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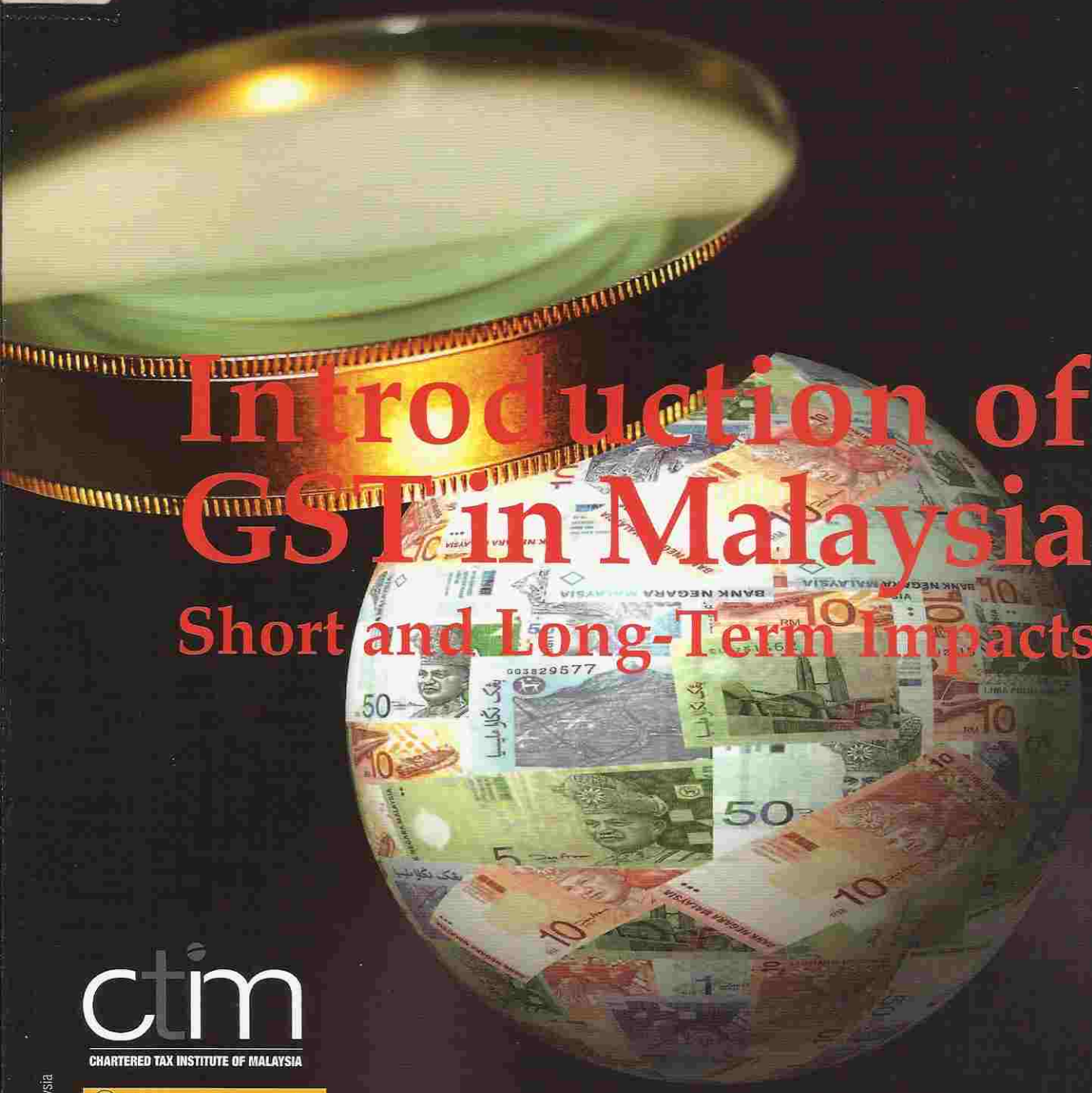

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- New Challenges in Malaysian Transfer Pricing Audits
- Do Business Promotion Expenses Amount to Entertainment Expenses? An Analysis of the *SM* Case

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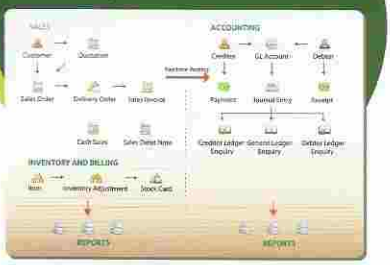

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Editorial Note

"In union there is strength" – Aesop

The Institute is once again gearing up for the National Tax Conference on 6 & 7 July 2010! CTIM members and readers are strongly encouraged to be at this premier event of the year. The national conference will bring together both international and local professional tax practitioners to discuss and debate over a broad range of tax issues and recent development in order to address the theme "*Driving Towards a High Income Economy*". On this note, do take the concerted effort to sign up today to ensure your seat.

I am also pleased to highlight that we have managed to put together noteworthy articles of interest, contributed by Pricewaterhouse Coopers (PwC), Ernst & Young (EY), KPMG and Deloitte – The Big Four accounting firms! On behalf of the institute, I would like to thank these firms for their generous contribution.

The cover story is a continuing series on the current hottest taxation topic in Malaysia – Goods and Services Tax (GST). The article aptly titled "Introduction of Goods and Services Taxes (GST) in Malaysia – Short and Long–Term Impacts", suggests that it is fairly impossible to determine the short or long–term ramifications in the implementation of GST in Malaysia. Could Malaysians positively look forward to some unexpected benefits from the introduction of GST? Please read more to find out.

The article on "Who wins in a Tax Audit?" intends to deal with the steps in the tax audit process and also provides an overview of the key areas for taxpayers to consider in preparing for and dealing with tax audits. Discover who REALLY wins in a tax audit – the tax authority or the taxpayers?

Still on the subject of audits, the Transfer Pricing (TP) environment has undergone vast and rapid changes from the time since the TP Guidelines were first introduced back in July 2003. The article "New Challenges in Malaysian Transfer Pricing Audits" investigates the importance in ensuring proper transfer pricing documentation to serve as a first line of defence in the event of an audit.

On our regular Practice Management section, the theme is largely centered on "talent". The article "Deciding Factors for Tax Talent" highlights the significance of assessing talent in order to uncover a good fit to the organisation. It is the values and shared beliefs of firms that mould an organisation's culture.

There are many other insightful articles in this issue that will leave our readers wanting more. On that note, happy reading!

Dato Raymond Liew Lee Leong
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. They may cover local or international tax developments. 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 size 10 in Microsoft Word via email.

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

Contributions may be sent to:

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Chartered Tax Institute of Malaysia
Unit B-13-2 Block B, 13th Floor
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50450 Kuala Lumpur
Malaysia.
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Continuing Professional Development (CPD)
CALENDAR OF EVENTS JULY - SEPTEMBER 2010

july

Date	Training Programme	CDP points	Venue	Fee (RM)			Speaker
				Member	Member's Firm Staff	Non-member	
6 & 7 July 9.00am - 5.00pm	**NATIONAL TAX CONFERENCE 2010**	**25**	**Kuala Lumpur Convention Centre**	**Early bird 1000 Normal 1200**	**Early bird 1100 Normal 1300**	**Early bird 1200 Normal 1400**	**Various Speakers**
12 Jul 2010 9.00am - 5.00pm	Workshop: Making the Most of Double Tax Agreements	8	Penang	315	365	415	Tan Hooi Beng
14 Jul 2010 9.00am - 5.00pm	Workshop: The Goods and Services Tax - Mechanism and Compliance	8	Petaling Jaya	330	380	440	Thomas Selva Doss
23 Jul 2010 9.00am - 5.00pm	Workshop: Making the Most of Double Tax Agreements	8	Malacca	315	365	415	Tan Hooi Beng
26 Jul 2010 9.00am - 5.00pm	Workshop: Making the Most of Double Tax Agreements	8	Ipoh	315	365	415	Tan Hooi Beng

august

9 Aug 2010 9.00am - 5.00pm	Workshop: Making the Most of Double Tax Agreements	8	Johor Bahru	315	365	415	Tan Hooi Beng
24 Aug 2010 9.00am - 5.00pm	Workshop: Tax Implications on Rental Income & Investment Holding Company	8	Kuala Lumpur	330	380	440	Chow Chee Yen
25 Aug 2010 9.00am - 5.00pm	Seminar: To be Confirmed	8	Kuala Lumpur	Early bird 375 Normal 425	Early bird 425 Normal 495	Early bird 495 Normal 545	Various Speakers
26 Aug 2010 9.00am - 5.00pm	Workshop: Tax Implications on Rental Income & Investment Holding Company	8	Ipoh	315	365	415	Chow Chee Yen

september

2 Sept 2010 9.00am - 5.00pm	Workshop: Tax Implications on Rental Income & Investment Holding Company	8	Johor Bahru	315	365	415	Chow Chee Yen
3 Sept 2010 9.00am - 5.00pm	Workshop: Tax Implications on Rental Income & Investment Holding Company	8	Penang	315	365	415	Chow Chee Yen
20 Sept 2010 9.00am - 5.00pm	Workshop: Withholding Tax & Cross Border Transactions	8	Kuala Lumpur	330	380	440	Sivaram Nagappan
21 Sept 2010 9.00am - 5.00pm	Workshop: Tax Implications on Rental Income & Investment Holding Company	8	Kota Kinabalu	315	365	415	Chow Chee Yen
22 Sept 2010 9.00am - 5.00pm	Workshop: Tax Implications on Rental Income & Investment Holding Company	8	Kuching	315	365	415	Chow Chee Yen
28 Sept 2010 9.00am - 5.00pm	Workshop: Tax Implications on Rental Income & Investment Holding Company	8	Malacca	315	365	415	Chow Chee Yen

DISCLAIMER: CTIM 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, Ms Ally or Ms Nur at 03-2162 8989 ext 108, 113 and 106 respectively or refer to CTIM's website www.ctim.org.my for more information on the CPD programmes.

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CTIM Welcomes its New President Mr Khoo Chin Guan

Khoo Chin Guan is a Fellow member of the Chartered Tax Institute of Malaysia. He has been a member of the Institute since its inception in 1991. He was admitted to the Council in 2005 and was elected as the President of the Institute at the recently concluded 18th Annual General Meeting.

