residents. This is not supported by the legislation nor clarified in the IRB Public Rulings. On the contrary, in the case of ***SEOD S.A. vs LHDN,*** both the Special Commissioners and the High Court decided that there is no requirement under the Act to require the acquirer to be a Malaysian resident for a controlled transfer to apply.

#### Proposal

It is proposed that Paragraphs 38-40, Schedule 3 of the Income Tax Act be clarified so as to avoid ambiguity in the case of controlled transfers between Malaysian residents and overseas related parties.

## 8. Waiver of the Need to Gazette Tax Exemption

It has been gazetted that the exemption of income tax, real property gains tax and stamp duty given only on a case-to-case basis be effected without the requirement for gazette notification.

#### Proposal

The Institute suggested that the provision be withdrawn.

## 9. Effective Use of Technology

In order to continue to collect more tax revenue (which will be essential in assisting future moves to attain a balanced budget) the need for effective enforcement by the tax agencies (both the IRB and the Customs Department) is an important component. With technology, we can do a lot to ensure that tax officers are free to concentrate on enforcement be it via audits, inspections or investigations.

#### Proposal

There must be a holistic plan to transform the tax agencies into truly "service-oriented" entities which use information technology effectively and efficiently. The agencies' websites and the press should be fully utilised to convey latest policies and accurate information instantly to taxpayers all over the country as well as to all tax agents.

# B. MAINTAINING A COMPETITIVE FISCAL ENVIRONMENT

## 1. Review of Income Tax Rates

The corporate tax rate is reduced to 26% and 25% in years of assessment 2008 and 2009 respectively. However, in view of regional developments and the need to attract Foreign Direct Investment, more changes need to be looked into. Currently, an individual resident in Malaysia will hit the top tax rate of 28% once the taxable income reaches RM250,000.

#### Proposal

The Institute proposed the following:-

(a) The Government should review the tax brackets for individuals with the objective of having larger income bands and aligning these to the corporate tax rates so as to improve its competitiveness and to ease the financial burden of individuals.

(b) The corporate tax rate should be further reduced to enhance competitiveness in attracting foreign investment.

## 2. Goods & Services Tax (GST)

The Ministry of Finance made an announcement on 22 February 2006 to defer the implementation of GST to allow businesses sufficient time to prepare for GST.

#### Proposal

It is hoped that the draft legislation on GST will be made available for public consultation before it comes into force. In addition, the Institute also hopes that guidelines/rulings on specific arrangements /administrative practices be made known to the public on a timely basis to ensure transparency and clarity in the application of the GST provisions.

## 3. STD Payments for Expatriates Working at an OHQ /RO /RDC /IPC

Currently expatriates working at an OHQ /RO /RDC /IPC qualify for the income tax exemption depending on the length of stay in Malaysia. However, this will be known only after the year end. Meanwhile, the employers have to continue to deduct STD payments based on the normal provision.

### Proposal

The Institute proposed that where there is a specific basis for ascertaining the length of stay in Malaysia fairly accurately, a concession be allowed to lower the STD payment accordingly.

### 4. Review of Fiscal Incentives

Competing for FDI has become an important focus in the fiscal policy of many developing countries. It is noted that many of our neighbouring countries also grant incentives similar to our pioneer status and investment tax allowance (PS & ITA).

### Proposal

To further differentiate ourselves from our competitors, the Institute proposed that:

(a) Malaysia gradually moves away from PS & ITA and adopt a system of according preferential tax rates for promoted industries/products over a fixed period of time. Extension of the period could be based on reinvestment or other criteria met by the company. The preferential tax rates should be minimal and be set at the level which is sufficient to compensate for the usage of public infrastructure.

This would simplify the compliance process and reduce compliance costs as both the taxpayer and IRB are relieved from the need to comply with/monitor compliance with the specific provisions under the PIA. *Alternatively,*

Malaysia may continue to provide PS & ITA for the specific periods but after the expiry of the incentive, a lower income tax rate should be granted for a specific period before the existing corporate tax rate comes into play. This would promote long term presence of FDI and encourage reinvestment. and avoid the difficulty or concern that an investor will have from transitioning from a nil or 7.5% effective tax rate to a 25% tax rate.

(b) In this connection, any offering of new incentives should be targeted at promoting the long term betterment of Malaysia's economy rather than achieving a knee jerk impact that provides investors and the country with short term gains only.

(c) The provision of incentives should not be solely targeted at attracting FDIs but should also promote investment/reinvestment by the local small and medium industries which have been identified as one of the drivers for sustainable economic growth.

## C. CONTINUOUS REVIEW IN ENSURING AN EQUITABLE AND BUSINESS FRIENDLY TAXATION SYSTEM

### 1. Convergence between Accounting and Taxable Profits

All companies, other than private entities, are required to adopt the FRS released by the Malaysian Accounting Standards Board. This results in changes in accounting treatment which impact the net profit of an entity. The adoption of the FRS is a move towards fair value accounting which would affect taxation. In the context of self-

assessment, there is a need to review the tax impact of such adjustments and to determine whether the tax treatment of certain transactions should be changed or modified.

### Proposal

A working group should be formed between IRB, MOF, the Institute and any other relevant organizations to ensure a greater convergence between tax and accounting. For example, interest receivable should be taxed on an accrual basis in the year in which it is accrued as required under the accounting standards rather than be taxed in the year it is received. Receipt of advance rental income for a period of say, five years which will be spread evenly throughout the said period of time (according to the accounting standard) should be taxed according to the accrual basis instead of taxing it in advance when it is received.

As for the taxability of the 5% retention sum retained under construction contracts, the amount so withheld during the warranty period should be treated as deferred income to be set off against expenses incurred during the warranty period. Therefore, it should be brought to tax after the warranty period so that the income and expenditure can be matched.

### 2. GST Implementation Costs

In view of the implementation of GST in the near future, businesses would need to incur additional expenditure to ensure that their current management and business information systems are adequately modified to account for GST. The employees would also need to be trained to understand the workings and mechanism of GST.

### Proposal

It is proposed that the legislation be specifically amended to allow the deduction of the expenditure incurred in preparation for GST, including enhancing or improving operating systems, training workforce, etc.

### 3. Withholding Tax under Section 109B

The scope of Section 109B of the Act and the types of payments that would be subjected to withholding taxes under this provision have been controversial issues. The IRB takes the view that Section 4A income includes payments which form part of the contract value for the services rendered by a non-resident. As a result, withholding tax is applicable on a wide range of payments, including the disbursements and reimbursements to non-residents, as stated in the Public Ruling No.4/2005: Withholding Tax on Special Classes of Income, Taxpayers are advised to pay the withholding

tax and subsequently attempt to recover it from the non-resident. In practice, most taxpayers end up bearing the withholding tax themselves. This thus increases the cost of operations and affects competitiveness.

The Institute is of the view that certain expenses payable to non-residents (e.g. management and administrative fees) and reimbursements of costs made to non-residents should not fall within the ambit of Section 109B(1)(b) and be subjected to withholding tax.

### Proposal

Section 109B should be amended to provide that reimbursements/disbursements are not subject to withholding tax. This will help to reduce the cost of doing business in Malaysia.

## 4. Harmonisation of Capital Allowances and Depreciation

Under the current tax system, deductions are not allowed for capital expenditure or for depreciation of assets used in the production of gross income. However, tax depreciation for certain types of capital expenditure in the form of capital allowances is allowed..

The adoption of FRS will also bring with it valuation of assets based on fair values. Reliance would be placed on third party valuation in estimating the fair value of the assets.

### Proposal

The following are proposed-

(a) small value assets should be given an outright revenue deduction instead of a 100% capital allowance claim as such assets have no economic value in the future. Any sale proceeds for such assets will be subjected to tax when sold.

(b) the cap for small value assets should be increased from the current value of RM 10,000 which would be easily exceeded.

## 5. Capital Allowances and Rental Claims on Private Motor Vehicles

Currently, a company that purchases private motor vehicles for its business and a leasing company that leases out private motor vehicles may claim initial allowances (20%) and annual allowances (20%) on private motor vehicles up to a limit of RM100,000, if the cost of the vehicle is less than RM150,000. Following the 2007 Budget, it has been legislated that any amount of debt released in respect of expenditure on which capital allowances have been claimed previously shall now be taxed. This is irrespective of whether the capital allowances were claimed in full or otherwise.

### Proposal

It is proposed that the limit on qualifying expenditure for capital allowances and lease rental claims on private motor vehicles be removed. Alternatively, it could be increased to reflect the current economic environment.

## 6. Deduction of Recurring Compliance Expenditure

In order to ensure compliance with statutory requirements set out by specific legislation or by regulatory authorities, companies necessarily incur expenses such as audit fees, tax agent's fees, secretarial fees, annual listing fees and other compliance/governance-related expenses. Except for audit fees, these expenses are not allowed deduction.

### Proposal

As these recurring compliance fees are expended in the course of an on-going business, it is proposed that

(a) Such expenses be legislated as specific deductions as such expenses are essential in operating a business. With the introduction of self-assessment, it can no longer be said that a company only fulfills its tax obligation after the year-end.

(b) In the absence of a specific amendment or a gazette order, the Institute would suggest to MOF/IRB to exercise their discretion to allow a concessional tax deduction on the above-stated expenses.

## 7. Deduction for Cost of Acquisition of Proprietary Rights

Pursuant to *the Income Tax (Deduction for Cost of Acquisition of Proprietary Rights) Rules 2002*, among others, the cost of acquisition of proprietary rights such as patents, industrial designs and trademarks may be claimed over five years of assessment by a manufacturing company which has incurred the same or by the manufacturing company's subsidiary if the proprietary rights are transferred to the latter.

### Proposal

It is proposed that the incentive be extended to non-manufacturing companies to encourage these companies to acquire new technologies to evolve into innovation-driven, knowledge-based companies. The incentive should also cover new business where the intellectual property was created or acquired prior to the commencement of business.

## 8. Tax Treatment of Advance Payments/Prepayments

Currently, except where it relates to interest and rental income, general provisions within the Act are relied upon for guidance on the recognition and taxation of advance payments/prepayments received. The taxation of prepayments in the year of receipt would result in a gross mismatch of income and expenses. In this regard, the upfront fees would not match the expenditure (e.g. repairs and maintenance) in future years.

### Proposal

It is proposed that an appropriate provision be introduced to tax advance payments/ prepayments as and when they fall due. This converges with the accounting method of recognising such income in the accounts. Prepayments should not be taxable until they fall due each year as the debt for the prepayments has not arisen until the payments fall due each year.

## 9. Entertainment Expenses

Pursuant to Section 39(1)(*l*) of the Act no deduction shall be allowed in respect of :

*"a sum equal to fifty percent of any expenses incurred in the provision of entertainment including any sums paid to an*

*employee of that person for the purpose of defraying expenses incurred by that employee in the provision of entertainment."*

The Institute has highlighted that entertainment of both potential and existing customers is part of a company's business activity to secure business and sales and segregation between entertainment of potential and existing clients would prove commercially and administratively impractical.

**Proposal**
The Institute has proposed that any expenses incurred in the provision of entertainment should be partially allowed as a deduction against the gross income while entertainment expenses which fall under Section 39(1)(*l*)(i) to (vii) of the Act should be allowed in full.

### 10. Confirmation of Tax Exempt Account

Section 21(3) of the Promotion of Investments Act, 1986 (PIA) requires the exempt income of a pioneer company to be confirmed by the IRB before the company can distribute tax exempt dividends to its shareholders.

***Proposal***
It is proposed that a suitable amendment be made to the PIA to dispense with the above requirement for confirmation from the IRB in line with the self-assessment system.

### 11. Waiver of Debt

Section 30(4) of the Income Tax Act 1967 provides that where a deduction has been taken in computing the adjusted income of a person from a business and the debt in respect of such expense is subsequently released, the amount that is released shall be treated as gross income from that business in the year it is released. However, there is no equivalent provision for the release of a debt in respect of an expense that is deducted from non-business sources of income.

**Proposal**
It is proposed that a provision similar to section 30(4) be introduced to address this anomaly. The proposed provision will ensure there is clarity and certainty in the tax treatment for non-business cases where a debt in respect of an expense claimed under section 33(1) has been waived.

### 12. Capital Allowances

To encourage companies to install security and surveillance equipment, Accelerated Capital Allowance (ACA) is now given on the expenses incurred for:

(i) security control equipment installed in the factory premises of companies approved under the Industrial Coordination Act 1975; and
(ii) vehicle surveillance equipment installed in the container lorries bearing Carrier License A and general cargo lorries bearing Carrier License A and C.

The ACA is to be fully written off within a period of one year with an initial allowance of 20% and an annual allowance of 80%. The eligible security and surveillance equipment shall be determined by the Minister of Finance.

**Proposal**
The Institute notes that all premises that are used for storage of goods require the security control and surveillance equipment to enhance the security control of goods. As such, the Institute recommended that the incentive should be extended to all premises so long as the equipment acquired is used to enhance the security control of goods.

The Institute also proposed that the above incentive should be applied to all equipment which is installed for security and surveillance purposes, whether in a factory environment or an office environment.

### 13. Building Allowances on Non-Industrial Buildings

Based on FRS 116: Property, Plant and Equipment, buildings have a limited useful life and therefore, are depreciable assets. However, currently, only buildings used in specific sectors qualify for Building Allowances. Industrial buildings such as a factory, warehouse, dock, wharf, jetty, public road, old folks care centre, building occupied by MSC status company, etc qualify for Industrial Building Allowance, whereas workers quarter, childcare facilities, school and educational institution qualify for Special Building Allowances. There is no relief accorded to capital expenditure incurred on commercial buildings, office complex, private medical clinic, private dental clinic and other healthcare facilities, etc.

**Proposal**
The Institute proposed that
(a) Building allowances be accorded to capital expenditure expended on all buildings, which are incurred solely and exclusively for the purpose of a business. This will provide relief for the costs incurred by businesses as well as simplify the computation of industrial building allowances. It also will help to boost the property market. This is also in line with accounting treatment of depreciating buildings and thus provide for further convergence between accounting and tax treatment.
(b) Eligibility to claim for building allowances be extended to the owners or lessors of non-industrial buildings.
(c) Building allowances are allowed on cost of renovation and alteration on all buildings except for residential buildings.

## D. STIMULATING THE BUSINESS ENVIRONMENT

### 1. Group Relief

Section 44A was introduced to provide for group relief for tax losses whereby a surrendering company may surrender not more than 50% of its adjusted loss in the basis period for a year of assessment to one or more related companies resident and incorporated in Malaysia in the basis period for that year of assessment. The conditions to qualify for group relief are very stringent. As a result, the previous 100% relief is no longer available to new companies engaged in food production, forest plantations, biotechnology, nanotechnology, optics and photonics sectors.