Khoo participates actively in the affairs of the Institute. He is currently the Co-chairman of the Joint Tax Working Group on Financial Reporting Standards (FRSs), a working group formed by the Institute, the Malaysian Institute of Accountants and the Malaysian Institute of Certified Public Accountants to look into the various tax issues arising from the adoption of FRSs in Malaysia. He has also served as the Chairman of the Technical and Public Practice Committee and was the Co-organizing chairman of the National Tax Conference, jointly organized by the Institute with the Inland Revenue Board from 2006 to 2008.
He was also the Organizing chairman of the 2nd Asia Oceania Tax Consultants Association conference held in Kuala Lumpur in 2007.

On the professional practice front, Khoo is currently the Executive Director – Head of Tax at KPMG Tax Services Sdn Bhd (KPMG Tax). He joined KPMG Tax after graduating from the Tunku Abdul Rahman College, Kuala Lumpur in July 1982.

Khoo also holds membership in the Association of Chartered Certified Accountants, United Kingdom, the Malaysian Institute of Accountants and the Malaysian Institute of Certified Public Accountants. He is an approved Tax Agent licensed by the Ministry of Finance. He is also a member of the International Fiscal Association.

On the academic front, Khoo is the External Examiner for the Malaysian Tax papers of the Advanced Diploma in Commerce courses offered at the Tunku Abdul Rahman College.

As the new President, Khoo will continue to pursue the Institute's Strategic Initiatives and Action Plan formulated by the Council earlier which includes enhancing the image of the Institute so that it continues to be the premier body representing the tax profession in Malaysia. Amongst others, Khoo hopes to see the setting up of the Malaysian Tax Research Foundation, representation of the Institute on the tax licensing interview process, collaboration with more institutes of higher learning in the area of tax education and an increase in the membership of the Institute during his tenure as the President of the Institute.

CTIM 18th Annual General Meeting

CTIM held its 18th Annual General Meeting on Saturday, 12th June 2010 at The Best Western Premier Seri Pacific Hotel Kuala Lumpur.

The 18th Annual General Meeting witnessed the re–election of Mr Chow Kee Kan and Mr Lim Thiam Kee, Peter. Mr Lai Shin Fah, David and Mr Poon Yew Hoe were also elected to the Council.

Subsequent to the Annual General Meeting, the council meeting was convened and the following office bearers were elected for the 2010/2011 term:

President :
Mr Khoo Chin Guan

Deputy President :
Mr S M Thanneermalai

Chartered Tax Institute of Malaysia Prize Giving Ceremony

The Chartered Tax Institute of Malaysia (CTIM) held its Prize Giving Ceremony for graduates and prize winners of the 2009 CTIM Professional Examinations on 12 June 2010 at The Best Western Seri Pacific Hotel , Kuala Lumpur. Tan Sri Hasmah Abdullah, Chief Executive Officer/ Director General of the Inland Revenue Board Malaysia (IRB) was the guest of honour at the event. Graduates who have successfully completed the examinations received their graduation certificates and six prize winners were awarded medals.

In his address, the Chairman of the Examinations Committee, Mr Adrian Yeo, congratulated the 14 new

graduates. He was glad to note that in the 2009 examinations there were winners for Best Performance in all Taxation subjects and Prize winners for Best Performance in the Intermediate and Final levels. He reminded them that their knowledge, skills, character and integrity would be tested in the competitive and challenging work environment. He added that graduates should strive to contribute to the tax profession upon their graduation.

Tan Sri Hasmah Abdullah, commended the Institute on the regularly and well–updated examination syllabus. In developing and conducting professional examinations in the field of taxation, CTIM has played a vital role in producing competent and knowledgeable tax practitioners to meet the current shortage in the country. Tan Sri Hasmah Abdullah congratulated the graduates for their achievement and advised them to discharge their duties efficiently to ensure that taxpayers are fully compliant with the law.

Also present at the Prize Giving Ceremony were representatives from various educational institutions, professional bodies, CTIM council members, families and friends of the graduates.

Congratulatory Message

The Institute congratulates YBhg Tan Sri Hasmah binti Abdullah, Chief Executive Officer/Director General of the Inland Revenue Board Malaysia on being conferred the Panglima Setia Mahkota (P.S.M.) by the Yang Di–Pertuan Agong on 5 June 2010 in conjunction with His Royal Highness' birthday celebration.

Memorandum of Understanding with University Tun Abdul Razak (UNIRAZAK)

Chartered Tax Institute of Malaysia (CTIM) signed a Memorandum of Understanding (MOU) with the Universiti Tun Abdul Razak (UNIRAZAK) in which both parties expressed their desire to develop stronger ties and a closer working relationship. The MOU was signed by Prof Datuk Dr Md Zabid Haji Abdul Rashid, President & Vice Chancellor of UNIRAZAK, and Dr Veerinderjeet Singh, President of CTIM, at the UNIRAZAK's Campus at Capital Square. The signing ceremony was witnessed by Prof Dato' Dr Mohamed Mahyuddin Mohd Dahan, Deputy President (Academic and Research) of UNIRAZAK and Mr Khoo Chin Guan, Deputy President of CTIM. The MOU is an agreement for UNIRAZAK and CTIM to work together in the area of tax education. Both parties will share information and resources relating to updates on tax matters and tax related courses conducted in their respective organisations.

By signing this MOU, both UNIRAZAK and CTIM are committing themselves further to developing a knowledgeable pool of qualified tax professionals.

Northern Region Tax Forum

The Perak Branch of the Chartered Tax Institute of Malaysia has successfully organised the Northern Region Tax Forum with the theme "Effective Tax Management – a Reality or Myth?". The one-day forum was held on 23 April 2010 at Syuen Hotel, Ipoh, Perak.

The Organising Committee invited Dato Ong Ka Chuan, Member of Parliament, Tanjong Malim to officiate the opening ceremony of the event.

There were four speakers sharing their perspectives on various topics at the forum. The speakers were Mr Ivan Goh, Puan Wan Azni Bt Wan Hassan, Dato Raymond Liew and Mr Saravana Kumar. Around 120 delegates, including staff from the Inland Revenue Board (IRB) were in attendance.

In the evening, the Perak Branch celebrated its annual dinner with guests from the IRB, Customs and Excise, speakers and sponsors of the forum, as well as fellow members and friends. It was a joyous night filled with fellowship and merriment.

Courtesy Call on the Director of LHDN, Kota Bharu Branch

Standing from left: Mr Yeo Chin Meng, Mr Leong Cheok Hoo, Mr Chu Eng Chiau, Mr Chua Eyu Bee, Encik Abdul Aziz bin Din, Mr Lee Kin Hua
Seated from Left: Encik Ramli bin Mohamed, Mr Wong Seng Chong
Encik Marzelan bin Kamaraddin, Encik Khairudin bin Abdul Ghani

From left: Encik Ramli bin Mohamed, Mr Chu Eng Chiau, Mr Wong Seng Chong, Mr Chua Eyu Bee, Encik Khairudin bin Abdul Ghani, Encik Marselan bin Kamaruddin, Encik Abdul Aziz bin Din, Mr Kee Kin Hua and Mr Leong Cheok Hoo

On 8 April 2010, a courtesy call was made to the Director of the LHDN Kota Bharu Branch. The delegation was led by the East Coast Branch Chairman, Mr Wong Seng Chong. En Marzelan bin Kamaruddin (Director of LHDN, Kota Bharu), En Khairudin bin Abdul Ghani (Deputy Director) and En Abdul Aziz bin Din (Director of the Investigation Branch) hosted the courtesy visit. There was a lively discussion on local tax issues and interesting views were exchanged with the LHDN officials.

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Resource Centre of the Chartered Tax Institute of Malaysia (CTIM)

The CTIM resource centre has a wide collection of tax–related books, tax journals, guides, bulletins, conference and workshop materials, reports, magazines, and periodicals that are published locally and internationally.

CTIM subscribes to the Malaysia and Singapore Tax Cases, the Malaysian Revenue Legislation and Malaysian Tax Treaties all of which are CCH's publications.

These publications can all be viewed online in the resource centre.

Members are cordially invited to come to the CTIM's resource centre to read these publications. Members will also be informed of any new publications in the resource centre via the Institute's quarterly journal, the Tax Guardian.

Visit to Universiti Teknologi Mara (UiTM)

On 25 February 2010, The CTIM President, Dr Veerinderjeet Singh, several Council members and Secretariat staff of the Institute visited UiTM to explore possible collaboration between CTIM and UiTM in areas that are mutually beneficial. The meeting discussed how both parties could work together in the areas of tax education and it was agreed that a memorandum of understanding will be signed between the two organisations.

Heartiest Congratulations

to

YBhg Tan Sri Hasmah Binti Abdullah

Chief Executive Officer/Director-General Inland Revenue Board, Malaysia

on being conferred the

Panglima Setia Mahkota which carries the title of Tan Sri

by

YANG DI-PERTUAN AGONG MALAYSIA

on the occasion of

His Royal Highness' Birthday

from

The Council
of
Chartered Tax Institute of Malaysia

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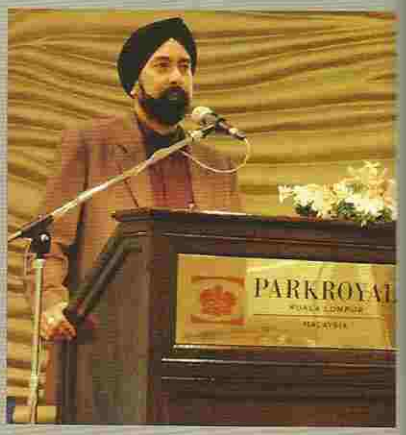
Seminar: Goods and Services Tax (GST) – The Way Forward

Dato Kamariah binti Hussain (Chairman, Tax Review Panel) & Dato' Raymond Liew (Council Member, CTIM) at the headtable



Dr Veerinderjeet Singh, at his welcoming speech

(L to R) Mr Khoo Chin Guan, Dato Kamariah binti Hussain, Dr Veerinderjeet Singh and Dato Raymond Liew

Participants at the seminar

Dato Kamariah binti Hussain, Chairman of the Tax Review Panel from the Ministry of Finance Malaysia presented a paper onthe "Rationale and Latest Developments on the GST Bill" at the seminar on "Goods and Services Tax – The Way Forward" which was organised by CTIM on 15 March 2010 at the Park Royal Hotel, Kuala Lumpur. A number of GST experts such as Mr Ronnie Lim (Managing Director, Deloitte KassimChan Tax Services Sdn Bhd), Mr Raja Kumaran (Executive Director, PricewaterhouseCoopers Taxation Services Sdn Bhd), Mr Bhupinder Singh (Partner, Ernst & Young Tax Consultants Sdn Bhd) and Mr Michael Hendroff (Director, KPMG Tax Services Sdn Bhd) were invited to present a paper on various GST issues. The objective of the above seminar was to promote a comprehensive understanding of the compliance, requirement and implementation of GST in Malaysia and its impact on business and the citizens. The seminar also provided an opportunity for experts from the government and private sectors to exchange their views.

Seminar: Highlights of the Leading Tax Cases in 2009: Discerning the Judicial Mood in Interpreting Tax Law

On 9 March 2010, CTIM conducted a seminar on "Highlights of the Leading Tax Cases in 2009: Discerning the Judicial Mood in Interpreting Tax Law" at the Park Royal Hotel, Kuala Lumpur. A number of the latest tax cases were discussed at the seminar. Participants enjoyed the presentations by the invited speakers namely Datuk D.P Naban (Senior Partner, Lee Hishamuddin Allen & Gledhill), Mr Andrew Davis (Partner, Isaacs & Davis), Mr Anand Raj (Partner, Shearn Delamore & Co.), Mr Vijey M Krishnan (Partner, Raj, Daryl & Loh) and Mr Sudharsanan Thillainathan (Partner, Shook Lin & Bok).

Career Talk at INTI College, Sabah


Q&A


With some of the participants


Memento from CTIM

On 12 March 2010, Madam Teo Chew Hiong (Chairman of Sabah Branch) conducted a career talk for the Accounting (Degree / Diploma) students of INTI College, Sabah. The presentation included CTIM's corporate video and an enlightening talk by Madam Teo on the various routes to become a Tax Consultant.

Dr Alan Lim (CEO / Principal of INTI College, Sabah) was present at the talk. The Sabah Branch Committee member, Mr Titus Tseu, shared his experiences and challenges as a Tax Consultant during the Q & A session where students actively participated in the session.

Members' Dialogue Session in Malacca

A members' dialogue session with Dato Raymond Liew (Chairman of CTIM's Public Relations Committee) and Mr Lew Nee Fook (CTIM Council member), was held at the Malacca Straits Hotel on 30 April 2010.

Mr Viknesvaran (Chairman of the CTIM Malacca Branch) chaired the session which was attended by about 25 members. The dialogue was lively and it was an opportune time for members to raise issues. The session was very eventful for the members as they were pleased to meet the CTIM Council members.

Career Talk at Taylor's Business School

On 16 March 2010, Dr Veerinderjeet Singh (CTIM President and visiting Fellow at the Taylor's Business School) shared his experience on a career in taxation with 170 students undergoing the University of the West of England degree programme at the Taylor's Business School.

Dr Veerinderjeet also talked about the various types of taxes in Malaysia, attributes of a tax consultant and why taxation would make an interesting career. He also explained the role and functions of the Chartered Tax Institute of Malaysia.

Career Talks at UiTM Branch Campuses

Career talks were held at UiTM branches throughout the country to encourage accounting students to consider pursuing a career in taxation and to write the CTIM professional Examinations.

Associate Professor Pn Faridah Binti Ahmad, Chairman of the Education Committee and some UiTM lecturers held career talks at the following UiTM branch campuses:

1.	Shah Alam, Selangor	6 March 2010
2.	Jengka, Pahang	8 March 2010
3.	Sg Petani, Kedah	11 March 2010
4.	Arau, Perlis	12 March 2010
5.	Puncak Perdana, Selangor	12 March 2010
6.	Alor Gajah, Melaka	16 March 2010
7.	Dungun, Terengganu	17 March2010
8.	Segamat, Johor	18 March 2010
9.	Machang, Kelantan	18 March 2010
10.	Sri Iskandar, Perak	18 March 2010

Workshop: Making the Most of Double Tax Agreements

The workshop was successfully conducted on 22 April 2010 at the Hotel Istana, Kuala Lumpur. Many participants were happy with the workshop as they felt that it had achieved its objectives and the speaker, Mr Tan Hooi Beng, provided them with a deeper understanding of the issues discussed. Due to an overwhelming response, CTIM will conduct a similar workshop across the country.

Career Talk in Melaka

On 9 October 2009, Mr Viknesvaran (Chairman of the CTIM Malacca Branch) delivered a career talk on taxation to the students of UiTM Kampus Bandaraya Melaka. 120 students attended the talk where he spoke about career opportunities in taxation as well as the role of CTIM.

ADVERTORIAL

UNISEL – MBA LEADING EDUCATOR IN LOGISTICS STUDIES

Unisel Graduate School of Management (UGSM) is certainly no stranger in the world of higher education, having scored a first in the nation's only educational institution offering postgraduate programmes for logistics professionals since 2004.

The Dean / Director of UGSM, Prof. Dr. Khalifah Othman remarks, "The transformation of the logistics and shipping sector in the coming decade has become prominent, much like the deregulation of the finance industry in the late nineties. The dramatic change in areas like waterfront and the airline industry, logistics and transport policies will begin to create a major impact on the local players."

"Supply Chain has always been our forte. We would like to become the centre for logistics and supply chain management for Southeast Asia," says the Dean. He adds that, Malaysia is already involved in the manufacturing business and when the manufacturers import raw materials and export the finished goods, it would definitely involve with supply chain management.

According to him, industrial professionals had previously practiced the "just in time management" approach when it comes to logistics, where they do not keep a substantial amount of stock as it costs a lot of money. However, with the vast improvement of the transportation system, containerization, refrigeration and the introduction of ICT, logistics is no longer about managing inventories alone. It's about creating a sufficient pool of knowledge workers to meet industrial needs.

"Therefore supply chain management and logistics has to be managed in an efficient way in order for you to create value for your customers. Otherwise, you are going to incur additional costs" he says. In realizing the importance of logistics education, UGSM is striving to provide high quality educations by forming strategic networking and collaboration with industry players.

Taught by industry professionals with more than 30 years of experience, the lecturers are more than capable to educate students their insight of industry, as well as dispense useful advice to the students. "We hope the close interaction with industrial professionals will enable students to tap onto their experience and expertise," says the Dean.

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Cover Story

Introduction of GST in Malaysia – Short and Long–Term Impacts

By Bhupinder Singh

On 16 December 2009, the Government of Malaysia tabled the Goods and Services Tax (GST) Bill in the Dewan Rakyat for first reading. This was a much anticipated Bill as the GST was announced way back in Budget 2005 but was then deferred indefinitely in early 2006. However, the Bill has already hit its first hurdle since the 2009 reading, with Second Finance Minister YBhg Dato Seri Ahmad Husni Hanadzlah announcing in March 2010 that the second reading – initially planned for the first parliamentary sitting of 2010 – would be deferred. Subsequently, the Second Finance Minister also commented that it was unlikely the GST would be introduced in the second half of 2011, as had been widely expected when the Bill was first tabled.

At this juncture, like in 2006, there is uncertainty about when the Government will proceed with the introduction of the tax. Not surprisingly, at the consumer level, there is little appetite for any talk of new or increased taxes. However, many in the Government, as well as the business and advisory communities continue to champion its cause as the most viable answer to the Government's goal of increasing revenue to reign in the ever–growing budget deficit, in the face of reducing oil revenues and the inevitable cost of implementing initiatives such as the New Economic Model.

What is the GST proposed for Malaysia?

Consumers conversant with GST or Value–Added Tax (VAT) regimes in countries such as Singapore, Australia and the UK, most likely through travel or studying abroad, will see little difference in the one being proposed by the Government for Malaysia.

The GST is a broad–based consumption tax levied on the import of goods, as well as most domestic supplies of goods and services. There are limited exceptions proposed such as certain financial products and the sale or lease of residential property, while exports are not burdened with the tax either to ensure that they remain competitive in the global market place. When effective, the GST in Malaysia will replace the existing sales and service taxes.

A key feature of the GST is that while it is imposed at each stage of the supply chain, most businesses will offset the GST they collect on their sales (output tax) with the GST they incur on their purchases (input tax); the net result being that the GST is only applicable to the "value–add" at each level. This is the fundamental difference between the GST and the existing sales and service taxes (not to be confused with the "service charge" imposed by restaurants). Currently, sales tax is imposed at the manufacturing level) and service tax is imposed at the retail level), while only single–stage taxes, or costs to business which are passed on down the supply chain. It is possible – perhaps even common – for one tax to be charged on the other as the supply chain progresses, resulting in a cascading tax ultimately borne by the consumer. GST is also supposed to only impact the end consumer, and this is achieved through the credit mechanism (input tax credit) available to most businesses, which should limit the cascading effect of "tax on tax" that is prevalent with the existing consumption taxes in Malaysia.

The original GST was the TVA (French, for VAT)) first introduced in France in 1954. Since then, the tax has expanded to over 100 countries throughout the world, most recently Sierra Leone, where the tax took effect in January 2010. Many of these countries have introduced the tax with the primary aim of moving their economies away from being dependent on direct taxation – personal and corporate taxes – towards indirect or consumption taxes.

Malaysia remains, along with Myanmar and Brunei, as one of only three countries in South–East Asia yet to introduce GST, while the Hong Kong S.A.R abandoned plans to introduce a GST in late 2006 (though Mainland China has its own, limited GST regime on goods, currently undergoing reform).

GST in Malaysia is expected to be set at 4%, which would make it the lowest single–rate regime in the world and would compare favourably in the wider Asia–Pacific region with countries such as China (top rate of 17% (goods only)), New Zealand (12.5%), Philippines (12%), Australia and Indonesia (10%), Thailand (increases to 10% in 2010), and Singapore (7%).

Given that so many other countries, and the majority of our region, already have a GST in place, what can be learnt about the impacts – short and long – term– of its introduction in Malaysia?