### Proposal

The Institute proposed that group relief be given to companies that fall under the definition of related companies as provided under the Companies Act, 1965 and the restriction of a 70% shareholding be removed. In addition, it is proposed that the losses to be allowed should be restricted only by the aggregate income of the claimant company (and not limited to only 50% being surrendered).

## 2. Unutilised Tax Losses and Unabsorbed Capital Allowances (Section 44 and Paragraph 75A of Schedule 3 of the Act)

It has been legislated that unutilised business losses and unabsorbed capital allowances shall not be carried forward to future years of assessment for deduction if the shareholders of that company on the last day of the basis period for that year of assessment were not substantially the same as the shareholder of the company on the first day of the basis period for the year of assessment.

The MOF had subsequently issued a guidelines in January 2008 stating that the unabsorbed losses and capital allowances can be carried forward regardless of the shareholding change that occur, provided that the company in question is not a "Dormant" company.

### Proposal

The Institute commends the Government on its decision to amend its policy on the carry forward of losses and unabsorbed capital allowances and it is envisaged that this measure will have a positive impact. The Institute proposed that the legislation be amended to reflect this change. The practical issues on revising the income tax returns for the affected years of assessment for taxpayers need to be looked into.

## 3. Real Estate Investment Trusts (REIT)

### 3.1 Mismatch of Income

Section 61A of the Act provides that where in the basis period for a year of assessment, 90% or more of the total income of a Real Estate Investment Trust (REIT) or Property Trust Fund (PTF) is distributed to the unit-holders, the total income for the REIT/PTF for that year of assessment shall be exempt from tax.

The Institute has highlighted that it is not possible to determine the income that can be distributed without knowing the amount of tax. Likewise, it is not possible to determine the amount of tax without knowing the income distributable.

### 3.2 Withholding Tax Rate

Currently the unit-holders will be taxed on the gross dividend income received at the ratesapplicable as follows:

| | |
|---|---|
| - Individual resident unit holders - | 15% |
| - Individual non-resident unit holders - | 15% |
| - Corporate resident unit holders - *(other than a company with paid-up capital in respect of ordinary shares of not more than RM2.5m at the beginning of the basis period for a year of assessment)* | 27% |
| - Corporate non-resident unit holders - | 27% |
| - Foreign institutional investors - | 20% |

### Proposal

The Institute proposed the following measures to attract foreign investors and promote REIT, -

(a) resident and non-resident individual unit-holders be exempt from tax on dividends received from the REIT for a specific period of time.

(b) non-resident institutional investors be subject to a reduced withholding tax of 10% instead of 20%. The withholding tax rate should be at par with the other payments subject to withholding tax such as royalties and technical fees.

(c) regulators, including SC and State Authority, need to work together to expedite the process of setting up and operation of REITs.

## 4. Reinvestment Allowance (RA)

Currently, RA is granted to manufacturing companies and producers of promoted food products on capital expenditure incurred on a factory, plant or machinery used in Malaysia for the purposes of any qualifying project. Such expenditure does not include capital expenditure incurred on plant or machinery which is provided wholly or partly for the use of a director or an individual who is a member of the management, administrative or clerical staff.

### Proposal

In this regard, the Institute proposed the following for the Government's consideration:

(a) To avoid any ambiguity, clear definitions and interpretation should be established. It is suggested that the capital expenditure incurred for the peripheral activities which are part and parcel of the manufacturing activity should be eligible for claiming RA.

(b) The construction or acquisition of additional storage facility is a direct consequence of a company's expansion phase. As such, RA should be extended to include the cost of these warehouses as part of the expansion cost.

(c) A pioneer company is excluded from claiming RA for the period in which the company has been granted a pioneer certificate in respect of any promoted activity/product. There is ambiguity as to whether capital expenditure incurred for purposes of a qualifying project (as defined in Paragraph 8, Schedule 7A) after the expiry of the tax relief period (in the basis period for a year of assessment) should be eligible for RA.

(d) The claim for RA, PS or ITA should be based on products rather than on the company as a whole, so that a company which enjoys PS in relation to product A may be allowed to claim RA in relation to product B where the RA criteria are met. Further, steps should be taken to widen the scope of RA for the agriculture sector.

(e) Certain business operations are situated in remote areas where accommodation needs to be provided to employees, including management staff., To encourage reinvestment in remote areas, RA should be extended to include the qualifying expenditure on provision of accommodation to staff as the expenditure is part and parcel of an expansion or diversification programme.

(f) The time limit for the RA incentive should be removed so as to encourage companies to undertake regular investment in modernisation and automation activities to increase productivity and hence competitiveness.

## 5. Investment Holding Company (IHC)

Currently income of a IHC from the holding of investments in a basis period shall be treated as gross income of that IHC from a source or sources consisting of a business for that year of assessment. However, unabsorbed tax losses and unutilised capital allowances are not allowed to be carried forward to the future years.

Where a company owns and manages its buildings or complexes, providing ancillary or support services/facilities which essentially is carrying on the business of letting real property, the rental income received will be treated as investment income and the company would not be able to carry forward its tax losses and unutilised capital allowances.

Pursuant to Section 60F, permitted expenses refer to expenses incurred by an investment holding company in respect of secretarial, audit and accounting fees, telephone charges, printing and stationery costs and postage, etc.

### Proposal

In this regard, the Institute proposed the following:-

(a) the tax treatment for an IHC should be based on the fundamental fact of determining whether the source of income is a business or non-business source.. Section 60F should only be applied to companies which derive passive income from its investments.

(b) Section 60F should be amended to include tax fees and other similar compliance expenses, EPF and SOCSO contributions as well as bank charges as part of the permitted expenses as these expenses are incurred in the business of holding investments.

(c) The Institute is of the view that listed and non-listed IHCs should not be discriminated and treated differently. The above discrimination in tax treatment creates tax compliance and administrative issues.

## 6. Tax Incentive on the Cost of Acquisition of Foreign Owned Companies

Under the Income Tax (Deduction for Cost on Acquisition of a Foreign Owned Company) Rules 2003, a locally owned company with at least 60% Malaysian equity ownership is eligible for a deduction in arriving at its adjusted income from a business equivalent to 20% of the cost of acquisition of a foreign owned company in the year of assessment in which the cost is incurred and the following four years of assessment.

In this respect, the Malaysian Industrial Development Authority (MIDA) has issued a guidelines which stipulate that only locally owned companies engaged in manufacturing trading or marketing activities are eligible to the incentive.

### Proposal

The Insitute has proposed that the incentive be extended to companies in the services sector, such as banking, finance, insurance, telecommunications, professional services, stock broking, etc since the services sector has been the engine of growth in recent years.

## 7. E-Commerce

Currently, there are no specific provisions in the Act that deals with e-commerce. With rapid globalisation in the business world, the use of e-commerce is inevitable. Taxpayers need to understand the tax treatment resulting from e-commerce transactions – the basis of taxation, double tax implications as well as the withholding tax implications on payments for internet services, electronic transactions, software payments, etc.

### Proposal

In view of the uncertainty surrounding the tax treatment of various activities relating to e-commerce, it is proposed that specific provisions/guidelines be introduced to provide clarity..

## 8. Franchising

Currently, apart from the availability of soft loans for SMEs, there is no other tax benefit for franchisees to lower their overall cost of investment. Besides capital investment , a franchise requires an upfront payment of franchise fees and training fees. There are royalty on sales,rental and security deposits.

### Proposal

It is proposed that in line with the deduction for cost of acquisition of proprietary rights which is available to the manufacturing sector, the lump sum payment of the franchise fee be allowed deduction over a 5 year period.

## 9. Incentives for Securitisation and Issuance of Securities

The costs of issuing asset-backed securities and private debt securities under Islamic principles incurred by a company were specifically allowed as a deduction against business income by various income tax orders. In addition, certain expenses incurred by a special purpose vehicle prior to the issuance of debt securities and the initial rating fees are not allowed against its income.

Proposal
The Institute proposed that a specific order be issued to allow the deduction of the costs mentioned above as well as appropriate guidelines be issued for asset-backed securitisation to incorporate such expenses.

10. Foreign Associations
Currently, internationally affiliated organization for the promotion of trade, culture, humanity, education, professions registered in Malaysia are subject to tax on their profits derived from Malaysia.

Proposal
The Government should consider providing favourable treatment for foreign organisations which may decide to set up their office or secretariat in Malaysia.

## E. DEVELOPMENT OF HUMAN CAPITAL

### 1. Deduction for Continuing Professional Education (CPE) Courses
In order to maintain continuous improvement of the professionals' knowledge, skills, competence and professional values in providing services to clients, employers, regulators and other stakeholders, professional bodies required members to complete a stipulated number of CPE hours within a specific time frame.

Proposal
Since such expenses are incurred in the production of employment income, it is proposed that the cost incurred by an individual in attending CPE courses be deductible against the employment income, in the same manner as professional subscription fees.

### 2 Incentive for Unemployed Graduates Training Scheme
Currently, allowances given by listed companies to participants in the Unemployed Graduates Training Scheme endorsed by the SC will be given a double deduction.

Proposal
The Institute proposes that the scope be widened to allow non-listed companies, including the professional firms to participate in such scheme and obtain the double deduction.

### 3 Double Deduction for Approved Training
It is noted that a company will be given double deduction on training if it is conducted by a small number of approved training institutions with limited courses.

Proposal
The Institute suggests that the double deduction incentive be extended to training programmes undertaken by firms involved in professional services such as accountancy, taxation, secretarial, engineering, architecture, law, medicine, etc.

### 4. Tax Residence Status of Individuals

Proposal
It is proposed that the distinction between residents and non-residents be removed to simplify tax administration and attract foreigners to invest in Malaysia.

## F. PROMOTING A CARING SOCIETY

### 1. Personal Income Tax Reliefs/Exemptions

#### 1.1 Personal Relief on Day-care Facilities for Children
The Institute wish to commend the Government for taking various measures and efforts to mobilise this available pool of resources, and therefore increasing the supply of labour and contributing towards enhancing the nation's output.

Proposal
The Institute proposed that a relief of up to RM2,000 be allowed to working parents for the use of day-care facilities or kindergartens or engage an assistant for their children.

#### 1.2 Personal Relief for Insurance Premiums and Contributions to Approved Schemes

*Proposal*
The Institute proposed that the current maximum aggregate relief of RM6,000 for life insurance premiums and contributions to approved schemes be amended as follows to reflect the current economic situation:

| Category | Maximum Aggregate Relief (RM) |
|---|---|
| Life Insurance Premiums | 6,000 |
| Contributions to Approved Schemes | 6,000 |

#### 1.3 Tax Relief for Interest on Housing Loans

Proposal
The Institute proposed that tax relief on interest payments to new buyers of completed houses and first-time owners of houses be reintroduced with an increased threshold to reflect the current market situation, or alternatively with a maximum relief capped at a certain threshold.

### 2. Cost of Living Allowance

Proposal
(a) To lessen the financial burden of individuals following the increase in food prices, the Institute proposed that the cost of living allowance, transport and travelling allowance, food allowance, etc. be exempted in the hand of employees.

(b) To encourage private sector employers to provide such an allowance to their employees, it is proposed that a double deduction be given to companies which pay cost of living allowances to their employees. TG

National Budget Memorandum

# TECHNICAL UPDATES

*The Technical Updates published here are summarised from the Government Gazette published as at 12 June 2008.*

## INCOME TAX

- **Income Tax (Deduction for Cost on Acquisition of a Foreign Company) (Amendment) Rules 2008 [P.U.(A) 81/2008]**

  The *Income Tax (Deduction for Cost on Acquisition of a Foreign Company) Rules 2003* [*P.U. (A) 310/2003*] is amended as follows:

  In rule 2, the definition of "locally owned company" has been amended to mean a resident company in Malaysia which is established under the Companies Act 1965 [*Act 125*] and involved in manufacturing, trading or marketing activities of local products. It is also provided that the company has to comply with the following equity ownership requirements:

  (a) for a company which is not listed on the stock exchange : at least sixty per cent of its equity is directly owned by Malaysian shareholders; or
  (b) for a company which is listed on the stock exchange:
  (i) at least fifty per cent of its equity is directly owned by Malaysian shareholders; and
  (ii) at least sixty per cent of its equity is directly owned by Malaysian shareholders on the first day of listing on the stock exchange.

A new rule 4 is inserted to the effect that a company that submits an application for this incentive to the Malalysian Industrial Development Authority after 31.12.2008 will no longer qualify for this incentive..

The amendment Rules are deemed to have come into operation from the year of assessment 2005.

- **Income Tax (Exemption) (No. 2) Order 2008 [P.U.(A) 101/2008]**

  With effect from the year of assessment , non-citizen individuals employed in a regional distribution centre (RDC) company or an international procurement centre (IPC) company are exempted from the payment of income tax in respect of the portion of income derived from employment exercised outside Malaysia.

  Under the Order, it is the chargeable income arising from the employment in a RDC company or an IPC company that is exempted. The formula for determining the amount of income to be exempted is laid out in the Order.

- **Income Tax (Exemption) (Revocation) Order 2008 [P.U.(A) 106/2008]**

  This Order revokes the *Income Tax (Exemption) (No. 14) Order 2007* effective from the year of assessment 2007 as it has been superseded by the introduction of a new section 60I to the Income Tax Act 1967. Section 60I provides that where a company sets up a Special Purpose Vehicle (SPV) for the issuance of Islamic securities, any income derived by the SPV shall be treated as the income of the company.

- **Income Tax (Accelerated Capital Allowance) (Renewable Energy) (Revocation) Rules 2008 [P.U.(A) 107/2008]**

  These Rules revoke the *Income Tax (Accelerated Capital Allowance) (Renewable Energy) Rules 2005* and come into effect from the year of assessment 2008.

- **Income Tax (Exemption) (No. 3) Order 2008 [P.U.(A) 114/2008]**

  Non-resident experts in Islamic finance are exempted from payment of income tax in respect of payments received from any person resident in Malaysia for those technical services set out under paragraph 4A(ii) of the Income Tax Act 1967.

  The period of exemption is from 8 September 2007 to 31 December 2016.

- **Income Tax (Set-off for Tax Charged on Actuarial Surplus) Rules 2008 [P.U.(A) 141/2008]**

  These Rules have been issued to ensure that double taxation is eliminated in the taxation of life insurance business. The Rules provide that where an amount of actuarial surplus from the life fund is transferred to the shareholders' fund of an insurer under subsection 60(3A) or (4A) of the Income Tax Act 1967, any amount of tax charged on the portion of that surplus is to be set-off against the tax charged on the chargeable income from the shareholders' fund of that insurer. The formula for determining the amount of tax charged on the portion of surplus is provided for in the Rules.

  These Rules come into operation from the year of assessment 2008.