Short –term impact

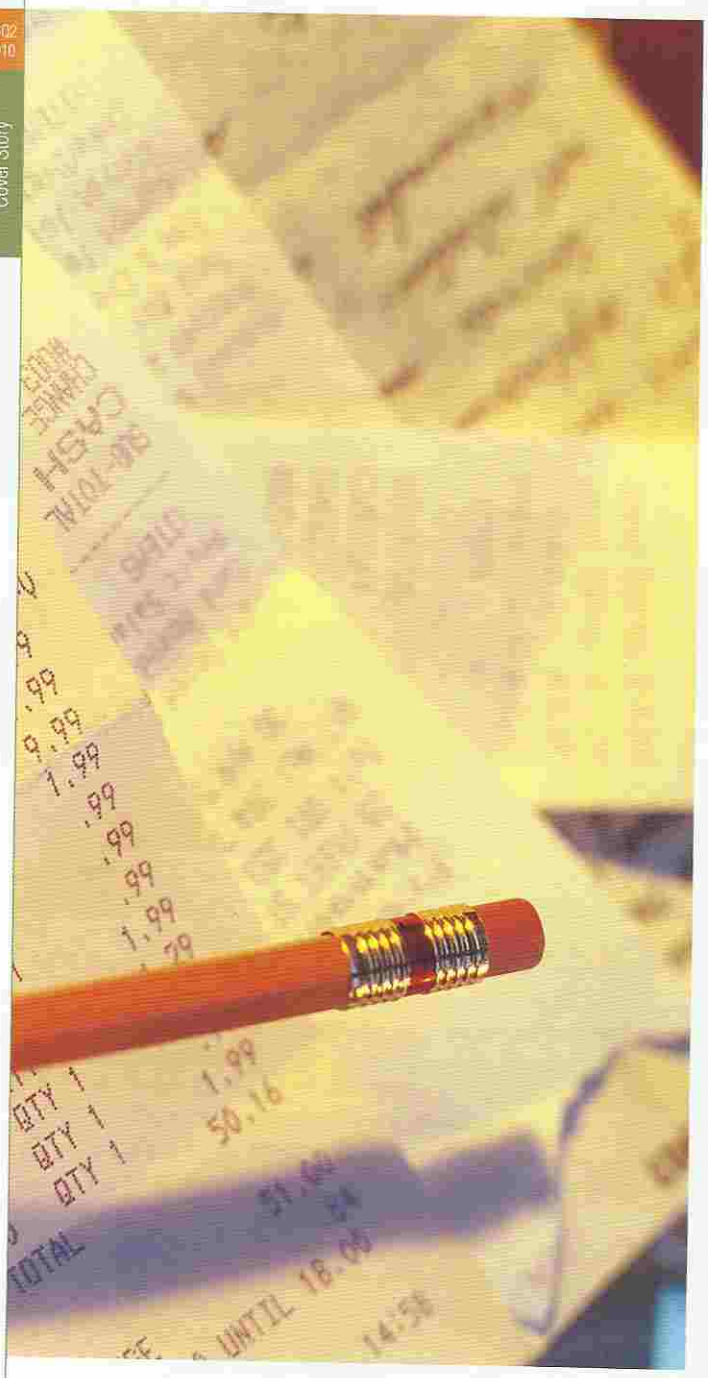
In considering the short– term impact of introducing GST, there is almost a blind belief by the general public that there will be an increase, perhaps as high as the full 4%, in prices across the board for end consumers. Prima facie, this would seem an obvious result of the addition of the tax on most goods and services consumed within the country. The reality, however, is somewhat different, and is based on several factors.

Firstly, GST is designed not to be a cost to business, due to the credit mechanism outlined above. With few exceptions, GST incurred by a business is recoverable and should not be passed on to the next consumer in the supply chain. It is only on the final supply to the end consumer – who is not entitled to the input tax credit by virtue of not being a registered taxable business – where the GST becomes a cost.

Secondly, upon introduction, GST will replace both service tax (5%) and sales tax (5% and 10%). In this regard, it is not a new tax, but rather a single tax – at a single rate – to replace existing consumption taxes. Suppliers will first be required to pass on savings from the abolishing of sales and service taxes prior to imposing GST. Theoretically this should actually result in a reduction in the price of taxable items. While there is only a small difference between a 4% GST and a 5% service or sales tax, the difference for items currently subject to a 10% sales tax – passenger cars are a good example – is a noticeable one, particularly as sales tax is not transparent to consumers in the same way service tax , which is separately stated on the bill for taxable services, is. The GST is often referred to as a regressive tax, due to the fact it is imposed on even the most basic of goods and services and that the lower income groups pay a much larger proportion of their income on these essential items than higher income earners. In this regard, imposing a GST can impact the poorer consumers much harder, relatively speaking. Most Governments introducing the tax recognise this adverse impact and seek ways to address it. In Malaysia, the Government has identified basic items which should be free from the burden of GST for this very reason. It is expected that basic foods such as rice, sugar, flour, cooking oil, vegetables, fish, meat and eggs will be zero–rated (no GST impact) while supplies of water (first 35 cubic metres p/mth) and electricity (first 200 units p/mth) for domestic use will also be given such treatment. Other key items such as public transport, private education and healthcare, and residential property will be exempt from GST, resulting in little GST impact for consumers of those services.

However, optimism over a potential price reduction in taxable goods or that basic goods and services will be free from the tax should be tempered with some realities. Firstly, the service and sales taxes are very limited in scope in that they apply on a relatively small range of goods and services. GST will apply on most domestic supplies of goods and services and as such, there will be a great number of items not currently subject to a sales or service tax that will be burdened with the GST.

Secondly, for items currently subject to sales or service tax, there will no doubt be vendors who, initially at least, seek to profiteer from the introduction of the tax by not passing on the savings from the elimination of the sales and service taxes, and merely imposing the GST on top of the existing price. It should be pointed out, however, that the



Government has plans in place to deal with this practice, such as introducing the Anti Profiteering Act, intensifying enforcement action through the National Pricing Council, distributing a GST Shoppers' Guide (a comparison of pre and post–GST prices), as well as a plan to make the hypermarkets act as price setters. While there will always be offenders who slip through the cracks, overseas experience would indicate that market forces will also play a big part. It will only take one vendor within an industry to do the right thing – likely resulting in his supply being cheaper than his competitors – to ensure all others eventually pass on the sales and service tax savings, bringing everyone onto an even level.

So with some goods expected to go up, some to go down, and others to not be impacted at all from the introduction of GST, what can Malaysians expect the net impact to be? Not surprisingly, the Malaysian Government has done its own research as to what the overall price impact will be. The Ministry of Finance (MoF) has spent the last few years conducting price impact studies to see the effect of GST implementation on over 700 types of consumer goods and services from almost 100 industries. According to their website guide on the GST, these studies showed that, based on a GST rate of 4%, the Consumer Price Index (CPI) is expected to actually **decrease** by 0.10%. The key reason for the CPI decrease would be expected price reductions in areas such as clothing and footwear, basic food, communications, furnishings, hardware and maintenance, transport, housing, water, electricity, gas and fuel.
The findings of the MoF are no doubt based on the ideal outcome – where all businesses pass on the reductions from the abolishing of sales and service taxes, and that businesses are compliant in terms of claiming, charging or not charging GST where applicable. But even where a perfect outcome is not achieved, the findings provide optimism that the inflationary impact for consumers could be negligible.

The overseas experience, in places such as Australia, Canada and New Zealand, is a little different. A review of CPI movements indicates an identifiable increase in the CPI following the introduction of the GST in those countries. However, it is generally accepted that such increases are one–off in nature, are not equivalent to the rate percentage of the GST at the time of implementation, and that, other economic factors notwithstanding, the increase subsides fairly quickly.

Long–term impact

So if the price impact of introducing GST in Malaysia should be negligible, why would the Government persevere with the unpopular policy of introducing a perceived "new" tax and what does it mean for Malaysian consumers in the long– term?

The answer to the first question probably lies in the inevitable squeeze on sources of government revenue in future and the need to both expand and grow the sources. No doubt the Government is planning for the day when oil receipts – a significant source of government revenue – become much less reliable or significant. The Government probably also recognises that the country can no longer be dependent on direct taxation when the majority of individuals fall under the non–taxable status. And in addition, the Government has, in recent years, implemented a programme to reduce corporate tax as an incentive to increase foreign–direct investment into Malaysia, in response to new foreign investment coming into the region being directed to more corporate–tax friendly countries. A small burden on taxpayers across the board might help offset this loss in tax revenue in the interim, before the positive impact of the investment is felt.

And of course, over time, as consumers' spending increases with their growing standard of living, in combination with increased customs audit effectiveness and business compliance, the Government can expect increasing revenues from GST.

By way of comparison, in the first year of GST in Australia (2000), net GST collections amounted to almost A$24bn and this increased in the second year by almost 15% to a little over A$27bn. By 2007, total collections had increased to A$39.5bn, making up almost 16% of the total tax take for that year.

So over time, the Government can realistically look forward to increasing revenue from this source, to be used in key national projects such as investment and infrastructure, with the benefits flowing down to the country as a whole.
With regard to the second question, what can Malaysian consumers expect, on a personal level, from the introduction of GST in the long term?

Many consumers, insisting that prices will rise across the board, warn that the imposition of GST at 4% is only the beginning. Once in, the Government will soon increase the rate to increase the revenue. The easy example is nearby Singapore where GST was introduced in 1994 at 3%, but later increased to 4% in 2003 and 5% in 2004. It was recently raised again to 7% with effect 1 July 2007. However, by contrast, Australia introduced a 10% GST in 2000 and the rate has never been increased; and in Canada, the tax has actually been reduced twice, from 7% upon introduction (1991) to 6% (2006) and then to 5% from 2008 onwards. So Malaysian consumers need not expect that a rate increase from the expected 4% upon implementation is inevitable.

The MoF points out on its website, in response to such a question, that the Government has no plans to increase the GST rate and will always take into consideration the impact on the rakyat before making any policy changes. It notes that while the sales tax was implemented in 1972, the rate has been increased only once (in 1983), whilst the rate of service tax has never been increased since its introduction in 1975.

Also of particular interest to taxpayers will be the impact the introduction of GST has on personal taxation levels. Other countries have, to varying degrees, used the introduction of the tax to reduce personal income tax rates to be consistent with the goal of moving away from direct taxation towards consumption taxes like GST. Reducing personal income tax rates (or relaxing the levels at which increasing rates apply) has the added benefit of limiting the negative feedback in the community concerning the introduction of the tax.