- **Income Tax (Deduction of Tax on the Distribution of Income of a Family Fund, Family Re-Takaful Fund or General Fund) Rules 2008 [P.U.(A) 188/2008]**

  It was proposed last year in the National Budget 2008 that a specific tax treatment in the legislation will be provided for the takaful business. Prior to the proposal, a takaful business was subject to the same tax treatment as a conventional insurance business. It was stated as one of the proposals that the share of profits distributed to the participants in relation to the investment income be taxed on the participants through a final withholding tax mechanism. The newly introduced section 109E of the

Income Tax Act 1967 (ITA), gives effect to the proposal. In addition to the new section 109E (ITA), the Income Tax (Deduction of Tax on the Distribution of Income of Family Fund, Family Re-Takaful Fund or General Fund) Rules 2008, provides a method of determining the amount of profits distributed or credited to the participants that will be subject to the withholding tax.

Under the Rules, effective 1 January 2008, a takaful operator which distributes or credits any profit from investments and/or underwriting income from a family fund, family re-takaful fund or general fund under section 60AA of the ITA to a participant, other than a resident company, will be required upon distributing or crediting the profit to deduct tax at a rate of 8% of the gross payments (Part XI of Schedule 1 of the Act). The formula for the determining the tax to be deducted is spelt out in the Rules.

## STAMP DUTY

- **Stamp Duty (Exemption) (No. 2) Order 2008 [P.U.(A) 82/2008]**

  All instruments which are in force to secure a loan not exceeding RM10,000 made in accordance to the principles of conventional or Islamic banking granted or to be granted by Bank Pertanian Malaysia for financing agriculture based project are exempted from stamp duty.

  This Order is deemed to have come into operation on 11 April 1986.

## SALES TAX

- **Sales Tax (Exemption) Order 2008 [P.U.(A) 91/2008]**

  The goods specified in Schedule A and the persons and goods specified in column (2) and column (3) of Schedule B or Schedule C of this Order are exempted from the payment of sales tax, subject to certain conditions.

  This Order revokes *Sales Tax (Exemption) Order 1980* and comes into operation on 1 April 2008.

- **Sales Tax (Rates of Tax No. 1) Order 2008 [P.U.(A) 92/2008]**

  All goods (except goods which are included in any exemption order made under section 8 of the Sales Tax Act 1972 and goods imported on or with any person entering Malaysia or in the baggage of such person and intended for non-commercial use (excluding motor vehicles, alcoholic beverages, spirits, tobacco, cigarettes, tyres and tube)) shall be subject to sales tax at the rate of ten per centum.

  This Order revokes *Sales Tax (Rate of Tax) Order 1972* and comes into operation on 1 April 2008.

- **Sales Tax (Rates of Tax No. 2) Order 2008 [P.U.(A) 93/2008]**

  Notwithstanding the provisions of the Sales Tax (Rates of Tax No. 1) Order 2008 [P.U. (A) 92/2008], the rate of sales tax on certain goods appearing in the First Schedule, Second Schedule and Third Schedule of this Order varies from the ten per centum stipulated in Sales Tax (Rates of Tax No. 1) Order 2008.

  This Order revokes Sales Tax (Rates of Tax) Order 1997 [*P.U. (A) 118/1997*] and comes into operation on 1 April 2008.

## GUIDELINES FROM MOF

- **Guidelines for Making a Claim for Deduction Under Section 34(6)(ha) Income Tax Act 1967**

  The Guidelines explain the criteria and general procedure for the application for tax deduction under section 34(6)(ha) of the Income Tax Act 1967 on expenditure incurred by a company on the provision of infrastructure which is approved for tax purposes.

  Claims for deduction for approved infrastructure projects must be made in the income tax return form for the relevant year of assessment. The following documents must be kept for the purposes of audit by the Inland Revenue Board:

  - letter from the Minister of Finance approving such tax deduction;
  - confirmation letter on the cost of services/cost of project from the relevant government agency.

The Guidelines can be accessed from the MOF's website: www.treasury.gov.my

## OTHER ORDERS

- **Loans Guarantee (Bodies Corporate) (Remiss ion of Tax and Stamp Duty) Order 2008 [P.U.(A) 121/2008]**

  *Remission of tax:* Any tax payable under the Income Tax Act 1967, shall be remitted in respect of any money payable under any agreement, note, instrument or document in relation to the Ijarah trust certificates ("Sukuk Ijarah") of up to RM2 billion issued by Syarikat Prasarana Negara Berhad ("Issuer") including any agreement, instrument or document in relation to the guarantee ("Guarantee") provided or to be provided by the Government of Malaysia, by–

  (a) the Issuer, to which the Loans Guarantee (Bodies Corporate) Act 1965 applies by virtue of the Loans Guarantee (Declaration of Bodies Corporate) (Syarikat Prasarana Negara Berhad) 2001 [P.U. (A) 351/2001];
  (b) the Government of Malaysia;
  (c) any holder of the Sukuk Ijarah; or
  (d) any other party to any agreement, note, instrument or document in relation to the Sukuk Ijarah (including any transferee or assignee thereto) or the Guarantee.

*Remission of stamp duty:* Any stamp duty payable under the Stamp Act 1949 [Act 378] in respect of any agreement, instrument or document in relation to the Sukuk Ijarah or the Guarantee shall be remitted in full.

This Order comes into operation on 28 April 2008.

# Case Summaries

## Ngee Tai Shipping Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri

High Court Sabah & Sarawak, Kuching
Judicial Review No. JR-08-2006-II

> *Revenue law – Income Tax Act – issuance of requisition by Revenue – interim dividend revoked – whether statutory debt or tax dispute related to assessment of tax – dispute to proceed by way of certiorari or tax appeal to the SCIT*

The taxpayer via a judicial review application sought a *certiorari* order to quash the Inland Revenue Board (Revenue)'s decision to issue a requisition. The requisition was issued under section 108 of the Income Tax Act 1967 (ITA). In January 2000, the taxpayer declared an interim dividend. The Revenue issued a requisition in June 2001. In August 2001, the taxpayer held its annual general meeting and revoked the interim dividend. The Revenue was informed of this development in May 2002. As the interim dividend was revoked, the taxpayer requested the Revenue to withdraw the requisition. The Revenue requested the taxpayer to file a notice of appeal to the Special Commissioners of Income Tax (SCIT). However, in May 2006, the Revenue advised the taxpayer that the SCIT had no jurisdiction to hear the appeal. The taxpayer was advised to apply for judicial review. Both parties relied on the earlier High Court cases of *Ketua Pengarah Hasil Dalam Negeri v Rheem (Far East) Pte Ltd* [1998] 2 CLJ SUPP 351 and *Malayan United Industries Berhad v Ketua Pengarah Hasil Dalam Negeri & Anor* [2005] MSTC 4,192.

The taxpayer contended that the Revenue had misdirected itself in law and acted *ultra vires* in issuing and maintaining the requisition. In reality, there was no payment of interim dividend to the shareholders. Thus, the Revenue's decision was irrational and unreasonable.

The Revenue submitted that its decision to issue the requisition was correct in law. It cited the following grounds:

(a) the taxpayer made a profit and it was distributed to the shareholders;
(b) tax was not paid for the dividends;
(c) the compared total exceeded compared aggregate;
(d) the excess in item (c) was a debt due to the Government;
(e) the AGM was convened after the requisition was issued; and
(f) the memorandum and article of association do not authorise the company to revoke the dividend.

The issue before the High Court was whether the Revenue was correct in issuing the requisition.

[Note: The High Court has the discretion whether to grant leave for judicial review or not. In this case, the court refused to grant leave.]

*Held:* Matter to be referred to the SCIT for hearing.

1. The High Court held that the dispute over the requisition should be heard before the SCIT and not the

High Court. Any tax disputes must be referred to the SCIT pursuant to section 99 of the ITA. The argument that requisition is a statutory debt as held in *Rheem* and *Malayan United* was rejected. Further, the requisition was inextricably interwoven with tax liability and assessment. A statutory debt under the ITA has no separate existence because a debt arising under the ITA is consequent of a tax liability in relation to an assessment. The court was not in favour of interpreting the ITA narrowly. The court considered the following factors in arriving at this decision:

- section 98 indicates Parliament's intention to establish SCIT as a specialised forum to adjudicate tax disputes;
- the Special Commissioners are selected for their specialty in tax law;
- the assessment referred in section 99 relates to a tax liability crystallising to a debt; and
- section 106(1) cannot be read narrowly as it would result in SCIT being redundant. The argument that an assessment becomes a statutory debt via section 106(1) will mean any claims relating to an assessment must be made six years or it will be statute barred. This will certainly result in the loss of revenue for the Government.

2. The court observed that anomalies in interpretation of statute must be avoided. With the introduction of the purposive approach, it is not appropriate to interpret section 106(1) in isolation. It must be read by considering the purpose behind the legislation of the ITA. It is essential that courts give effect to an interpretation that would promote the purpose or object of the ITA. Having these principles in mind, the court commented that a requisition only creates a statutory presumption that a statutory debt is created. If one objects to the requisition, then there is a tax dispute, which relates to an assessment. The court exercised its prerogative and directed the Revenue to refer the matter to the SCIT. The application for judicial review was dismissed.

For the Applicant (taxpayer): Albert Tang Yew Liong (Messrs Chew, Jugah Wan Ullok & Co)

For the Respondent: Hazlina Hussain Mohd Zaidi (Legal Officer, Inland Revenue Board)

Before: Hamid Sultan Abu Backer, JC

### Government of Malaysia v Margaret Au Nyat Fah
High Court, Kuching
Suit No. 22-77-2005-II

*Taxes due and payable to the Government — section 106(3) of the Income Tax Act — grant of a stay of judgment*

The appellant's summary judgment application before the Deputy Registrar was dismissed. The appellant appealed to the High Court. The respondent is the administratrix of an estate. The appellant was claiming the tax and penalties owed by the estate. The respondent was sued in her capacity as the administratrix. The respondent argued that the claim was statute barred pursuant to the Sarawak Limitation Ordinance.

The respondent added:

(a) the appellant had filed a suit in 1991 but withdrew the suit later;
(b) the estate had appealed to the SCIT, which ruled in favour of the appellant in 1979;
(c) the estate had requested for a case stated and the appeal was still pending;
(d) the appellant had agreed in writing in 1979 to stand over the tax collection until the appeal before the High Court is disposed;
(e) in 1997, the respondent was informed that she is barred from leaving Malaysia until the tax and penalties due are settled; and
(f) the tax appeal process and travel restriction had caused mental stress, hardship and expenses to the respondent.

[Note: The term "appellant" refers to the Government of Malaysia and "respondent" refers to Margaret Au, the administratrix.]

The issue before the High Court was whether the Deputy Registrar's decision to dismiss the summary judgment application was correct.

*Held:* Appeal allowed with costs; summary judgment granted to the appellant.

1. The High Court intimated a stay of the judgment to the respondent. However, the plea of limitation does not apply to any proceedings by the Government to recover tax. Taxes due and payable to the Government are recoverable even if the taxpayer objects to the mode or quantum of assessment.

2. Section 106(3) of the ITA precludes the court from entertaining a plea on the basis that the amount of tax raised is excessive, incorrectly assessed, under appeal or incorrectly increased. The High Court commented this provision was in breach of natural justice and violates the spirit of the Federal Constitution. The Court highlighted that if a judgment was obtained on erroneous assessment and the taxpayer is unable to settle the sum, that may lead to the taxpayer being made a bankrupt. Besides being harsh, some measures taken to collect taxes appear to be oppressive. In the present appeal, the administratrix was deprived from travelling abroad although the tax due and owed was not personal to her. The High Court observed that in such circumstances, the court is not restricted from granting a stay of judgment.

3. These factors would influence the court to grant a stay:

- the appellant's claim was 29 years old;
- the dispute has been referred to the SCIT; and

- despite not being personally liable for the tax, the administratrix was put to hardship.

For the Appellant: Ashrina bt. Ramzan Ali (Legal Officer, Inland Revenue Board)

For the Respondent: Bexter Michael (Messrs Ee & Lim Advocates)

Before: Hamid Sultan Abu Backer, JC

## Ketua Pengarah Hasil Dalam Negeri v Hypergrowth Sdn Bhd
High Court, Kuching
Tax Appeal No. 14-02-2006-II

*Revenue law – disposal of shares – whether adventure in the nature of trade – long term investment or profit making scheme*

The Revenue had appealed against the decision of the SCIT. The SCIT had ruled that the taxpayer's investment was a long term investment. It was held that the taxpayer was not a trader in shares as the investment was not an adventure in the nature of trade. Hence, the gains made upon the disposal of the shares were not subject to income tax. The following factors influenced the SCIT's decision:

(a) the audited accounts classified the shares as an investment;
(b) there was only one investment;
(c) it was to be a long term investment;
(d) the sale was due to unstable economic conditions;
(e) the taxpayer was not a trader in shares; and
(f) the taxpayer had no employees or special skills to trade in shares.

The Revenue contended the taxpayer was not an investment company. The shares were purchased for a short term investment and in the course of trade. The gains on the share disposal were profits and subject to income tax. The Revenue alleged the profits were business income pursuant to section 4(a) of the ITA.

Further, the Revenue argued that:

(a) the profits made from the sale were not reinvested in other investment;
(b) the profits were used to pay the loan from its director;
(c) the taxpayer had no ability to acquire the shares as a long term investment as its paid-up capital was only RM 100;
(d) the voluntary winding up of the taxpayer's company shows it wanted to make a quick disposal of the shares and make a profit;
(e) the SCIT had failed to consider the whole surrounding facts of the case; and
(f) the treatment of the shares as investment in the taxpayer's accounts is not conclusive evidence.

The taxpayer contended that the shares were meant to be long term investment and not a profit making scheme. The taxpayer had no organised structure or the skills to undertake share trading. Further, the shares were sold as a result of the unstable market conditions.

The issue before the High Court was whether the disposal of the shares was an adventure in the nature of a trade.

**Held:** Appeal dismissed with costs.

1. The High Court reiterated that it can only disturb in the SCIT's fact finding in limited circumstances. The court may interfere if SCIT had acted without any evidence or upon a view of the facts which could not be reasonably be entertained.

2. The onus is on the taxpayer to establish that the gains were not business income. The taxpayer must establish that the share investment and gains made from it were not as a result of an adventure in the nature of trade. As observed by the Supreme Court in *Lower Perak Co-operative Housing Society Berhad v Ketua Pengarah Hasil Dalam Negeri* [1994] 3 CLJ 541, this is a question of fact. In *Hypergrowth*, the taxpayer had successfully established this fact before the SCIT.

3. The High Court ruled the Revenue had failed to demonstrate the SCIT's decision was based on the misconception of the law. Further, there was no evidence to suggest that the SCIT's conclusion cannot be supported by the primary facts. In determining whether the shares were acquired in the course of business, his Lordship applied the "badges of trade" test. His Lordship firmly upheld the SCIT's decision that the shares were not purchased in the course of a business was upheld. The Revenue's appeal was dismissed with costs.

4. The court's decision was influenced by the following factors:

   - the taxpayer was at all material times an investment company;
   - the taxpayer had no means, knowledge or expertise to be a company trading shares;
   - the dominant purpose for acquiring the shares was for investment purposes;
   - the shares were sold because of unstable market conditions and this was not challenged by the Revenue; and
   - the sale of shares was an isolated case. TG

For the Appellant: Liz Ellyna Mohd Zaid (Legal Officer, Inland Revenue Board)
For the Respondent: Cheng Hui Hong (Messrs Cheng & Cheng Advocates)

Before: Hamid Sultan Abu Backer, JC

***S. Saravana Kumar LL.B** is a tax lawyer of Lee Hishammuddin Allen & Gledhill. He has appeared before the Special Commissioners of Income Tax and High Court for various tax matters. Besides tax litigation, he also advises multinational and local enterprises on tax advisory and tax planning matters. He can be contacted at sks@lh-ag.com.*

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# Case Commentary

## ALF PROPERTIES SDN BHD V KETUA PENGARAH JABATAN HASIL DALAM NEGERI[1]

### The Facts

In 1980, Alf Properties, a company incorporated under the Companies Act 1965, purchased a few pieces of land for the sum of RM6,100,000 and obtained approval to build a 31-storey office block on the land. Subsequently, part of the land was rented out and the proceeds were assessed to tax as rental income under section 4(d) of the Income Tax Act 1967 ("the ITA"). Alf Properties sold a portion of the land which was not included in the development plan in 1990 for RM42,500,000. The Director-General of Inland Revenue assessed the gains from the sale to income tax.

Alf Properties, aggrieved by the assessment, appealed to the Special Commissioners of Income Tax ("the SCIT"). The main issue before the SCIT was whether sale of the land was a disposal of a capital asset or a disposal of stock-in-trade. Gains from a capital realisation are not subject to income tax but profits from the disposal of stock in trade would be subject to income tax under the ITA. The SCIT found that the profits from the sale were trading income and thus assessable to income tax. Alf Properties appealed to the High Court which affirmed the decision of the SCIT.

### The Decision

On further appeal to the Court of Appeal, Alf Properties' appeal was allowed. The Court held that the disposal of the land was a disposal of a capital asset so that the gains are not subject to income tax.

In arriving at the decision, the Court highlighted certain well-established principles:

- **The Objects of the Taxpayer**
  The objects as stated in the Memorandum and Articles of Association ("M & A") of a company are not conclusive and it is not safe to conclude that the taxpayer's principal activity is to deal in property merely because it is one of the stated objects of the taxpayer. The past and present activities of the taxpayer have to be considered to discover whether the activities are one of the stated objects of the taxpayer.

  Whilst the proposed objects of a company are relevant when considering the transactions which a company is engaged in, it does not follow that anything done by the company must necessarily amount to carrying on the activities of the professed objects of the company merely because the company has powers to do certain things.

- **Intention of the Taxpayer**
  It is crucial to determine the intention of the taxpayer at the point of purchase of the property; whether it was purchased for resale at a profit as soon as possible or to be developed for sale in the developed form to profit from the transaction or whether it was for long-term investment. It has been judicially established that property kept for some time from the time it was purchased would be considered as an investment.



- **The Treatment of the Property in the Accounts**
  The manner in which a taxpayer keeps its accounts may be evidence of the taxpayer's intention but such evidence must be weighed against other evidence to decide the nature of the transaction[2]. In income tax issues, it is settled law that the method of accounting is a guide but is never conclusive[3]. The character of the sum received will not be altered by the method of accounting that the taxpayer adopts.

## Conclusion

The Court of Appeal came to the decision that disposal of the land by Alf Properties was disposal of a capital asset because there was no evidence to show that the taxpayer was trading or dealing in land before or after the transaction. There was also no evidence to show that Alf Properties was making any preparation to trade in land or to develop it for resale. It was clear that Alf Properties had purchased the land for investment and there was no evidence of a change of such intention.

## Comments

The Court of Appeal's decision reiterates an important principle of law: not every isolated act of a kind that is authorised by the M & A if done by a taxpayer necessarily constitutes the carrying on of a business. The nature of the transaction must be determined from the intention of the taxpayer and a mere sale at a profit is not by itself a trading activity. Ultimately, the dominant purpose for which a particular property was originally acquired is paramount.

For the taxpayer: Goh Ka Im and Elaine Lee Pei Sze (Shearn Delamore & Co.)
For the Revenue: Hazlina Hussain and Normareza Mat Rejab (Legal Officers, Inland Revenue Board) TG

**Footnotes:**

1 *(2006) MSTC 4, 243.*
2 *Shadford (HM Inspector of Taxes) v H. Fairweather* 43 TC 291.
3 *Gold Coast Selection Trust Ltd. v Humphrey* 30 TC 228.

# International Cases

By S. Saravana Kumar

## *The Minister of National Revenue v Jay Currie*
## 2008 FC 237 (Federal Court, Canada)

### The Facts

The taxpayer was asked to provide the following information and documents by the Revenue:

a) all financial transactions with financial institutions;
b) all monies received from third parties for all contracts entered into by the taxpayer;
c) all monies receivable by the taxpayer;
d) all money, shares, securities, interest, dividends and any other held by the taxpayer; and
e) all income earned by the taxpayer.

The information and documents sought by the Minister were not protected from disclosure by solicitor-client privilege. The taxpayer failed to provide the requested materials. The Revenue applied for an order from the court to compel the taxpayer to provide the materials. The taxpayer had originally challenged the constitutional validity of the Revenue's request. Before the hearing, taxpayer amended his record and changed his ground of defence. The taxpayer alleged that the Revenue's application:

a) was not consistent with the Federal Courts Rules;
b) failed to set out a discernible process as a result of which he was unable to respond it;
c) was procedurally deficient and any order issued would infringe his individual rights; and
d) was contrary to fundamental justice.

Prior to the hearing, the Revenue had filed the Notice of Application, an affidavit sworn by one of its officer, Memorandum of Fact and Law and Book of Authorities with the court. Meanwhile, the taxpayer only filed the Memorandum of Fact and Law and Book of Authorities. He did not file a Notice of Constitutional Question or affidavit evidence.

### The Issue

Whether the Revenue may apply to obtain the said information and documents from the taxpayer?

### The Decision

The Federal Court allowed the Revenue's application. The court considered the following factors in arriving at its decision:

a) the Revenue had filed the necessary papers with the court;
b) the taxpayer had clear notice of the proceeding initiated against him;
c) the taxpayer was informed that he had to serve and file a "Respondent's record" if he wished to oppose the application;
d) any deficiencies or lack of clarity in the procedure to be followed could easily be corrected by seeking the court's direction;
e )the taxpayer had failed to demonstrate how the application impugned process would have caused him any prejudice; and
f) the taxpayer had in excess of 90 days to prepare his case.

The Federal Court ordered the taxpayer to furnish the information and documents to the Revenue. The court was satisfied that the taxpayer had a tax debt and that the information and documents sought were necessary to the administration and enforcement of the Income Tax Act.

## *Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Ltd*
## Final Appeal No.2 of 2007 (Civil) (Court of Final Appeal, Hong Kong)

### The Facts

Tai Hing Cotton Mill Ltd ("parent company") manufactures cotton spun yarn. It had a piece of land, which it sold to the taxpayer. The taxpayer was its wholly owned subsidiary. The land was sold for an initial sum of HK$ 346 million. The taxpayer agreed to pay a further sum of HK$ 400 million if it made a profit and another 50% of its additional profit. The market value of the land was HK$ 800 million. The parent company sold the land to construct a new factory and develop some of its surplus land. Upon acquiring the land, the taxpayer entered into a joint venture development with a third party. The taxpayer sought to deduct the money paid to the parent company as its expenditure. The parent company claimed the money received was tax free as it was realisation of its capital asset.

The Revenue regarded the whole structure as a tax avoidance scheme. According to the Revenue, the

transaction conferred a tax benefit on the taxpayer. The transaction enabled the taxpayer to deduct more from its profits than it could have if the sale was at market value.

### The Issue
Whether the transaction amounted to a tax avoidance scheme?

### The Decision
The Court of Final Appeal observed that the tax avoidance rule was not peculiar to Hong Kong alone. The court acknowledged that the Revenue had the power to treat the transaction as if it had not been carried out. The transaction was held to be a tax avoidance scheme. According to the court, the agreement to share the profits was acceptable if the parties had been dealing at arms' length. Here, the parties were not dealing at arms' length. The land was simply being passed from one company to the other. The court allowed the Revenue's method of taking the market value to determine the price of the land.

The Revenue's application to disregard the transaction was allowed.

## *Troughton v Deputy Commissioner of Taxation* [2008] FCA 18 (Federal Court, Australia)

### The Facts
The taxpayer was a British citizen. Between 1995 and 1999, he worked in Australia. Upon his retirement in 2002, he returned to Britain. The taxpayer arrived in Australia on 16 April 2007. He was prevented from leaving Australia on 30 May 2007. The Revenue had issued a Departure Prohibition Order ("DPO"). On 9 May 2007, the Revenue assessed the taxpayer for income tax. The total assessment was A$5,616,712.30, of which A$112,303.00 remained outstanding. The taxpayer was furnished with the details of the assessment. The Revenue also explained the need to issue and maintain the DPO. The taxpayer requested the Revenue to revoke the DPO. When the Revenue refused to do so, the taxpayer made an application for judicial review. The taxpayer alleged the Revenue's decision was an improper exercise of statutory power.

### The Issue
Whether the Revenue may issue and maintain the Departure Prohibition Order?

### The Decision
The Federal Court examined the reasons why the DPO issued. The Revenue explained that the taxpayer's tax liabilities were recoverable. Further, the taxpayer's tax liability was substantial. According to the court, the purpose of the DPO was to ensure "a person does not depart from Australia for a foreign country" without discharging his tax liability. The court observed that the prevention of a person with an undischarged tax liability was of high priority. The court considered the following arguments raised by the taxpayer:

a) the personal hardship imposed by the continuation of the DPO;
b) the personal circumstances of the taxpayer's spouse and the hardship imposed on her; and
c) the absence of utility of the continuation of the DPO.

The Federal Court held that the taxpayer had no reasonable prospect of establishing that the Revenue's decision was without basis. The taxpayer's application was dismissed with costs in favour of the Revenue. TG

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# International News

By Kay Kimkana

The column only cover selected developments from the Asia-Pacific region and relate to the period March to May 2008.

## Australia: Budget for 2008/09

The Federal Treasurer delivered his first post-election Budget for 2008/09 on 13 May 2008, which is the first Labour Budget in 13 years. The main taxation measures included in the Budget are:

– *Reduction of income tax rates.* From 1 July 2008, the 30% threshold will increase from AUD 30,001 to AUD 34,001, the 40% threshold will increase from AUD 75,001 to AUD 80,001 and the 45% threshold will increase from AUD 150,001 to AUD 180,001. In addition, from 1 July 2009, the 30% threshold will increase to AUD 35,001 and the 40% marginal tax rate will be reduced to 38%. From 1 July 2010, the 30% threshold will increase to AUD 37,001 and the 38% marginal tax rate will be reduced to 37%. The government has also set an aspirational tax goal over 6 years for a personal income tax system which reduces the number of rates from four to three with a personal income tax scale of 15%, 30% and 40%.

– *Increase of low income tax offset.* The low income tax offset is increased from AUD 750 to AUD 1,200. From 1 July 2009, it will increase further to AUD 1,350; and from 1 July 2010, to AUD 1,500. This will allow taxpayers eligible for the full low income tax offset to have an effective tax-free threshold of:
  – AUD 14,000 in 2008/09;
  – AUD 15,000 in 2009/10; and
  – AUD 16,000 in 2010/11.

– *Introduction of an income threshold for tax offsets.* The threshold of AUD 150,000 is introduced to determine eligibility for the dependent spouse, housekeeper, child housekeeper, invalid relative and parent/parent-in-law tax offsets. Currently, these tax offsets are available regardless of the claimant's income level.

– *Taxation of Financial Arrangements.* The legislation dealing with Taxation of Financial Arrangements (stages 3 and 4) will be reintroduced and will apply from 1 July 2009. The legislation has been in the works for a number of years and will implement substantial changes to taxation of financial arrangements.

– *Scrip Capital Gains Tax (CGT) roll-over.* The scrip CGT roll-over provisions will be modified so that the acquiring entity's cost base of shares in the target entity reflects the tax costs of the target entity's net assets. This cost base will also be used in determining the value of the target entity's assets in consolidation if the target entity subsequently joins the acquiring entity's consolidated group. Currently, the use of the roll-over followed by the target entity joining a consolidation group may produce an unintended tax benefit.

– *Depreciation of in-house software.* The period over which capital expenditure on in-house software is depreciated will be increased from 2.5 years to 4 years. "In-house

software" is computer software, or the right to use computer software, that is acquired, developed or developed by someone else and that is mainly used by the taxpayer in performing the functions for which the software was developed (i.e. not for resale).
- *Fringe Benefits Tax (FBT)*. The current FBT exemption for certain work related items (including laptop computers, personal digital assistants and tools of trade) will be tightened by ensuring the exemption only applies where these items are used primarily for work purposes. In addition, depreciation deductions for FBT exempt items (i.e. items purchased primarily for work purposes) will be denied.
- *International taxation*. The existing 30% non-final withholding tax applying to distributions of Australian source net income (other than dividends, interest and royalties) of Australian managed investment trusts to foreign residents will be replaced with a final withholding tax.

  Residents of jurisdictions with which Australia has effective exchange of information arrangements will be subject to:
  - a non-final withholding tax at the rate of 22.5% for the first income year (intended to be 2008/09);
  - a final withholding tax of 15% for the second income year (intended to be 2009/10); and
  - a final withholding tax of 7.5% for the third (intended to be 2010/11) and later income years.

  Residents of other jurisdictions will be subject to a 30% final withholding tax. Countries with which Australia has "effective exchange of information arrangements" will be specified by regulations.

## Treaty between Australia and US – No Treaty Relief for US Tax Paid

The Australian Taxation Office (ATO) released its Interpretative Decision ATO ID 2008/57 on 18 April 2008, which states that the Australia-United States tax treaty does not provide for a foreign tax credit in Australia in respect of a US tax paid by an Australian resident.

The taxpayer in question was a citizen of the US and a resident in Australia under the treaty. The taxpayer made a capital gain on a sale of units in a limited partnership situated in the US and paid a US tax on the gain. The tax was assessed on the basis that the taxpayer was a citizen of the US, in accordance with Art. 3(1) of the treaty, as no other article would appear to allow the US to tax the gain.

While Australia has a right to tax that gain on the residence basis, Art. 22(2) does not allow a credit for tax imposed by the US under Art. 3(1). (Note, however, that Art. 22(4) requires the US to provide a credit for tax paid in Australia in respect of income subject to tax in the US under Art. 3(1).)