Currently, the New Zealand Government is considering increasing the applicable GST rate from 12.5% to 15% to coincide with any reduction in the corporate tax rate. The Government considers that personal income tax reductions should be a part of the overall taxation changes to ensure that, for the consumer, the impact is "tax neutral". Anecdotal evidence suggests that while consumers are largely opposed to an increase in GST in isolation, the increase would garner significant support were it to be introduced in conjunction with a corresponding reduction in personal income tax.

The Malaysian Government has not yet approached the subject of reducing personal taxes. Certainly, no reductions are envisaged to coincide with the introduction of the tax, with the Government presumably taking a wait–and–see approach with regard to revenue collection once the GST is effective. However, as mentioned above, such an approach would be consistent with any goal of moving taxation revenue dependency away from direct taxation to consumption taxes, and may also help with confronting negativity towards GST implementation and as such, should be encouraged.

In summary

It is impossible to accurately assess the short or long– term impacts of the implementation of GST in Malaysia, based on the experiences of other countries where, for many, a GST is an entrenched part of the taxation framework.

While the GST regimes that operate throughout the world operate on the same basic fundamentals, they each have their own unique applications which impact consumers, industries and, ultimately, government taxation revenue differently.

Furthermore, countries introduce a GST for different reasons and with their economies in different states of health. As such, the short and long– term impacts will differ across the board.

However, generally speaking, Malaysia could look forward positively to some expected benefits from the introduction of a GST – being less dependent on its traditional sources of non–taxation government revenue; being able to plan for increased economic growth underpinned by a more broad–based, efficient and consistent source of taxation revenue, with the GST component of that revenue increasing over time; and with the overall impact on the consumer relatively negligible both upon its inception, and in future. We look forward with anticipation to the Government's plan for GST implementation in Malaysia. TG

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

Taxation in the Virtual World – Prospects and Potential

By Professor Barjoyai Bardai

Introduction

Virtual world is the world of the Internet. It is seen as a parallel world competing with the existing physical world. Whether we realise it or not, slowly but surely our lives have migrated progressively to the virtual world. Our permanent address has been changed from a house address to an e–mail address. Corporate and individual's wealth has shifted from the focus on physical assets to intangible assets such as intellectual properties – patent rights, copy rights, trademarks and etc. Our most important wealth – houses can now be converted into a virtual form – just a membership card in our wallet – in the form of living accommodation rights. Cars can also be converted into virtual cars – also kept in the wallet as pre-paid card – in the form of driving hours right just like mobile phone pre–paid cards. The list goes on to clothing, restaurants services, hospital services, educational services and so on.

More than 65% of world trade in 2009 was done through the Internet. More than 70% of global wealth in 2009 was in the form of intangible assets ie intellectual properties. In travel and tour services alone, more than USD110 billion were spent online. In China, the M–Commerce transaction is the latest craze and it has reached USD1 billion in 2009.

Virtual world and the E–Commerce

Virtual world only exist in the Internet in the form of the web as well as virtual organisation and wealth. Of course the players are still the living beings that occupy the physical world. However, as living beings, we are slowly migrating into the virtual world by dissolving our physical identity. We are shifting our reliance to the Internet in our life affairs, especially in the commercial transactions.

E–Business is the modern day equivalent of the industrial revolution; and it is drastically changing almost every industry. If we are not already engaged in ebusiness, our competitiveness will be at risk.

We normally define Commerce as 'the exchange or buying and selling of commodities; especially the exchange of merchandise, on a large scale, between different places or communities; extended trade or traffic'. E–commerce on the other hand is defined as "any transaction conducted over

the Internet or through Internet access, comprising the sale, lease, license, offer or delivery of property, goods, services or information, whether or not for consideration, and includes the provision of Internet access." (ITFA 1998)? This covers a range of different types of businesses from consumer–based retail sites, like Amazon.com, through auction and music sites like eBay or MP3.com, to business exchanges such as the trading of goods or services between corporations. It also covers the production, advertising, sale and distribution of products via telecommunication networks (WTO, 1998).

Products that are sold via e–commerce can be categorised into two kinds. First are products that have the same characteristics as in a regular market. This kind of product is ordered via Internet and sold by delivering them to customers via mail, post, or other regular delivering. This is done because the nature of product is tangible. Second are products that do not have the same characteristics as in a regular market. This specific kind of product is usually called digital goods. This is because the nature of such a product is intangible. The term "digital goods" refers to information–based products that can be digitised and delivered via electronic networks, such as software, stream video, MP3, etc.

E–commerce facilitates mobile, long–distance, or anonymous transactions when the seller may be outside the territorial power of the taxing government or when the destination of goods and services can be masked. Commercial activities on the Internet are predicted to rise dramatically over the coming years. E–Commerce operating almost exclusively on the global online environment of the Internet, it has a number of features that distinguishes itself from traditional commercial activities (Joseph, 2004).

E–commerce has a lot of advantages. It increases sales and decreases cost by allowing small businesses to have a global customer base. It also reduces cost through electronic sales enquires, price quotes and order taking. At the same time, e–commerce provides purchasing opportunities for buyers (businesses can identify new suppliers and partners). It increases speed and accuracy for exchanged information, thus reducing cost. At the same time, businesses can be transacted 24 hours a day. E–commerce allows the level of detail of purchase information that is selected by the user. For digital products, it can be delivered instantly. Tax refunds, public retirement and welfare support costs less when distributed over the Internet. It also allows products and services to be available in remote areas, eg remote learning.

On the other hand, e–commerce has some shortcomings that follow. There is the issue of the inability to sell some products (eg high cost jewelry and perishable foods, although supermarkets like www.tesco.com delivers to your home). It also involves the newness and evolution of the current technology which may be beyond most consumers. Many products require a large number of people to purchase to be viable, and it requires high capital investment. There is also some difficulty in integrating current databases and transaction processing systems into e–commerce solutions. Besides, there are cultural and legal obstacles such as the transmission of credit card details, some consumers resist to change and the unclear laws. At the same time, in the shipping profile, products with a low value–to–weight ratio that can not be efficiently packed and shipped are unsuitable (use traditional commerce).
E–commerce businesses can be classified into different classification of transactions as follows:

1. Business–to–business (B2B) e–commerce
- Logistics– transportation, warehousing and distribution (eg Procter and Gamble).
- Application service providers– deployment, hosting and management of packaged software from a central facility (eg Oracle and Linkshare)
- Outsourcing of functions in the process of e–commerce, such as web–hosting, security and customer care solutions (eg outsourcing providers such as eShare, NetSales, iXL Enterprises and Universal Access).
- Auction solutions software for the operation and maintenance of real–time auctions on the Internet (eg Moai Technologies and OpenSite Technologies).
- Content management software for the facilitation of web site content management and delivery (eg Interwoven and ProcureNet).
- Web–based commerce enablers (eg Commerce One, a browser–based, XML–enabled purchasing and automation software).

2. Business–to–consumer (B2C) e–commerce
- B2C e–commerce, or commerce between companies and consumers, involves customers gathering information; purchasing physical goods (ie tangibles such as books or consumer products) or information goods (or goods of electronic material or digitised content, such as software, or e–books); and for information goods, receiving products over an electronic network.
- B2C e–commerce reduces transactions costs, as it eliminates the middlemen.
- The major factor in B2C model is customer care.

3. Business–to–government (B2G) e–commerce
- B2G is generally defined as commerce between companies and the public sector.
- It refers to the use of the Internet for public procurement, licensing procedures, and other government–related operations.
- Examples are **www.fcw.com** , **www.washingtontechnology.com**, **www.Gcn.com** , **www.signalmag.com** and **www.governmnmentexecutive.com**.

4. Consumer–to–consumer (C2C) e–commerce
- C2C is simply commerce between private individuals or consumers.
- This type of e–commerce is characterised by the growth of electronic marketplaces and online auctions, particularly in vertical industries where firms/businesses can bid for what they want from among multiple suppliers.
- This type of e–commerce comes in at least three forms:
  - auctions facilitated at a portal, such as eBay, which allows online real–time bidding on items being sold in the Web.

- peer–to–peer systems, such as the Napster model (a protocol for sharing files between users used by chat forums similar to IRC) and other file exchange and later money exchange models.
- classified advertisements on portal sites such as Excite Classifieds and eWanted (an interactive, online marketplace where buyers and sellers can negotiate and which features Buyer Leads & Want Ads").

- Examples are www.ebay.com and www.napster.com

5. M Commerce

- **M–commerce** (mobile commerce) is the buying and selling of goods and services through wireless technology–ie handheld devices such as cellular telephones and personal digital assistants (PDAs).

- **Applications of M–commerce** are as follows:
  - Mobile Ticketing.
  - Information Services.
  - Mobile Banking.

6. Internet advertising

- Advertising is a form of communication whose purpose is to inform potential customers about products and services and how to obtain and use them.
- Advertising in the web pages.
- Advertising before playing any videos.
- Advertising in between the videos.
- Advertising while the pages load.
- Advertising by search engines.
- Advertising as a scroll bar while playing videos.

With all these features, international tax policy will take up the growing concerns that billions in tax revenues will disappear as a result of the Internet's ability to shift both the location of a transaction, and the paperless means of completing a transaction. Commerce will shift in the following manner (Rowbotham, 1998):

- Products (tangible and intangible products, intellectual property and services) will take the form of digitised information; and
- The source or residence of both the provider and user can, if needed, be relocated almost at will.

E–commerce and Taxation

The "how and where" to tax profits on exchange of goods and commerce on the Net should follow traditional rules in many situations. However, the fundamental change in how many aspects of Internet commerce differ from traditional forms of business will mean that existing domestic laws and international tax treaties will not always work. In some cases, the struggle will be defined or fit new methods of transacting business within traditional rules of taxation. New tax legislation will inevitably need to be drafted.

Taxation of e–commerce has long been debatable; Internet business "presence" in any land is a difficult concept.

- Special e–commerce problems arise with electronically–conveyed services and digitised products. These include whether a particular transaction involving an intangible should be classified as a service, as a "license" or right, or as a "sale" of goods. Such transactions range from the provision of customised software to access to data, programs or games held in a server but displayed on the screen of the user in a different jurisdiction (Wong, 2002).
- Even when conceptual issues are clarified by agreement or statue, problems of practical administration exist in the complexity of reporting, registry, and record–keeping that must be maintained.
- Also, it attracts attention to privacy issues involved, and the compliance burden placed on taxpayers and businesses charged not only with collection and payment of the taxes, but also with ascertaining the appropriate tax rates to be applied when those rates vary depending on the location of user.
- Nellen (2001) mentioned several problems of taxing on e–commerce, that is:
  - location;
  - nature of products;
  - new marketing techniques;
  - new types of assets;
  - remote workforce; and
  - the nature of transaction.