## China: New Filing and Payment Rules for Enterprise Income Tax

The State Administration of Taxation (SAT) issued new tax filing and payment rules for enterprises having branches in different regions across China on 10 March 2008 (*Guo Shui Fa* [2008] No. 28). The Notice applies as from 1 January 2008 and is summarized below.

Resident enterprises having branches (which are not separate legal entities) in different regions of China are subject to the provisions of the Notice. The new tax filing and payment procedure is concerned with the following five aspects:

- *Combined computation*: The taxable income and tax due must be calculated on the basis of the total results of the head office and all of the branches;
- *Supervision in different tiers*: The head office and its branches will be administrated for the enterprise income tax purposes by the local tax authorities in the jurisdictions where they are registered;
- *Advance payment at the local level*: The head office and its branches must file monthly/quarterly tax returns with the tax authorities at the local level and make advance tax payments locally in accordance with the provisions of the Notice;
- *Centralized annual settlement*: At the end of the tax year, the head office must calculate the total amount of tax due of the enterprise (head office plus branches) after the deduction of the advance tax payments and settle the final tax liabilities by paying the tax in case of underpayment and claiming a refund in case of overpayment with the tax authorities in charge of the head office; and
- *Allocation of shared tax revenue*: The Ministry of Finance will allocate and transfer the tax revenue deposited into the temporary account of the central government to the relevant local government on the basis of prescribed coefficient factors.

Additionally, the notice details a number of exceptions to the above rules.

50% of the calculated advance tax payments should be borne by the head office (25% goes to the local treasury and 25% to the central treasury) and another 50% by the branches. The head office must allocate the tax payments to its branches in accordance with ratios determined by reference to the factors operating revenue (35%), employee remuneration (35%) and total assets of the branch (30%). If the tax rates of the regions of the head office and branches are different, the head office must calculate taxable profits and divide them among the head office and branches based on the three ratios mentioned above, and subsequently apply different tax rates to the allocated profits of the head office and branches to determine the tax amounts.

The unused losses of the head office and branches suffered in 2007 or the preceding years may be carried over to the coming years prescribed by the tax authorities.

The Notice does not apply to a number of state-owned enterprises such as railway transportation enterprise, most state owned banks and special types of business (e.g. oil and gas industries).

## China: Draft Administrative Regulations on Special Tax Adjustments

The State Administration of Taxation (SAT) has drafted the administrative regulations on special tax adjustments which are expected to apply as from 1 January 2008. The regulations apply to transfer pricing, Controlled Foreign Corporation (CFC), thin capitalization, general anti-avoidance rules (GAAR), and other special tax adjustment rules.

## China: Stamp Duty on Share Transactions Reduced

With effect from 24 April 2008, the stamp duty on share transactions has been reduced from 0.3% to 0.1%.

## Hong Kong: Guidance on Tax Treatment of Stock Awards Issued

The Hong Kong Inland Revenue Department issued, in March 2008, a revised edition of the Departmental Interpretation and Practice Notes No. 38 (DIPN 38) on Salaries Tax Employee Share-Based Benefit. The first and second editions of the DIPN were issued in February 2001 and March 2005 respectively. The March 2008 revised edition is to replace the earlier editions and takes effect immediately.

DIPN 38 provides formal guidance on the tax treatment of stock plans and stock awards, and contains a new section on the assessability of stock award benefits (including a commentary on phantom stock plans), as well as an analysis of reporting and administration considerations. There are no changes to the commentary and practice on the tax treatment of stock options.

## India: Tax Concessions for IT Sector and Export Oriented Units by a Year Extended for One Year

The Finance Minister announced in Parliament that the tax benefits under Secs. 10A and 10B of the Income Tax Act 1961 (ITA) are to be extended by 1 year. These tax holiday schemes were to expire in March 2009 under the sunset clause provided in Secs. 10A and 10B, which have now been extended till March 2010.

Sec. 10A provides for a 100% tax holiday to an undertaking on income from exports, which manufactures or produces articles in a Free Trade Zone, Electronic Hardware Technology Park, Software Technology Park or Special Economic Zone (SEZ) (SEZs notified before 2005-06 under the previous scheme). Sec. 10B provides for a 100% tax holiday on income of an Export Oriented Unit, which manufactures or produces articles in a Domestic Tariff Area.

## Kazakhstan: New Transfer Pricing Bill in Process of Approval

The Bill on State Control over Application of Transfer Prices has been approved by Majlis (lower chamber of the parliament) on 19 March 2008 and approval by the Senate (upper chamber of the parliament) is pending. Notable aspects of the bill include:

- introduction of the arm's length principle;
- application of transfer pricing control to related and independent parties;
- abolition of the 10% safe harbour for independent party transactions;
- introduction of price ranges instead of a single benchmark price;
- application to cross-border and certain domestic transactions, including transactions by subsurface users whose products are intended for exports;
- Advance Pricing Agreement mechanism;
- list of documents and information required for supporting transfer prices;
- additional methods for market price determination – "profit split" method and "transactional net margin" method; and
- application of the "resale price" method only to distribution activities and simple assembly/processing activities.

## New Zealand: Budget for 2008/09

On 22 May 2008, the Minister of Finance presented the 2008/09 Budget. The highlight of this election year Budget is a reduction in personal income tax rates and additional benefits under the Working for Families tax credit scheme. Changes in the area of business taxation include increases in a range of business tax thresholds and an announcement that the final proposals for the new international tax regime are to be released.

*Personal Taxes*

The reduction in the personal income tax rates, together with increases in the income thresholds of each tax band in the progressive tax rate scale, is to be implemented in three stages: from 1 October 2008, 1 April 2010 and 1 April 2011. The new tax rates and thresholds are as follows (all amounts in NZD):

| Current | From 1 October 2008 | From 1 April 2010 | From 1 April 2011 |
|---|---|---|---|
| 0 to 38,000 – 19.5% | 0 to 14,000 – 12.5% | 0 to 17,500 – 12.5% | 0 to 20,000 – 12.5% |
| – | 14,001 to 40,000 – 21% | 17,501 to 40,000 – 21% | 20,001 to 42,500 – 21% |
| 38,001 to 60,000 – 33% | 40,001 to 70,000 – 33% | 40,001 to 75,000 – 33% | 42,501 to 80,000 – 33% |
| over 60,000 – 39% | over 70,000 – 39% | over 75,000 – 39% | over 80,000 – 39% |

The new lowest step arises from the removal of the current low income rebate.

*Working for Families Tax Credits*

As well as the reduction in personal income tax rates and threshold changes, the Working for Families tax credits are to be increased. The Working for Families tax credits are made up of the family tax credit, in-work tax credit, parental tax credit and minimum family tax credit. The Budget announced an increase in the rates and income threshold of the family tax credit from 1 October 2008. The new rates and threshold are:

Legislation to enact the personal income tax cuts and family tax credit changes was introduced into Parliament following the reading of the Budget, in the Taxation (Personal Tax

| Category | Current weekly rate (NZD) | Weekly rate from 1 October 2008 (NZD) |
|---|---|---|
| first child under 16 | 82.00 | 86.29 |
| first child over 16 | 95.00 | 99.96 |
| subsequent child under 13 | 57.00 | 59.98 |
| subsequent child 13 to 15 | 65.00 | 68.40 |
| subsequent child over 16 | 85.00 | 89.44 |
| income threshold | 35,000.00 | 36,827.00 |

Cuts, Annual Rates and Remedial Matters) Bill 2008. The bill also contains a number of remedial amendments to the portfolio investment entity and KiwiSaver tax regimes, and drafting corrections to the re-written Income Tax Act 2007.

*International Taxation*
It was also announced that the government is to release in a separate document its final proposals from its review of international taxation. The government confirmed the introduction of an active income exemption from tax on earnings by New Zealand based companies operating in foreign jurisdictions. Only Australia is to remain on the controlled foreign companies (CFC) grey list, which exempts New Zealand shareholders in CFCs from including their share of a CFC's income in their New Zealand taxable income. This follows the earlier releases of discussion documents and issues papers, and submissions from the public.

The Minister also announced that a much more limited set of base company rules will be introduced, which will apply only to services performed in New Zealand.
Offshore controlled foreign insurance companies will be able to apply to the Commissioner of Inland Revenue to qualify for the active income exemption.

*Simplification of Business Taxation*
In order to reduce the compliance costs of small businesses, the Budget provides for the following increases to thresholds in various areas of business tax:

- PAYE monthly filing and FBT annual return filing: from annual employer PAYE tax and superannuation contribution payments of NZD 100,000 to NZD 250,000;
- provisional tax use-of-money interest safe harbour: from current year residual income tax of NZD 35,000 to NZD 50,000;
- low-value trading stock: from trading stock value of NZD 5,000 to NZD 10,000;
- GST registration: from annual supplies of NZD 40,000 to NZD 50,000;
- GST 6-monthly return filing: from annual taxable supplies of NZD 250,000 to NZD 500,000; and
- financial arrangements accounted for on a straight-line basis: from the total value of financial arrangements of NZD 1.5 million to NZD 1.85 million.

The Budget also proposes to allow non-individuals, within certain thresholds, to return income from financial arrangements on a cash accounting basis.

A further set of initiatives for simplification and cost reduction for businesses is to be announced later.

Note: On 23 May 2008, the New Zealand Parliament passed the Taxation (Personal Tax Cuts, Annual Rates, and Remedial Matters) Bill, which was introduced on 22 May 2008 to enact the changes to personal income tax rates and thresholds, and amendments to the Working For Families tax credits introduced in the 2008/09 Budget.

## New Zealand: Limited Partnership Legislation Enacted
Legislation was passed by Parliament on 11 March 2008 enacting new regulatory and tax rules for limited partnerships. The purpose of the legislation is to provide a more attractive investment vehicle for international investors providing capital into New Zealand. It enables a limited partnership to be a separate legal entity and also allows foreign investors to have the taxable income and losses from their limited partnership investments recognized in their own countries. The new legislation removes the old concept of a "special partnership" and also provides a more modern regulatory scheme for the taxation of all partnerships.

## Philippines: Consolidated Regulations on Taxation of Disposals of Shares of Domestic Companies held as Capital Assets
The Bureau of Internal Revenue has in Revenue Regulations 6-2008, consolidated the rules for the imposition of tax upon the sale, barter, exchange or other disposition of shares of domestic companies that are held as capital assets.

Pursuant to the Regulations, the taxes apply to individuals, companies, estates, trusts, trust funds and pension funds, amongst others. However, securities dealers, investors in mutual fund companies who realize gains from redemption of such shares and persons specifically exempt under investment incentives and special laws, are excluded. The Regulations also provide information on the timing of tax payments, the manner of filing returns and the consequences of non-payment of the taxes.

The Regulations mainly cover the application of Philippine taxes for the following five types of share dispositions:

- sale, barter or exchange of listed and traded shares;
- sale, barter exchange or issuance of shares through Initial Public Offering;
- sale, barter or exchange of non-listed and non-traded shares;
- surrender of shares upon dissolution and liquidation of a company; and
- shares redeemed for cancellation or retirement.

## Philippines: Circular clarifying taxability of sale of shares
The Bureau of Internal Revenue issued Revenue Memorandum Circular No. 21-2008 which provided clarification on the taxability of the sale, barter or exchange of shares listed and traded through the Local Stock Exchange, or through Initial Public Offerings.

### Philippines: Circular clarifying tax treatment of payments to directors

The Bureau of Internal Revenue has issued Revenue Memorandum Circular No. 34-2008 on the tax treatment of payments to directors. Based on this Circular, where it is established that directors and the corporation have an employer-employee relationship, fees received by the directors constitute "compensation" income as defined in Revenue Regulations No. 298. Accordingly, the directors' fees are subject to the withholding tax on wages imposed under Section 79 of the National Internal Revenue Code. Such income is also exempt from value added tax (VAT) as they are received in the capacity of an employee.

In the absence of an employer-employee relationship (e.g. where payments are made to directors whose duties are confined to the attendance and participation in board meetings), payments received by the directors do not constitute compensation income and are instead treated as gross income derived from the conduct of trade or business or exercise of a profession. Accordingly, the directors' fees and all other forms of income such as allowances and per diems received by the directors are subject to the creditable withholding tax of 15% if their annual gross income exceeds PHP 720,000, or 10% if otherwise. Such directors are also liable to pay VAT of 12% on their gross receipts if the VAT threshold is met, or 3% if otherwise.

### Philippines: Interim Transfer Pricing Guidelines

The Bureau of Internal Revenue is currently revising the final draft of the Revenue Regulations on Transfer Pricing. Until the said regulations are issued, all transfer pricing matters are to be resolved in accordance with the principles laid down by the OECD Transfer Pricing Guidelines.

### Taiwan: Private ruling on source of income from service charges paid to foreign securities brokers

The Taipei National Tax Administration (TNTA) recently issued a private ruling on the source of income of securities brokers who engage in foreign securities transactions. Under the current rules, a domestic broker acts as an intermediary between clients and foreign brokers and only earns a spread from the foreign transactions. Prior to the issuance of the private ruling, it was unclear whether the income earned by the foreign broker was Taiwanese-sourced income.

The private ruling sets out the TNTA's position, i.e. that the entire service charge (instead of a mere spread) received by the domestic broker from the foreign transaction should subject to a 2% business tax. In addition, the amount which the domestic broker pays to the foreign broker (i.e. commission) should be subject to a 5% business tax. Additionally, the total service charge received by the domestic broker from the Taiwanese client is to be treated as Taiwanese-sourced and subject to income tax. Any related costs and expenses (i.e. payment to the foreign broker) are tax deductible to the domestic broker.

### Taiwan: Ruling on availability of creditable tax to non-resident shareholders

Taiwan prevents the economic double taxation of dividends by utilizing an imputation system, which does not extend to non-residents. For non-resident shareholders, a 10% advance tax on all undistributed retained earnings paid at the corporate level may be credited against the withholding tax on dividends distributed to non-residents.

The Ministry of Finance (MOF) issued a ruling on 26 March 2008 on the availability of creditable tax to foreign shareholders. The ruling indicates that non-resident shareholders (including non-resident individuals and foreign profit-seeking enterprises with no fixed place of business in Taiwan) of Taiwanese companies that declared a dividend *after* 22 October 2007 would not be entitled to a credit against their withholding tax if the dividends are from current year distributed earnings.

On 22 October 2007, the MOF had issued a previous ruling stating that if dividends received by a non-resident shareholder are from current year distributed earnings (to which the 10% advance tax would not have been already applied), no creditable tax against withholding tax is permitted. The ruling issued on 26 March 2008 extends this treatment to dividends declared after 22 October 2007.

### Vietnam: Draft Value Added Tax Law, and, Enterprise Income Tax Law released

The Ministry of Finance has recently circulated the draft Value Added Tax Law (VATL) for public comment, which is expected to come into effect on 1 January 2009. The draft law proposes a change in the value added tax (VAT) rates from the current 5% to three categories of 0%, 5% and 10%. International transportation and the export of goods are zero-rated, with the exception of overseas reinsurance services, credit services, post and telecommunication services and unprocessed minerals. The 5% VAT rate is levied on 13 groups of goods and services, including medicine, education and learning materials and toys for children. Other goods and services would be taxed at 10%.

The Ministry of Finance also circulated the draft Law on Enterprise Income Tax (LEIT), which is expected to be effective from 1 January 2009. In addition to the proposed reduction of the current enterprise income tax rate from 28% to 25%, the draft law also proposes (i) a number of changes to the tax incentive regime, (ii) allowing losses from sale of immovable property to be only offset against income derived from the same activity, and (iii) allowing enterprises to allocate up to 10% of their taxable income to establish a development fund for science and technology research activities subject to specified conditions.

### ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD): Draft of 2008 Model Tax Convention Released

The draft of the 2008 Model Tax Convention was released on 21 April 2008. The draft contents are available on the OECD website.

The draft incorporates proposed modifications to the Commentaries included in previously released reports and a number of technical changes that have not been previously released for public discussion.

The Committee on Fiscal Affairs intends to finalize the proposals by June 2008. To that end, comments on the update should be sent before 31 May 2008.

*Summary*
The contents of the 2008 update result primarily from the following previously released reports:

– Improving the Resolution of Tax Treaty Disputes;
– Revised Commentary on Article 7;
– Application and Interpretation of Article 2 (Non-Discrimination);
– Tax Treaty Issues related to REITs; and
– The Tax Treaty Treatment of Services: Proposed Commentary Changes.

However, the update does *not* include the revised draft changes on Article 15(2) (short-term assignments).

The draft also includes a number of technical changes to the Commentary that have not been previously released for comments as follows:

– the concept of "place of effective management";
– the situation of dual-resident persons who are treaty non-residents under the tie-breaker rule;
– certain aspects of the definition of royalties;
– an interpretation issue related to the distribution of software;
– whether days of residence should be taken into account for the purposes of the computation of the 183-day rule of Subpara. 2(a) of Article 15;
– a minor drafting change to Para. 32.6 of the Commentary on Articles 23 A and 23 B; and
– a minor updating of Para. 12 of the Commentary on Article 21.

## TAX TREATY DEVELOPMENTS

The following tax treaty developments were reported:

– *Australia-South Africa*: A protocol to the existing 1999 tax treaty between Australia and South Africa was signed on 31 March 2008, which provides for the reduction of dividend withholding tax for non-portfolio dividends received by a corporate entity from 15% to 5%, and royalty withholding tax from 10% to 5%. The protocol will enter into force when both countries advise that they have completed their domestic requirements.
– *Hong Kong-Thailand*: On 21 February 2008, Hong Kong replied to the Note from Thailand, confirming the understanding that either party shall not impose a tax on profits remitted by a permanent establishment of an enterprise of the other party, as defined under Art. 5 of the Hong Kong-Thailand income tax treaty. The treaty was signed on 7 September 2005 and entered into force on 7 December 2005. The Note shall form an integral part of the treaty.
– *India-Myanmar*: India and Myanmar signed a first-time tax treaty on 2 April 2008.
– *South Korea-Iceland*: South Korea and Iceland signed a first-time income and capital tax treaty on 15 May 2008.
– *Vietnam-Ireland*: Vietnam and Ireland signed a first-time income tax treaty on 10 March 2008.
– *Vietnam-Oman*: Vietnam and Oman signed a first-time income tax treaty on 18 April 2008. TG

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# Feedback and Letter of the Month

Share your thoughts and comment on any tax or business issue, or let us know what you think of Tax Guardian. Send your feedback to publications@mit.org.my. Letters should be kept fewer than 250 words, and may be edited for length and style.

The writer of the letter of the month will receive **RM150 Jaya Jusco cash voucher,** sponsored by Lee Hishammuddin Allen & Gledhill and a **thumbdrive cum pen**, sponsored by CCH.

# Organisational Culture

The culture of any organisation is easy to experience, yet difficult to define. When contrasting the cultures of companies such as Apple, Microsoft and IBM, we can use adjectives such as "formal" or "informal" but it is not always easy to find any objective signifiers that justify these (beyond superficial factors such as dress codes). After all, the three companies are seeking to make profits from products and services in the IT sector.

Another problem is that the culture of an organisation is often inextricably linked to the broader culture within which it operates, and from which it draws its members. Thus, a branch of McDonald's in Los Angeles might have a somewhat different culture from one in Kuala Lumpur, even if many products and processes are the same. Moreover, the boundaries between an organisation's management structure and its overall culture are often so blurred as to be indistinguishable. Does a non-hierarchical management structure breed an informal culture, or vice versa? In this article, we will look at the various means of quantifying and qualifying organisational culture, and also consider the corporate structures and wider aspects of society that are of particular importance to Asian organisations, and global organisations operating in Asia. The Samsung case study deals with the attempts of one large Asian company that effected a major structural change in an effort to save itself from financial crisis, and subsequently to seize and then maintain a market advantage over a rival company.

## Defining an Organisation's Culture

An organisational culture can be defined as "a set of habitual, traditional and expected, but unwritten and informal rules and norms which strongly influence the behaviour and reactions of all employees."[1] Immediately, we face a problem — if the rules are unwritten and informal, how do we identify them objectively?

Various methods have been suggested. Deal and Kennedy[2] identified a number of key signifiers that will determine the type of culture to be found in an organisation. These include:

- business environment;
- values;
- heroes and role models;
- rites and rituals.

Below are questions that can be asked to determine what sort of culture exists in your organisation:

1. **Business environment**
   What does the organisation produce? Who are the customers and competitors? What are the influences of government policy or economic conditions? What is the current state of relevant technology? What operational aspect is most significant: sales/innovation/cost control?

2. **Values**
   What are the core beliefs and standards that help to define "success" for an organisation? These might be expressed overtly, as mission statements or as part of an organisation's branding; or more subliminally, for example, in the importance accorded to individuals in particular areas of the organisation in terms of promotion or salary increases. An organisation in which finance staff attain senior positions in disproportionate numbers might be seen to have different values from one where this occurs with IT staff.

3. **Heroes and role models**
   Who are the individuals who inspire others within an organisation? What characteristics do they have in common? Do they share a personality or operational

trait (eg, nurturing; self-promoting; working long hours; challenging rules and regulations)? Or do they tend to fill a specific role in the company? Are sales staff more likely to be heroes than engineers? The varying importance given to these qualities and roles suggest the sort of culture that exists in the organisation.

4. Rites and rituals
What are the regular, programmed routines that indicate the type of behaviour expected of staff? Do these routines tend to be collective in nature (eg, Christmas parties; early-morning callisthenics; singing the company song) or do they focus on individuals (eg, parties marking birthdays, or long service with the organisation)? Are they purely social and relaxing in function (eg, regular drinks after work); or are they more specifically related to work (eg, brainstorming or workshops)?

## Formal and Informal Factors

Certain codified rules and regulations can have an impact on the organisation's culture.[3] These include:

- **Language**
  Do members tend to use formal titles (eg, Mr Khun-san), given names or nicknames? Is swearing tolerated? Do members use slang or jargon that is impenetrable to those outside the organisation, or outside the profession or sector (eg, IT jargon)?
- **Interpersonal behaviour**
  Does the organisation tolerate disruptive behaviour (eg, practical jokes)? Can people play music or eat in their work spaces? Are there rules about dating colleagues?
- **Appearance**
  Are there rules about dress codes (eg, shirt-and-tie, no trousers for women, dress-down Fridays)? Are there uniforms for some or all members? Are tattoos, piercings, etc prohibited?
- **Instructions**
  Are instructions to subordinates detailed and explicit, or general, offering room for initiative?
- **Meetings**
  Are meetings key to the operation of the company? Are they formal, regular, scheduled, structured (eg, agenda and minutes) or freewheeling? Are they an arena for discussion, consultation, or top-down instruction?
- **Workload and work level**
  How much work is expected of each person? How rigorously is this measured, and by what means? How many holidays are available per year?
- **Timekeeping**
  How strictly are people expected to observe working hours? Is there flexi-time? Is working beyond allotted hours allowed or even expected?
- **Work-life balance**
  How tolerant is the organisation to family or other non-work needs? Is there maternity/paternity leave or sick pay (above and beyond the statutory requirement)? Is there a policy about sabbaticals or other discretionary leave? Is there flexibility to cope with workers leaving because of unexpected emergencies?

Informal, unofficial influences on the culture of an organisation can come about through what Deal and Kennedy identified as "the cultural network". In this model, individuals within an organisation are identified not only by the jobs they do, but by their role in the spread of communication throughout the organisation (although some jobs are more likely to be filled by those in specific roles). These roles are:

- **Storytellers:** People who interpret events within the organisation to suit their own perceptions and interests.
- **Priests:** People who guard the "official" culture and can provide expert knowledge to help others. HR professionals often fulfil a "priestly" role.
- **Whisperers:** People who have gained the ear of senior managers, and are extremely loyal to them.
- **Gossips:** People who spread the latest news on what is happening in an organisation, especially matters that are not covered by "official" versions. Their stories may not be accurate, but they do give an indication of a general mood within the company at any given time.
- **Secretarial sources:** People who are privy to key facts, but are more disinterested and unbiased about their interpretation. As the name suggests, secretaries and personal assistants often fall into this role.
- **Spies:** People who have access to a wide range of individuals within an organisation, and can act as conduits for those in other roles. IT and maintenance staff might have the opportunity to act as spies.
- **Cabals:** A cabal is a group of people acting and spreading information to provide mutual support and preferment.

The relative strengths and weaknesses of these informal modes of communication within an organisation give some indication as to the prevailing culture.

## Risk and Speed

A more precise (if restrictive) method of classifying culture might be to define an organisation in terms of the degree of risk involved in its operations, and the speed of feedback, response or other action that is required by members to make it function. One way to codify this is in the table below:[4]

| Degree of Risk | Speed of Feedback | Other Features | Examples |
|---|---|---|---|
| High: sometimes life or death | Fast, little emphasis on long-term persistence | Emphasis on speed rather than endurance; risk of burnout; internal competition; high stress; procedures exist as safety net | Emergency services; construction; venture capital; advertising; sport |
| Low | Fast and tangible; emphasis on short-term targets and achievements | Success comes about by action and persistence; emphasis on customer service, teamwork | Sales, real estate, retail, manufacturing |
| High: risk to organisation, not individuals | Slow | Involves heavy investment; top-down decision-making; main ritual is business meetings | Exploration for oil and other natural resources; aircraft building; investment banking; actuaries |
| Low | Slow | Caution; emphasis on perfection; rules and regulations; hierarchy | Banks; insurance companies; government agencies |

Of course, an organisation might show a combination of these characteristics; it could be argued that the strongest organisations can demonstrate all four traits, and this makes them responsive to all circumstances. As we will see, conglomerates that include organisations with widely differing areas of expertise are particularly characteristic of the Asia corporate culture.

## Organisational Structures

An organisation's culture and its structure are distinct concepts, but they have profound effects on each other. All organisations are, of course, different, but it can sometimes be helpful to identify characteristics that identify particular types of structure. Fons Trompenaars, an authority on cultural diversity in the workplace has identified four stereotypes of corporate culture that he calls the Incubator, the Guided Missile, the Family and the Eiffel Tower.[5] In this analysis,

- the Incubator is characterised by leaderless teams in which the organisation exists to serve the needs of its members;
- the Guided Missile is results-and-task oriented;
- the Family is power oriented, usually structured around the needs and wishes of a single, dominant individual; and
- the Eiffel Tower is characterised by rules, systems and bureaucracy.

While Western tendencies have affected Asian business structures to some degree, especially since the 1997 financial crisis, it is probably true that the Family and Eiffel Tower models are still the most prevalent in the region. This has a specific effect on the role of HR within an organisation, and may also determine the sort of individuals who are best suited to take on HR roles.

According to Trompenaars, within a Family structure, the key role of HR is to serve the management by encouraging loyalty within the workforce. Loyalty is rewarded with enhanced authority, in an environment where many employees might expect to be with the company for a working lifetime. An organisation of this type is also likely to provide numerous benefits to employees, even if the financial compensation is not particularly substantial. An Eiffel Tower structure is more likely to be a governmental, state-owned or state-managed organisation. Here, the core function of HR is to follow specified administrative procedures, in order to ensure that each employee fulfils the function of his or her role. Again, financial compensation may be modest, but stability and a sense of "belonging" is important; staff members are often rewarded with education and training opportunities that can prepare them for promotion within the organisation.

In identifying these types, Trompenaars argues that it is dangerous, and may be pointless to attempt to carry out a root-and-branch reconstruction of a corporate structure and culture. "We have observed many Western organisations that have sought to impose Western (or rather, Anglo-Saxon) HR systems on organisational culture that were based on entirely different assumptions ... What do we do with a pay-for-performance scheme in the Family?"[6]

One example of cultural imposition came when Orange, the French-owned mobile telephony company, implemented a policy of importing its own corporate culture when it sets up in a new environment. This culture can be characterised as individualistic and results-driven. When it set up its Thailand operations, the company was able to attract skilled staff from its rivals, such as AIS and DTAC, with the lure of high salaries, and a prestigious corporate brand (something that is even more significant when recruiting in Asia than it is in the West). However, staff turnover was very high, as many Thai workers, used to a more structured, hierarchical, relationship-driven working model, were unhappy with the individualistic, results-driven environment that they encountered.

Of course, there are many organisations in Asia that do not fit neatly into one or the other of these neat stereotypes. Despite Trompenaars' warning of the Western imposition of organisational cultures on Asian organisations, the Asian economic crisis of the late 1990s forced many organisations to consider at least partial cultural change, and HR departments were crucial in implementing these. In more globally oriented companies, one might find something closer to the Incubator or the Guided Missile. Moreover, many organisations that have their headquarters in the West might wish to inject elements of the corporate culture that pertains at the global headquarters, moderated to a greater or lesser extent by regional norms.

Also, even organisations that might on the surface appear to have very similar cultures may have radically different priorities. For example, the Korean chaebols (ie, a conglomerate of businesses, usually owned by a single family), often considered to be the epitome of rigidly structured, hierarchical monoliths, in fact can be seen to have very different characteristics and organisational priorities.

### The nature and characteristics of Korean *chaebols*

- Daewoo: consensus
- Hyundai: can-do spirit, discipline, aggressive marketing, profit, efficiency
- LG: group harmony, long-term relationships, positive towards change
- Samsung: technology, risk-taking, excellence
- Sunkyong: empowerment, open communication[7]

Here, the Hyundai model could be seen as closer to Trompenaars' Guided Missile, which requires HR to act as a strategic business partner; Sunkyong is more akin to the Incubator, in which HR plays a more creative, educational role.