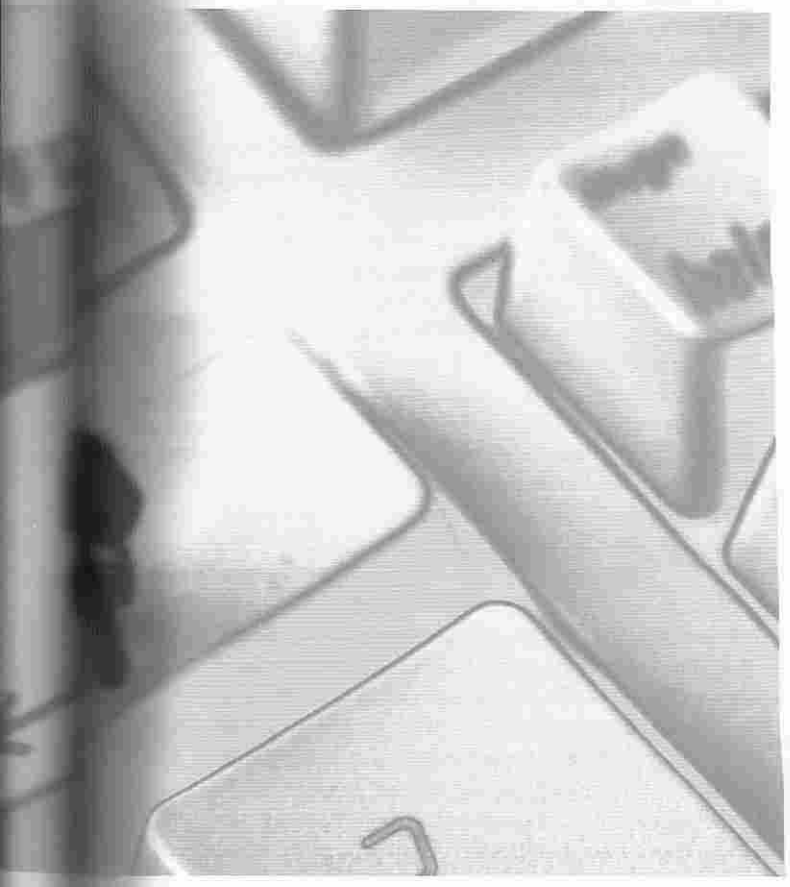
Location

Existing tax systems tend to determine tax consequences based on where the taxpayer is physically located. The e–commerce model enables businesses to operate with very few physical locations. An online vendor can easily sell to customers throughout the world from a single physical location. It also involves more customised inventories so storage needs are reduced. The model also involves less

vertical integration and more outsourcing – with fewer physical locations used by a vendor. Business assets such as servers are not necessarily tied to a single physical location. They can easily be relocated without any interruption to business operations. Hence, the location of the server is not relevant for business purposes and thus, may not be a logical taxing point (Hughes and Glaister, 2001).

Out–of–state vendors engaged in e–commerce do not have an obligation to collect sales taxes if traditional remote sellers, such as mail–order and telephone solicitation vendors, do not collect sales taxes. Sales tax cannot be levied on a transaction just because the purchaser uses e–commerce to access the seller's computer to acquire property, goods or services. Also, one particular country cannot use an "agency nexus" theory to claim that a purchaser's internet service provider (ISP) is an in–country agent for the seller (Sommers, 2000).

- Example: If a purchaser in Malaysia uses his computer to connect with a bookseller's computer located in Indonesia (a non–sales tax country), Malaysia may not have levied a sales tax, even if the purchaser used a Malaysia ISP to connect to the Internet.
- If books, magazines, newspapers or other forms of tangible information are not subject to sales tax, then downloads of that same information cannot be taxed. Also, a tax obligation cannot be imposed on different countries, if the vendor selling the product, service or property would be the entity responsible to collect sales tax under conventional commerce. Thus, the location factor primarily raises tax issues at the international levels.



Nature of products

E–commerce allows for some types of products, such as newspapers and music CDs, to be delivered in digitised (intangible) form, rather than in a tangible form. Digitised products raise issues at the country level as to whether sales tax applies and in which country income is generated for country income tax purposes. The nature of products can also raise income tax issues regarding the type of revenue generated and how it is to be reported, as well as whether digitised products are subject to traditional inventory accounting rules.

New marketing techniques

The Internet has allowed for new ways of selling and buying goods and services. For example, individuals can offer their items to a worldwide group of potential buyers via auction sites, such as E–Bay. The Internet can also be used to easily link business buyers and sellers through exchange web sites where buyers post what they have to sell and sellers match up with them, or vice versa. Such sites can almost operate without human intervention for the matching function. In addition, the Internet has increased the use of bartering, most notably with respect to exchange of web banners that serve as advertisements. These new techniques raise various tax issues at all levels.

For income tax purposes, issues include whether an exchange intermediary or broker should be accounting for inventory, and what amount of information reporting should be required for low value bartering transactions, and how such transactions should be valued. At the international level, the source of the income generated (which country) might be uncertain.

At the country level, issues exist as to when individuals have sold enough goods to be required to become sales tax collectors and how to enforce such rules. Another issue raised by changes or elimination of intermediaries is that some intermediaries collected excise tax, such as sellers of fishing equipment. When buyers interact directly with a foreign manufacturer, rather than a domestic retailer, the excise tax may go uncollected.

New types of assets

Some of the new assets created by commercial use of the Internet are domain names (URLs) and web sites. For income tax purposes, issues exist as to how to treat the costs of creating or acquiring such assets, as well as the characterisation of any gain or loss generated upon disposition of the asset. Sellers of such assets may face uncertainty in the law as to how to characterise the gain or loss generated from the disposition (capital or ordinary)

Remote workforce

The workforce of an Internet company may be scattered throughout countries, rather than working in a single work location together. This can raise issues as to whether the presence of the employee in a particular country creates tax obligations for the employer in that country.

Nature of transactions

The Internet allows for paperless transactions and the potential for the use of electronic cash. This raises administrative concerns for the Internal Revenue Service

(IRS) as to whether transactions were properly reported, whether an audit trail exists, and whether new reporting rules are needed. The Internet provides new ways for tax administrations to improve the ease and transparency of tax collection. But new technology also raises certain problems. In a world where cyber–transactions are growing at a rapid pace, tax administrations face the challenge of adapting existing tax systems to an economy that increasingly ignores physical borders. In such a world, it will be easier for companies to avoid tax collectors by operating worldwide through web–sites based in jurisdictions that are unwilling to share taxpayer information.

The potential solutions

There are possible ways of dealing with the problems above.

- **Sales taxes based on the location of the seller**

One of the most alternative solutions for taxing e–commerce is based on the location of the seller. In implementing this alternative, each country will have a pre–set tax rate for each kind of industry, ie, a different tax rate for each industry in each country. The desirable side effect of this kind of taxation is the competition it will create among countries, in lowering the tax rates. That would also imply that consumers will identify the businesses that have lowest overall prices for each kind of industry and try to shop from those merchants.

Of course, businesses located in jurisdictions with lower GST or VAT will be able to charge lower overall prices or enjoy higher revenues per sale. This will result in loss of market share for other jurisdictions which will be forced to bring down their prices to marginal cost, eventually bringing tax rate to zero (Uzuner and McKnight, 2001).

Charging taxes based on the location of retailers is not as simple as it sounds. The companies need to keep track of the location of their customers and charge taxes only on the purchases that are actually used within the same country as the retailers. As a result of this, consumers will try to purchase items only from companies that are not located in their home–country.

- **Sales and use taxes based on the location of the consumer**

The second possible way of taxing electronic commerce would be to set taxes depending on the location of the consumer. In this taxing scheme, each country will have its own tax rate which can be different for each industry. During online purchases, the companies will identify the location of the customer and add the applicable taxes to the bill. This option requires the international community to form an international organisation which will force businesses to collect sales taxes and transfer it to the country where the purchaser lives.

This alternative solution offers several ideas:
First, forming an international organisation to audit and oversee the taxation process. E–commerce taxation requires special attention from international organisations especially because international e–commerce makes fraud easy and prosecution difficult. Due to the nature of the Internet, there may be a need for more strict enforcement and auditing agencies which will make sure the consumers will be charged the correct amount of taxes and that these taxes will reach their rightful owner (country of the consumer). Such agencies can be formed by international co–operation among governments.

The second, paying taxes on the local residence basis is a passive self–regulatory approach to taxation since people are more willing to comply with tax laws when they know that the tax will benefit their own country. For simplicity purposes, one could argue that one tax rate per jurisdiction should be set regardless of the kind of goods sold, and regardless of the industry. As unjust as this intermediate solution might be, it is a good transition from the no–tax moratorium to the more complex, country based, and industry–based taxing scheme.

- **Industry–uniform taxation among countries**

The previous two proposals are overly complicated and their enforcement is very difficult. A simpler solution would be easier to audit and enforce, however it may not be as fair. As an example, let's consider industry–uniform taxation among countries. By this, in each industry sector, there will be a set tax rate and the same tax rate will be enforced everywhere. The reason for infeasibility of this option, especially on an international level, is obvious. Different countries have different economic strengths, different economic needs and different standards. Each country would like to set their respective tax rates. Therefore, forcing these countries to agree to the same standards is impossible.

- **Uniform taxation among countries**

This method of taxation is a variation on the industry uniform taxation. In this case, each country agrees to charge the same percentage of taxes for each of the other country based on the home– country of the consumer. Although a thorough solution to Internet taxation may not be possible through uniform taxation, the idea behind this alternative can be put into practice to a certain extent. The uniformity can be established as much as possible.

For example, a country can agree on a single definition of nexus (jurisdiction rules for tax purposes) which could by itself simplify the taxation problem to a certain extent. With regard to sales and use tax rules on e–commerce, regardless of how broad an individual country chooses to make its sales tax base, it would be helpful for the country to clearly spell out the different types of services that it considers taxable under its statutes. In addition, a certain degree of uniformity can be established amongst countries about how to tax multi–country and international transactions.