These can only be general guidelines, as leaders do not set out to create organisations that fit tidy academic brackets. In the search for a single best practice, human resources management maintains what one academic calls "messy diversity",[8] a diversity that is reflected in the corporate cultures it serves. The appropriate practice here is to be aware of the various indicators discussed, to determine the correct response — and then to be flexible enough to respond to cultural or structural change, which can be provoked by internal or external pressures.

## Wider Cultural Factors

We have seen that many organisations can contain a mixture of cultures within them. For example, the marketing department will often have a completely different culture from that of the factory floor. As globalisation becomes more prevalent, wider cultural differences will begin to have an impact.

For example, Malaysia has made a great success of welding different ethnic groups together into a single national identity. However, these groups still maintain particular cultural traits, and one group might have a disproportionately larger or smaller presence in a particular profession. Thus, in any specific organisation, we might find Chinese, Malay or Tamil speakers dominating in particular areas, which will necessarily have some kind of effect on organisational culture in those sectors. Even in a more homogenous society such as Thailand, an organisation might have English-speaking Westerners in roles that require strategic negotiation with foreign clients or partners; and day workers from Burma or Cambodia in manual roles.

At the same time, it is possible to make some overall generalisations about cultural norms within Asia, and more specific suggestions about the norms that exist in individual countries. In the broadest sense, Asian cultures, and the businesses and other organisations that operate in them, tend to be collective and hierarchical, especially when compared with cultures in North America, Europe and Australasia. An overview of the key characteristics of many large Asian organisations can be seen in the following table.

**Management and corporate structure in Asia and the West[9]**

| Large Western firm | Large Asian firm |
|---|---|
| Short time frame for decision-making | Longer time frame for decision-making |
| Driven by profit and/or market share | Driven by growth |
| Corporate direction is determined by overall corporate vision and strategy | Corporate direction is determined by opportunity |
| Highly structured | Often poorly structured |
| Wide ownership (institutions) | Narrow ownership (families) |
| Professionally managed | Family managed |
| Focused on core businesses | Highly diversified |
| Invests on the basis of research | Invests on the basis of connections |
| Minority shareholders are well treated | Minority shareholders are not well treated |
| Dispersed decision-making | Centralised decision-making |
| Relatively small number of units/companies | Large number of units/companies |
| Prefers accrual accounting | Prefers cash accounting |
| Lots of contracting-out and buying-in | High degree of vertical integration and lots of internal transactions |
| Reliant on external funding | Prefers internal funding |
| Services very important | Dislikes services |
| R&D-intensive | Little or no R&D |
| Management is participative | Management is patriarchal |
| Senior management relatively aloof | Senior management hands-on |
| There is a well-defined career ladder for staff | There is a vague career ladder for staff |
| High priority is given to transparency, auditing and disclosure | Low priority is given to transparency, auditing and disclosure |
| Fringe benefits are generally a small part of total remuneration | Fringe benefits are a high component of salary (remuneration is paternalistic) |
| Staff training is formal and structured | Staff are trained informally and on the job |
| Employees tend to be promoted on the basis of their inherent productivity | Employees tend to be promoted on the basis of their connections and perceived loyalty |
| Job descriptions are precise and employees are encouraged to use initiative | Job descriptions are vague and employees work as directed |
| Staff initiative is expected and rewarded | Staff initiative is discouraged |

One important consideration to remember is that many significant business entities in Asia are large, family-owned conglomerates. Although these businesses have seen changes in recent years and professional managers have been brought in various capacities, many are still controlled by family groups, often dominated by a senior, patriarchal figure. The nature of the family, rather than the work being done, is likely to have a major effect on the corporate culture. Apart from anything else, many of these family concerns have diverse interests, often the result of opportunistic takeovers rather than long-term policies.

For example, the Japanese *keiretsu* (a network of businesses that own stakes in one another as a means of mutual security) Mitsubishi covers the automotive, brewing, oil, plastics, paper and retail sectors; the Thai Chearavanont family has interests in agribusiness, broadcasting, petrochemicals, retail and telecoms; the Korean chaebol LG (before it was split up in 2005) covered chemicals, construction, electronics, retail and telecoms. Even when such large concerns are broken up, links between the individual components may remain, especially in the form of family ownership. Because of the significance of individuals and relationships to these organisations, cultures can be determined by powerful personalities, more than by what the organisation actually exists to do.

Obviously, as with any generalisation, there are differences in degree, and many individual organisations that completely contradict the above stereotypes. Three key points should be remembered.

1. Many Asian businesses are becoming more global in perspective, with executives having worked or studied in Western countries. Multinationals and foreign-run companies operating in Asian countries also affect the overall corporate culture

2. Characteristics that we associate with Asian business are not exclusive to Asia: Scandinavian and Australian businesses are often consensus-driven (like Japanese

companies); French and Spanish management styles can be hierarchical, even autocratic; despite a supposed leaning to meritocracy, many successful Western concerns are effectively family-controlled (eg, Wal-Mart).

3. Within such a broad generalisation, one should take note of the fact that there are major differences between individual Asian cultures.

The key characteristics of specific national cultures are outlined below.[10] Once again, these are generalisations: a Malaysian company run by Chinese people may be very different from one run by Malays; a company based in the centre of Mumbai or Delhi might be very different from one in a rural location. Also, levels of contact with and investment from other countries, including those outside Asia, will have significant impact. As globalisation and free trade make a common international culture more feasible, these distinctions will become less pronounced, but it will be many years before they are entirely eradicated – if ever.

**Case Study: Samsung Electronics, Korea**

**Corporate Profile**

Samsung is one of the major chaebols (family-controlled conglomerates) that have dominated Korean business for decades. The original Samsung company began in 1938, when Korea was under Japanese colonial rule. In fact, Samsung Corporation was founded in 1951, during the Korean War.

For many years, Samsung followed a standard pattern for Asian companies, diversifying into a wide range of industries (brewing, chemicals, insurance, a hospital, even a baseball team), and relying on personal relationships with influential people for continued success. But it was Samsung Electronics, which was founded in the late 1960s, that was to ensure the continued success of the group.[11]

At first, the company was generally perceived to be a producer of cheap and cheerful consumer electronics, and the global reputation of its finished products was poor. However, the company only stayed in the black because of the strength of its domestic sales.

| | National Cultures and their Key Characteristics |
|---|---|
| China | Benevolent autocracy; respect for age and rank; relationships more important than tasks; collective more important than the individual; principles and values more important than expediency; little concept of absolute truth (in Western terms); long-term decision-making; bureaucracy; still some reservations about dealing with foreigners |
| Hong Kong | Entrepreneurial spirit; cosmopolitan outlook; urgency and fast decisions; eye for the bottom line; desire for concise facts (no padding) |
| India | Strong work ethic; cosmopolitan outlook; desire to bargain and negotiate; willing to take risks; language can be ambiguous; class consciousness is important; openness about emotions; complex bureaucracy |
| Indonesia | Islam important; punctuality not important; relationships more important than results; confrontation to be avoided; no strong work ethic; endemic corruption |
| Japan | Synergy through consensus; courtesy, formality and ritual very important; avoidance of criticism and overt refusal; punctuality important; sense of Japanese cultural separateness |
| Korea | Maintaining face, propriety (*kibun*) very important; competitive nature; tenacious sense of self-sacrifice (*hahn*) for country and for organisation |
| Malaysia | Courtesy, gentleness (*budi*) very important; no strong work ethic; ability to compromise, maintaining relationships more important than results, bottom line; Islam is important |
| Philippines | Respect for age and status; people are upfront with their emotions, but public criticism and loss of face is avoided (hiya); cosmopolitan and pro-Western; Catholicism, family values important; punctuality not so important |
| Singapore | Respect for the law and conformity are valued; strong work ethic; teamwork is important; respect for multiculturalism; punctuality is expected |
| Taiwan | Confucian respect for age and rank; entrepreneurial spirit, technical knowledge important; strong work ethic; long-term decision-making |
| Thailand | Confrontation and loss of face to be avoided; work should be enjoyable (*sanuk*); initiative, non-conformity not always valued; fatalism (*mai pen rai*); punctuality; deadlines are not very important; Buddhism is important |
| Vietnam | Collective leadership; respect for seniority (Confucianism); open in conversation (by Asian standards); punctuality valued; new entrepreneurialism (Chinese model); government bureaucracy |

From the early 1980s, Samsung built a reputation as an innovative developer and producer of memory chips. In 1996, the company developed the first ever one-gigabyte DRAM.

**3P Innovation**
In the second half of the 1990s, Samsung took action to reform its whole management structure. The resulting programme was known as “3P Innovation” – for Products, Processes and Personnel. In more specific terms, this meant:

1. **Product Innovation:** reducing dependency on memory chips and developing a product portfolio of computers, telecoms and related goods;
2. **Process Innovation:** focusing on allowing staff to reach decisions more quickly, and fostering a cycle of ongoing improvement;
3. **Personnel Innovation:** transforming the organisation's orientation from function to process, enabling the company to become more responsive to market and customer needs.

Responsibility for individual product lines was taken out of the centralised decision-making system, and handed to autonomous Global Product Managers. Employee compensation was now assessed transparently, and on the basis of performance. Incentives such as stock options and profit sharing were introduced.

In practice, of course, the “3Ps” were by no means discrete and separate; each component had a profound effect elsewhere in the Samsung organisation. Culturally, the orientation of the company switched from manufacturing to marketing.

**Financial crisis of 1997**
The economic crisis of 1997 led to Korea being propped up by an International Monetary Fund loan. One side effect was that the Government was forced to implement long-needed reforms of the chaebols, which were perceived to be inefficient and often corrupt. Samsung was vulnerable, mainly because of its weak operational structure and poor export capabilities.

In the latter part of 1998, Samsung launched a complementary policy called “Concentration on Selective Resources”, which involved all non-core functions and assets being sold off or otherwise disposed of. The largest of these was Samsung Motors, which had cost the company US$3.5 billion to set up.[12] At the same time, the workforce was reduced by over 30%. This was a risky move. In 1987, it had only been possible to improve production capability of semiconductors – by now the most profitable part of the company – by transferring financial resources from elsewhere within the chaebol..

It should also be noted that the effects of reform were not felt immediately, and in the view of CEO Yun Jong Yong, the main stumbling block at first was “employees continu[ing] to follow old habits and ways of doing things.”[13] It was only when the true scale of the 1997 crisis sank in (huge profits in 1995 had led to a sense of complacency) that the bulk of employees fell into line, and their loyalty to the company and country came into play.

**“Five Ills”**
In 1999, Mr Yun identified “Five Ills” that would continue to hamper progress if not checked[14]:

1. complacency;
2. habitual practices;
3. formality;
4. authoritarianism;
5. egoism.

All these, except the last, are generally regarded as being symptomatic of traditional Asian business cultures. But it is notable that Mr Yun was able to exploit another traditional trait, which is corporate loyalty and patriotism, and use a traditionally Asian medium, the CEP's annual adress to all employees, to tackle these ills.

Even when the general economic conditions improved, and Samsung's own status was more assured, Mr Yun continued to foster a sense of danger and impending crisis, in order to keep his staff on their toes. Rather than maintaining the conventional Korean wariness of expenditure on research and innovation, he made massive investments in these areas. By 2004, Samsung was spending 8.3% of its revenue on research and development (R&D), more than any other technology company on the planet. Research now accounts for 40% of the company's global workforce, working in 17 international R&D centres.[15]

**The way forward**
Samsung has introduced structural innovations such as Value Innovation Programmes – intensive research functions that favour focused brainstorming over more conventional methods – and the Innovative Design Lab of Samsung, an in-house design faculty that exposes staff designers to top US teaching, and arranges international visits to experience design in other cultural contexts.[16]

By leveraging certain desirable cultural traits within the company and in society at large (a sense of loyalty and self-sacrifice), Samsung was able to jettison others that were less desirable (undue deference to hierarchy, complacency, etc). It seems to have worked. In 2004, Samsung's revenues and profits outstripped those of its older, bigger and better-known Japanese rival, Sony.

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# Assessibility and Taxability of Employment Income (Part 2)

By Associate Professor Hajjah Faridah Ahmad

## *Gratuity*

Gratuity is normally referred to as "a sum of money" given to the employee in recognition of past year services. Gratuity is normally paid to the employee upon resignation or retirement from employment after serving a long period with a company or group of companies under common control.

Gratuity is taxable in full unless exemption is granted under Schedule 6 ITA 1967:

a. **Schedule 6 Paragraph 25(1)(a)**
Gratuity is fully exempted from income tax if the Director General is satisfied that the retirement was due to medical reason.

b. **Schedule 6 Paragraph 25(1)(b)**
Gratuity is fully exempted from income tax if the retirement takes place on or after reaching the age of 55 or on reaching the compulsory age of retirement from employment specified under any written law, and in either case the employment must have lasted for at least 10 years with the same employer or with companies in the same group. The ten-year period must be a continuous period immediately prior to retirement.

*Example:*

Mr Lim, aged 56, retired from his job as an accountant with Sunny Sdn Bhd on 31 March 2008. On his retirement day, he received RM280,000 as gratuity. He had worked with Sunny Sdn Bhd for 15 years.

The gratuity of RM280,000 will be exempt from income tax because he fulfilled the conditions stipulated under Schedule 6, Paragraph 25(1)(b).

c. **Schedule 6 Paragraph 25(1)(c)**
Employees who retire on the compulsory age of between 50 and before 55 are given a partial exemption on retirement gratuity of up to RM6,000 for each completed year of service.

*Example:*

Mr Thiru, aged 52, retired as an engineer with Complex Sdn Bhd on 31 January 2008. He joined the company since 1 March 1995. On his retirement day he received RM210,000 as gratuity. He is still in good health. The amount exempted and subjected to tax will be computed as follows:

| | RM |
|---|---|
| Amount received | 210,000 |
| Less: Exemption given (RM6,000 x 12 years) | (72,000) |
| Amount taxable | 138,000 |
| | ======== |

The amount taxable will be spread over 6 years (since he has worked for more than 5 years). The amount per assessment year will be RM23,000 (ie RM138,000 ÷ 6).

| | | |
|---|---|---|
| YA 2008 | RM 23,000 | Annual assessment |
| YA 2007 | RM 23,000 | Additional assessment will be raised for each year |
| YA 2006 | RM 23,000 | |
| YA 2005 | RM 23,000 | |
| YA 2004 | RM 23,000 | |
| YA 2003 | RM 23,000 | |

**Note:**
If the total period of employment from the date of commencement to the commencement of the last basis period is 5 years or less, the gratuity is spread over the actual number of years.

*Example:*

Mr Andrew was employed by Kimko Sdn Bhd since 1 April 2003, as an architect. On 31 March 2008, his employment was terminated by the company, and he was paid RM60,000 as gratuity. Mr Andrew was 42 years old on 31 March 2008, and he is in good health.