- **No taxes**

Applying no taxes on electronic transactions is another scheme to be considered. This alternative is simpler than previous alternatives. This is the direction the Internet taxation has been heading over the past years. Clearly, this is a solution preferred by both businesses and consumers, it does not present the enforcement issues posed by the earlier alternatives but it does not provide the states with the income they very much need to fund most of their services.

It is claimed that the erosion of revenues is really not a concern any more because e–commerce is creating many more jobs than it is destroying, and has been responsible for higher levels of employment, productivity and economic growth (Kemp, 2000). Not taxing the Internet (without increasing other forms of tax to make up for the lost revenues) does not resolve the concerns/issues that resulted in Internet taxation or even the concerns that require a sales tax on conventional commerce.

By not taxing sales over the Internet, governments are losing not only new potential income sources but also losing some of their current revenues that come from businesses that migrate to the Internet. Since there is no real fair way of replacing sales taxes with other forms of taxation, not taxing the Internet cannot possibly be a permanent and satisfactory solution.

The current situation

As we always looked at US as the leader in the taxation system development and because the virtual world was virtually created by them, we should look at them as the future indicator. In the US, the ***Internet Tax Freedom Act*** was enacted. It has four components:

- prohibits state and the local government from imposing tax on Internet access charges;
- prohibits tax from being imposed on out–of–state business through defined concept of "presence";
- creates temporary commission to study taxation of e–commerce and report to Congress on whether Internet ought to be taxed; and
- calls on executive branch to demand foreign governments keep Internet free of taxes, tariffs.

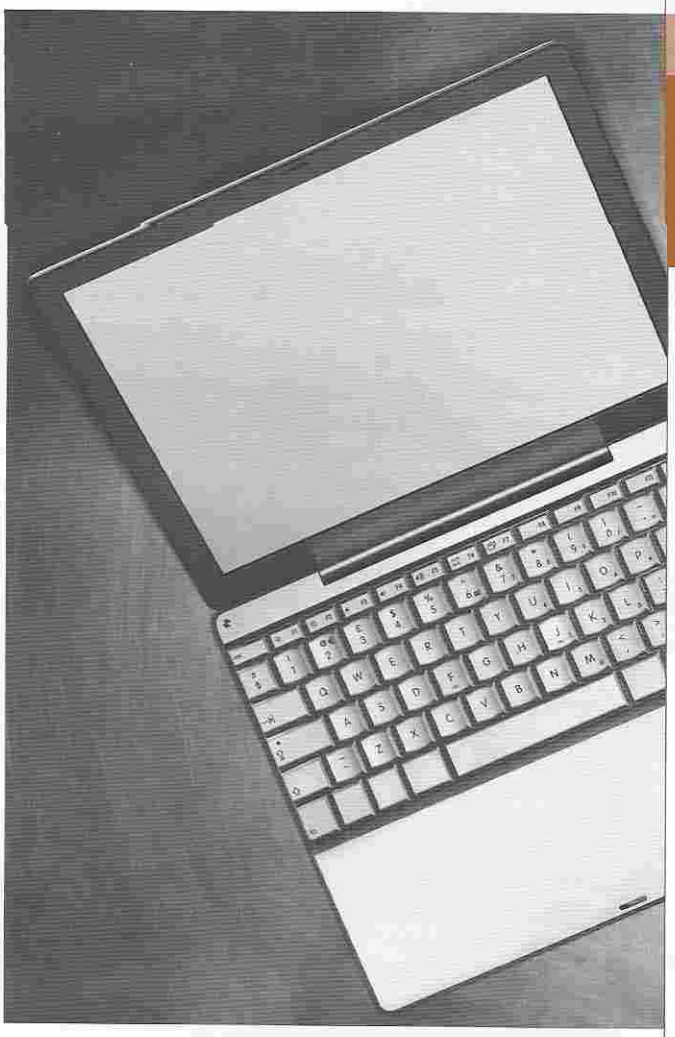
The ban was initially imposed for three years as part of the Internet Tax Freedom Act in 1998 (which also established the Advisory Commission on Electronic Commerce). It was extended for a further two years in 2001 and then for a further four years in November 2003. The November 2003 moratorium also held up moves to extend online sales (e–commerce) taxes across all US states. In October 2007, the moratorium on Internet access taxes was given a further extension of seven years, one day before it expired.

In October 2005, the Streamlined Sales Tax Project (SSTP) agreement took effect in the US. This was an attempt to harmonise online sales taxes across the states that do have them.

In the European Union, a new regime for levying Value–Added Tax (VAT) on on–line purchases came into force in July 2003.

Conclusion

Why should e–commerce be treated differently to any other channel? Shouldn't there be a level playing field with online sales taxed at the same level as offline retail sales? Different on–line and off–line taxes cause distortions as do different degrees of enforcement of online taxes. Erosion of the tax base in the US state and local authorities that rely on sales taxes amounted to 49% of state revenues. Many have increasing revenue deficits to try and close. On the other hand, the most valid reason



not to impose tax on virtual transactions were using the infant industry argument that e–commerce is still small and needs protection. But, perhaps it is now sufficiently "grown up". Buyers will only go elsewhere to suppliers in countries without e–commerce taxation protectionism argument. Taxpayers don't like paying taxes and this is one way of avoiding them. The US wants to ensure that online sales will be taxed before they become important rather than after. While e–commerce sales at that time were only around 1% of overall retail sales. G&Z (1999) argue that it may be more difficult to extend sales tax to these transactions once they reach 10 or 20%.

The Organisation of Economic Cooperation and Development (OECD) stand on e–commerce taxation is clear.The Taxation Framework Conditions – agreed in Ottawa in 1998 – provide the principles which should guide governments in their approach to e–commerce. It states that ***'e–commerce should be treated in a similar way to traditional commerce and emphasises the need to avoid any discriminatory treatment. This Framework was welcomed by member countries, non–member economies, and the business community'.***

It must be stressed that the concept of permanent establishment exist in the current tax policy applied to traditional business operations may not be applicable to e–commerce on running similar transactions.

The inapplicability makes the internet traders not subject to Malaysian tax. It is unfair for conventional business operators to pay tax by running similar transactions. The inequality may affect their adoption of the business model. This violates the concept of neutrality. The growth in electronic forms of commerce is expected to worsen the present situation that only 10% of all business entities are required to pay profits tax.

Tax revenue losses were estimated based on the exemption provided to the e–commerce transactions are as follows:

- Bruce and Fox (2000) estimate that US$10.8 billion were lost across US in 2003;
  [Note: some authors say that the University of Tennessee study suggested a shortfall of US$13 billion in 2001. Varian H.R. (2000) points out that this may sound a lot but it is still < 2% of total state & local tax revenue.]
- Direct Marketing Organisation puts the figure for 2001 at about US$2.5 billion; and
- A 2003 study by the Center on Budget and Policy Priorities warned that state and local governments could lose up to US$9 billion per year in tax revenue as services such as telephone, music and movies migrate to the Internet.

If e–commerce taxation is to be implemented, who should be made responsible for collection? Basu (2003) argues that ISPs should be responsible for the calculation, collection and payment of taxes. He rejected arguments by the OECD that credit card companies should be responsible. He says that putting a financial intermediary in the position of tax collector in a credit context produces a conflict of interest and privacy concerns. In any case, not all transactions are via credit cards – unaccounted digital cash may in the future be a more important means of payment. Obviously, ISPs would need appropriate remuneration. There needs to be global agreement on standards and the development of suitable software and databases.

There should be greater international cooperation for administering consumption taxes and a role for bodies such as the OECD and the World Trade Organisation (WTO). The principle of tax competitive equality suggests that those who provide goods or services in e–commerce should be taxed no differently than those who provide goods or services in conventional commerce (Basu, 2002). The tax authorities should take the opportunity to use technology to increase the efficiency of tax collection (not just e–commerce). There have, of course, already been steps in this direction with online submission of income tax returns. Basu would like to see online assessment and collection of tax becoming the norm rather than the exception.

Taxation is not only about collecting tax revenue – tax can also be levied to dissuade or limit customers from purchasing what might be regarded as socially undesirable products. In July 2005, a Democratic Senator from Arkansas, Blanche Lincoln, proposed a special federal tax of 25% on transactions taking place on "adult" websites (as part of the proposed Internet Safety Child Protection Bill). However, the Bill wasn't passed into law.

Should tax be payable on information goods delivered via the Internet (electronic entertainment – games, music and video downloads) as well as the physical goods that are ordered over the Internet but delivered offline? In May 2005, the Wisconsin Joint Finance Committee considered a proposal for just such a tax. However, it was turned down on the grounds that it would disadvantage companies in Wisconsin.

Some music industry players have recently called for a $5 per month "surcharge" on Internet users to be collected by ISPs to "compensate songwriters, performers, publishers and music labels" (The Register 29/7/08). In Europe, they have already in place VAT on downloads from the iTunes Music Store. TG

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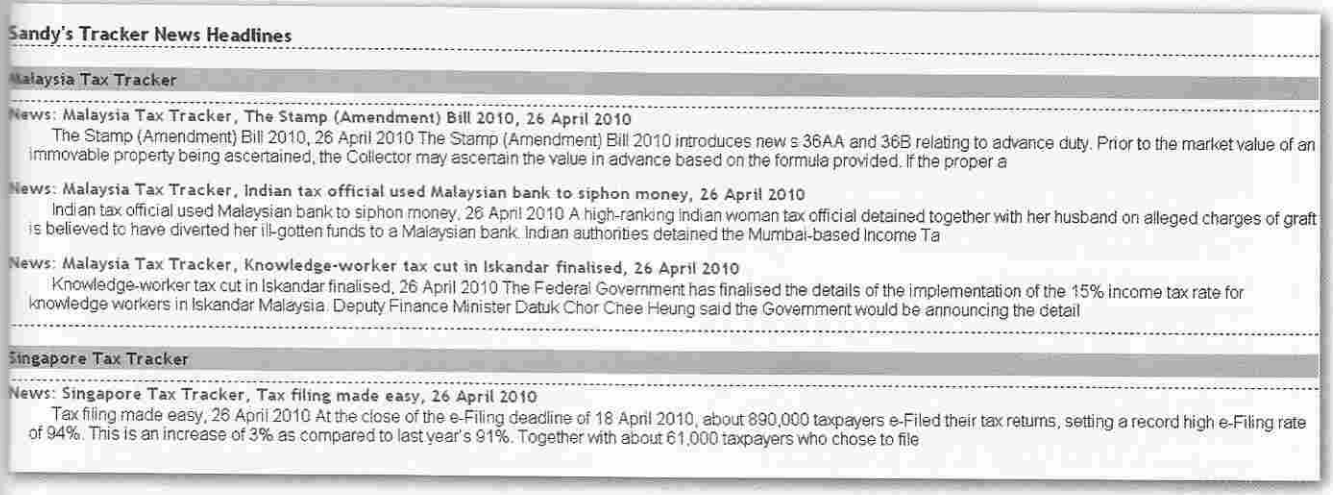

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Who Wins in a Tax Audit?