Mr Andrew will not get any exemption and the gratuity will be assessed to tax according to the length of service in the company.

| Year of Assessment (RM) | Amount Assessed of Service | Related Period |
|---|---|---|
| 2008 | $\frac{3}{60}$ x 60,000 = 3,000 | 1/1/08 – 31/3/08 |
| 2007 | $\frac{12}{60}$ x 60,000 = 12,000 | 1/1/07 – 31/12/07 |
| 2006 | $\frac{12}{60}$ x 60,000 = 12,000 | 1/1/06 – 31/12/06 |
| 2005 | $\frac{12}{60}$ x 60,000 = 12,000 | 1/1/05 – 31/12/05 |
| 2004 | $\frac{12}{60}$ x 60,000 = 12,000 | 1/1/04 – 31/12/04 |
| 2003 | $\frac{9}{60}$ x 60,000 = 9,000 | 1/4/03 – 31/12/03 |

d. **Schedule 6, Paragraph 25A**
Sums received by way of gratuity or by way of payment in lieu of leave, paid out of public funds on retirement from employment under any written law.

e. **Schedule 6, Paragraph 25B**
Sums received by way of gratuity paid out of public funds or terminated of a contract of employment (less any amount of the employer's contribution to the Employees Provident Fund, if any, and interest thereon).

f. **Schedule 6, Paragraph 25C**
Sums received as perquisite consisting of long service, past achievement or service excellence award by employee from employer will be exempt from income tax up to a maximum

amount or value of RM1,000 for each year of assessment. This exemption shall be given only to employees who have served the same employer for more than 10 years. Prior to year of assessment 2007, this value was subject to income tax.

## Share Option and Share Incentive Scheme (ESOS)

This is a scheme that allows an employee an option to acquire shares in a company where he works at a fixed price and with a right to exercise the option at some future dates. If the employee takes up this option, he will be taxable on the income under Section 13(1)(a).

Effective from year of assessment 2006, the benefits derived from ESOS are calculated as follows:

| | RM |
|---|---|
| Share price in share market at date of offer | xx |
| *Less*: | |
| Purchase price of shares in the share market at date of exercise | xx |
| Value of benefits as perquisite under Sec 13(1)(a) | xx |

Benefits from the grant of ESOS will arise on the date the option is exercised. For the purpose of tax computation, this benefit will be related back to the basis period for the year in which the option is offered.

Any subsequent changes in the value of the shares will not affect the taxable value of the employee. Such changes include:

- fluctuations in the value of the shares,
- changes in the share price resulting from the grant of bonus shares based on the holding of ordinary shares by the employee, and
- gain or loss from the shares arising from the disposal of the shares.

*Example (1)*

On 12 March 2008, Mr Daniel, a managing director of Excellent Sdn Bhd, was granted 5,000 shares in the holding company free of charge in addition to the salary received by him. The shares were traded in the Hong Kong Stock Exchange and the market value of the share on 12 March 2008 was equal to RM5.50 per share. On 30 April 2008, Mr Daniel sold the shares at a price of RM6.00 per share.

The benefit taxable as perquisite on Mr Daniel determined on 12 March 2008 is the market value of the share on 12 March 2008 (i.e. 5,000 ? RM5.50) = RM27,500.

The benefit is taxable as part of the employment income of the employee for the year of assessment 2008. The gain obtained from the sale of the shares on 30 April 2008 does not have any tax consequences on the employee.
In a situation when an employer grants his employees options to purchase shares under favourable terms, that means shares are offered to employees:

- at par value whereas shares have a premium value in the share market, or
- at a fixed price whereas the shares have a higher market value in the share market.

The difference between the amounts paid for obtaining the shares and the market value of the shares at the date the option was offered, is a benefit to the employee, taxable as a perquisite.

*Example (2)*

On 2 February 2008, Mr Teo was granted an option by his employer to purchase 5,000 shares of the company valued at RM 1.00 per share, at par. The share price on the same date in the share market was RM1.90. Mr Teo exercised that option on 2 February 2008.

The benefit taxable as perquisite on the employee is determined on 2 February 2008 as follows:

| | RM |
|---|---|
| Market value of share on 2 February 2008 (5,000 x RM1.90) | 9,500 |
| Share price under offer option 2 February 2008 (5,000 x RM1.00) | (5,000) |
| Perquisite under Sec 13(1)(a) | 4,500 |

This benefit is taxable as part of the employment income of Mr Teo for year of assessment 2008.

## Leave Pay

Leave pay is a cash item taxable when an employee receives it. The amount assessable to tax is either in the year of departure or later depending whether the tax payer fulfills the conditions under sec 25(b), ie:

a. the employee has left or is leaving Malaysia in the year concerned,
b. the employee will not be a resident for the following basis year,
c. the employee will have no pension income in the following basis year,
d. there will be no gross income from employment derived from Malaysia after the employee has left Malaysia.

*Example (1)*

En Mior, a Brunei citizen ceased employment with Maldi (M) Sdn Bhd on 30 November 2007. He left Malaysia for Brunei on 1 December 2007. He would have no pension or other employment income after he left Malaysia.

For the year 2007, En Mior received a salary of RM132,000, entertainment allowance of RM28,000 and leave pay of RM12,000 per month starting from December 2007 until 31 March 2008.

**Year of Assessment 2007**
**Section 13(1)(a)**

| | |
|---|---|
| Salary | RM 132,000 |
| Entertainment allowance | 28,000 |
| Leave pay (Dec 2007) | 12,000 |
| Leave pay (Jan, Feb, March 2008) (12,000 x 3) | 36,000 |
| Gross income | RM 208,000 |

**Note:**
En Mior, however, is allowed to make a written request under Section 25(6) for proration of the leave pay, so that the amount which belongs to the following year will be assessed in the following year (i.e. year of assessment 2008).

*Example (2)*

Using example (1), if En Mior makes an election under Section 25(6) to prorate the leave pay, his assessment will be as follows:

**Year of Assessment 2007**
**Section 13(1)(a):**

| | |
|---|---|
| Salary | RM 132,000 |
| Entertainment allowance | 28,000 |
| Leave pay (Dec 2007) | 12,000 |
| Gross income | RM 172,000 |

**Year of Assessment 2008**
**Section 13(1)(a):**

| | |
|---|---|
| Leave pay (Jan, Feb, March 2008) | RM 36,000 |
| Gross income | RM 36,000 |

If any one of the conditions stated under Section 25(6) is not satisfied, there will be two years of assessment involved.

*Example (3)*

En Karto, a citizen of Indonesia, has been working with Marker (M) Sdn Bhd since 2 April 2000. On 30 September 2007, he ceased employment, and will be leaving Malaysia for Canada on 1 February 2008.

En Karto received a salary of RM180,000 for the year 2007 and leave pay of RM25,000 per month from 1 October 2007 to 29 February 2008.

**Year of Assessment 2007**
**Section 13(1)(a):**

| | |
|---|---|
| Salary | RM 180,000 |
| Leave pay (Oct, Nov, Dec 07) (25,000 x 3) | 75,000 |
| Gross income | RM 255,000 |

**Year of Assessment 2008**
**Section 13(1)(a):**

| | |
|---|---|
| Leave pay (Jan, Feb 2008) (25,000 x 2) | RM 50,000 |
| Gross income | RM 50,000 |

In the example above, one of the conditions under Section 25(6) was not fulfilled, i.e. he is leaving Malaysia the next year, thus for year of assessment 2008, he will be a resident of Malaysia.

## *Other Perquisites*

(i) **Pecuniary liabilities**
Employee's pecuniary liabilities paid by the employer will include income tax, water bill, electricity bill, telephone bill, road tax, car insurance premium, car parking fees and car maintenance charges. The actual value will be taxed on the employee. However the amount can be reduced if the employee makes use of such amenities in the performance of his official duties.

(ii) **Credit card facilities**
Where the employee is provided with a credit card used exclusively for performing his duties including entertaining the employer's customers, the annual membership fees of the credit card are not considered as perquisites. However, where the credit card is also used by the employee for private purchases and payments, any amounts paid by the employer in respect of such private purchases and payments, including the annual membership fee are perquisites and subject to tax.

(iii) **Waiver of advance or loan:**
Where an employer waived the amount of the loan or advance given to employee the amount is a perquisite to the employee as it is payment for services performed. The perquisite will only arise in cases where the employer provides a loan to an employee to enable the employee to attend courses or training and subsequently waives the loan or advance after the employee has served the required time with the employer. It is taxable in the year in which the loan is waived.

(iv) **Individual Membership of recreational club**
If the membership is owned by the individual, the entrance fee and monthly or annual membership subscription and other related reimbursements are the pecuniary liabilities of the employee and the perquisites is subject to tax.

(v) **School Fees or Tuition Fees of a child**
Any payment or reimbursement in respect of school fees or tuition fees of employee's children is a taxable perquisite. Fees will cover both local and overseas education.

(vi) **Gift vouchers**
They are not taxable in the hands of the employee unless they are of a recurring in nature, and also if they are provided in the circumstances where the employee expects such gifts as part of his remuneration.

(vii) **Asset provided free of charge or sold at a discounted price**
Where assets such as houses, cars or other items are provided free of charge or sold at discounted prices by the employer to his employee, the difference between the market price of such assets and the amount paid by the employee (if any) is a perquisite to the employee. The amount is gross income from employment.

*Example:*

NAVY is a company selling imported luxury cars. The company has a policy for its employees at the managerial level to buy the cars at discounted prices as follows:

| Type of asset | Market price per unit (RM) | Discount given (%) |
|---|---|---|
| Car Model 2000CC | 700,000 | 10 |
| Mercedes | | |

The discount of 10% on the price of the car received by the employee (ie RM70,000) is a perquisite and is subject to tax because:

- the car has money's worth and can be convertible into money; and
- the employee upon purchasing the car, has ownership rights over the car and is subsequently able to sell the car to a third party. TG

**References:**

1. Malaysian Tax Workbook 3rd edition, by Faridah Ahmad, published by CCH, 2007
2. Fundamentals of Malaysian Taxation 3rd edition, by Faridah Ahmad and Loo Ern Chen, published by Pearson Prentice Hall, 2008

***Hajjah Faridah Ahmad** is an Associate Professor at the Faculty of Accountancy, UiTM specialising in Malaysian Taxation. Besides teaching the various levels of professional courses of ACCA, MICPA and ICSA, she also provides consulting services on taxation and cash flow management to SMEs. She can be contacted at farid466@salam.uitm.edu.my.*

# Notice Board

1. **Submission of Form R31**
The following filing deadlines for the submission of Form R31 were confirmed by the Inland Revenue Board (IRB) in its letter of 9 April 2008:

| Type of Companies | Deadline |
|---|---|
| Companies with year end on or before 30 September 2007 | 30 April 2008 |
| Companies with year end on 31 October 2007 | 31 May 2008 |
| Companies with year end on 30 November 2007 | 30 June 2008 |

The IRB informed that the law will be amended to require every company whose basis period ends on a date other than 31 December 2007, to file the Form R31. It is unclear as to when the law would be amended.

For a company whose basis period ends on 31 December, there is no need to file the Form R31.

For advance tax payments made on or before 7 September 2007 in respect of tax instalments due and payable after 31 December 2007 (Item A2b of Form R31), the IRB has stated its view that tax paid (for non-31 December year end companies) in the context of Section 39 of the Finance Act 2007 means payments in respect of tax liability which arises from the first day of the basis period for the year of assessment 2008 to 31 December 2007. The concession granted by the Ministry of Finance is to allow the tax paid in respect of tax liability (payable by way of instalments) due after 31 December 2007 to be included in the Section 108 account, provided the advance payment was made on or before 7 September 2007.

The IRB confirmed that only Malaysian resident companies and Singapore resident companies subject to Malaysian tax with a basis period ending on a day other than 31 December need to file the Form R31.

2. **Minutes of Operations Dialogue**
The IRB has issued the minutes of the Operations Dialogue held with the professional bodies on 25 February 2008. Members can download the minutes from the website of the Institute.

3. **e-Filing**
The IRB is in the process of developing an interface that will allow users (i.e. tax agents) to upload data files directly into the system using the tax agents e-filing module. The prototype for testing is expected to be ready by the end of June 2008. The relevant data format will also be made available then to the software providers and to tax agents who have developed their own internal software for preparing tax computations.

4. **Tax Agent's License**
The following were the Institute's understanding of the matters discussed at a dialogue (held early in the year) with officers from the Ministry of Finance (MOF) relating to the renewal of the tax agent's license. Kindly note that the Institute has not yet obtained a written confirmation from the MOF on the clarifications listed below:

(a) *Accumulation of CPD Points*
A commonly asked question is whether the CPD points acquired during the period after submission of a renewal application until the expiry date of the existing license (a four-month period) can be included in the subsequent renewal of the license. It was agreed that the points acquired during this period will count towards the subsequent renewal of the tax agent's license. However, all CPD points from attendance at workshops, seminars, etc., can only be counted once.

*(b) Insufficient Points*

Can a member with insufficient CPD points accumulate the points while waiting for approval of the license, i.e. can the CPD points obtained in the interim period while waiting for renewal make up for the shortfall?

For the time being, the MOF has been lenient in the application of the guidelines and does allow a tax agent to make up the shortfall while the application is being processed. However, no license will be issued until all the requirements have been met. Any prolonged delay can cause a delay in the issuance of the license which will cause difficulties to tax agents if the existing license has actually expired.

Members are reminded that the tax license guidelines have been in place for some time now and it is not acceptable to plead ignorance of the guidelines.

*(c) Failure to Meet Requirements*

Where a tax agent, having submitted his application for renewal of the tax agent's license, fails to obtain the renewal within the time period, the license would have expired or the license may be renewed at a later date due to the failure to meet specific conditions. This would happen for a number of reasons, including the following:

(i) the tax agent fails to submit his application four months before the expiry of the existing license;
(ii) the tax agent has insufficient CPD points and has not been able to make up the points in the interim period as may be allowed by the MOF; or
(iii) the tax agent fails to respond to queries or issues raised by the MOF or the IRB.

The tax agent would then be unable to practice as a tax agent until such time that he fulfills the requirements of the MoF or IRB and succeeds in getting the tax license renewed at a later date.

*(d) Certification of Documents*

The Commissioner of Oaths does not certify documents to be submitted together with an application to renew the tax agent's license. The tax agent has to make a Statutory Declaration in the presence of a Commissioner of Oaths that whatever information (including copies of certificates) that is listed/provided with the declaration is correct.

*(e) Submission of Past Academic Qualifications*

It has been clarified that in the event of the renewal of tax agent's license, there is no necessity to submit past academic qualifications. Where the MOF had requested for copies, this was due to the fact that the MOF was merely updating the files, etc. This however does not apply to new applications where evidence of all academic qualifications has to be provided. TG