By SM Thanneermalai and Farah Rosley

The Malaysian Inland Revenue Board (IRB) has significantly increased their focus on tax audits and tax investigations over the past years. To many taxpayers, tax audits and tax investigations may seem daunting and sometimes even scary. When a taxpayer faces this for the first time, the entire process may even be confusing and tiring with no real certainty till the conclusion of the audit. Is this perception correct? This article intends to deal with each step of the tax audit process and also provide an overview of key areas for taxpayers to consider in preparing for and dealing with tax audits.

Taxation issues in line with business transactions are becoming more and more complex. Various transactions that companies enter into such as raising capital or financing, restructuring of operations and expansion to foreign countries are amongst business dealings that may have taxation implications and may need to be considered prior to and during the implementation of the transaction. During a tax audit, the IRB will check the taxpayers' financial affairs to ensure that the correct amount of taxes has been paid and that the taxpayers are complying with the tax rules and legislation. The tax audit process could range from a simple checking of the scheduler tax deduction forms or extend to a full examination of business records. With the introduction of Self–Assessment System (SAS) for companies from the year of assessment 2001, taxpayers are expected to file their Tax Returns correctly and accurately with the relevant supporting documentation being kept for future checks by the IRB. The SAS regime has clearly shifted the burden of ensuring the correctness of the tax declared in the tax return to the taxpayer.

What is a Tax Audit?

According to the Tax Audit Framework issued in January 2009:–

"A tax audit is an examination of taxpayer's business records and financial affairs to ascertain that the right amount of income should be declared and the right amount of tax should be calculated and paid are in accordance with tax laws and regulations."

Who is chosen?

Tax audits are part and parcel of the compliance system under the Self Assessment System. As such, it is intended that all companies will have to be audited at some point. However, given the large number of companies, IRB relies on some of the following criteria in selecting companies for tax audits:–

- Risk analysis (eg losses, significant incentive claims, etc)
- Period since last audit
- Information obtained from third parties
- Non submission of tax return
- Industry focus
- Particular issue or matter affecting the taxpayer or affecting a group of taxpayers
- Geographical location
- Public information about the taxpayer
- Random selection

In view of the above, the question one should ask is not "why am I being audited?" but rather, "when am I going to be audited?".

The conduct of an audit

A tax audit involves various interrelated parts which need to be well understood in order for one to deal with the entire process effectively and efficiently:-

1. Prior to the tax audit

Where a taxpayer is identified for an audit, tax returns and tax files are allocated to an IRB auditor assigned to the case. The tax audit starts with an audit plan whereby the IRB may review the taxpayer's background and financial information prior to the actual audit visit. During this process, certain facts and data are gathered. This data may be from the taxpayers' own records or from public sources.

The information and data obtained will be summarised and analysed to enable the IRB to identify key focus areas. Weeks before the actual audit visit, the information and data gathering would have been done and the audit plan laid out. Closer towards the tax field audit visit, IRB may request for further financial or company information to be provided and increasingly, IRB are requesting for require softcopy information to be provided to them. Some of the information that may be requested prior to an audit visit includes:-

- Audited accounts and tax computations for the relevant years;
- General ledger details;
- Company's chart of accounts;
- Payments vouchers and receipts for specific transactions or expenditure;
- Breakdown of significant expenditure in the profit and loss accounts;
- Claim forms, any approval letter and supporting computations in respect of incentive claims;
- Original receipts of donations;
- Withholding tax forms, receipts and bank remittance slips;
- List of employees or for large companies, list of "top 20 or 30" of the management; and
- Any other information or documents relevant to the business.

The Income Tax Act, 1967 (ITA), under the Sections shown below gives the IRB wide ranging powers to call for information and documents:–

- Section 78 – Power to call for specific returns and production of books
- Section 79 – Power to call for statement of bank accounts, etc.
- Section 81 – Power to call for information (3rd party confirmation)

The IRB auditor will contact the taxpayer to arrange and confirm a date for the audit visit. Subsequent to this, a letter confirming the date, time, documentation required and names of the IRB officials attending the audit will be provided to the taxpayer.

2. The tax audit visit

This may seem to be the shortest in terms of time spent but is an important step of the process. The IRB will normally conduct audit visit for two or three days at the taxpayers premise. However, in more complex cases, the visit may extend to a much longer period. During the audit visit taxpayers' records will be checked and interviews will be conducted. Normally, there will be two main discussions held. The first discussion will be on the first day of the audit visit whereby the taxpayer's representative will be asked to explain about the business generally and also specific issues on financials and transactions occurring during the year including the record keeping system. The second discussion will be an audit closure meeting, normally conducted during the last day of the audit visit to mark the end of the audit visit. During the course of the audit, the auditor will examine all business records and verifying the claims made in the tax returns.

There will be a wider range of questions raised by the IRB during the tax audit visit. Questions may range from background of the company and other general information about the business to more specific questions about a specific transaction or entry in the books.

Some pertinent points during the oral enquiry by the IRB is avoid straying away from facts unconnected with the enquiry as such answers will only mislead the tax officials which may subsequently require a great deal of effort and time to explain. Therefore, the golden rule is to answer the IRB directly within the relevant facts and evidence and move away from any use of technical jargon which can again lead to misunderstanding or misinterpretation by the IRB. It is best that a senior official familiar with the taxpayer's business and its finance be present to answer any such oral enquiries.

3. Post tax audit visit

Following the audit visit, the IRB will review the documents obtained during the audit visit and may request for additional documents and information that may be relevant. The auditor may then document the audit findings or request for additional or further information from the taxpayer. At this stage, specific tax issues may be raised or clarification sought. The issues would largely depend on the transaction and the industry the taxpayer is operating in as well as the tax positions adopted by the taxpayer. Some of the more common tax issues raised during tax audits are discussed below:–

- Deductibility of expenditure

  This issue is a common issue raised by the IRB during any tax audit. The tax rules governing deductibility of expenditure is provided under s 33(1) of the ITA:

  "... the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income...."

  Common problems faced by taxpayers are the availability of documentation to support the expenditure. Expenses such as entertainment expenditure, travelling costs, provisions or accrued expenses, repairs, maintenance costs, etc. are particularly of interest to the IRB especially where the expenses claimed are substantial.

- Incentive claims

  Incentive claims such as reinvestment allowance, investment tax allowance and double deduction are areas of focus. On this matter, a few points to note are as below:–

  - Is the taxpayer eligible for the incentive?
  - If there are conditions imposed in the award of a particular incentive, has the taxpayer met the qualifying criteria?
  - Is there sufficient documentation to substantiate the incentive claimed?
  - Is the taxpayer aware of any changes to the tax rulings and legislation that may impact the taxpayer in respect of the incentive?
  - Is there consistent treatment of the incentive claim over the years?

  It is important for taxpayers to ensure that they are able to substantiate the incentive claims made over the period and that documentation is available. Leaving the matter to the last minute and not being able to substantiate the claims may lead to potential tax adjustments by the IRB giving rise to additional taxes and penalties subsequent to the audit.

- Withholding tax

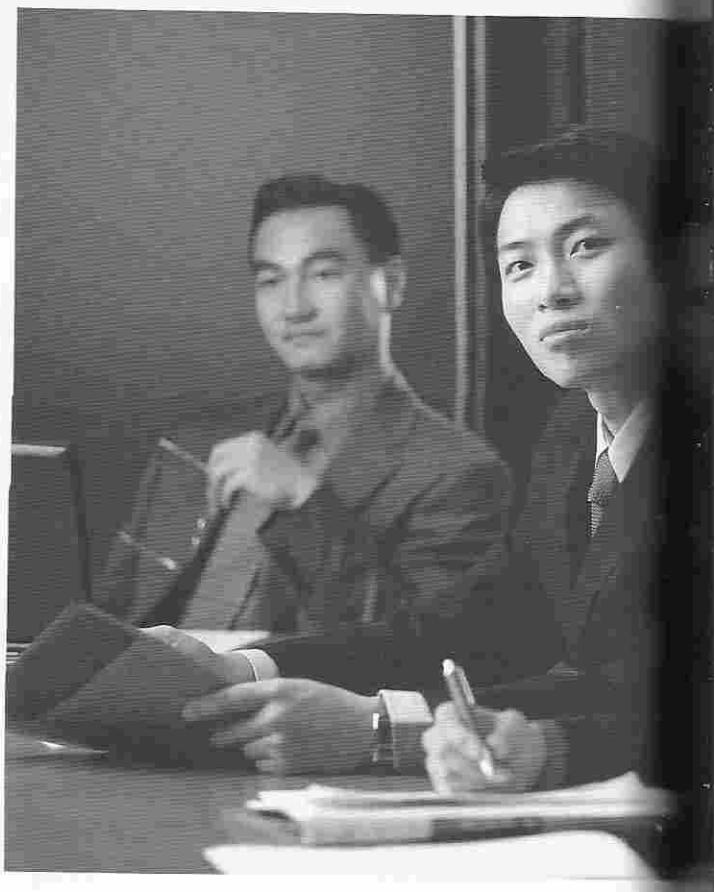
  Certain payments to non–residents such as royalties, interest, contract payments, rental of movable properties and technical assistance fees for services performed in Malaysia may be subject to withholding tax.

  Withholding tax is an issue that continuously comes under scrutiny in any audit, regardless of whether the taxpayer is profitable or otherwise. In managing withholding tax issues it is imperative that taxpayers are aware of the position adopted on the payments to non–residents. The following summarises the area of focus by the IRB:–

  - Ensure the availability of the relevant withholding tax forms and receipts
  - Is the withholding tax rate being applied correct? There are different withholding tax rates for different types of payments to non–residents
  - Ensure that there are no late payments
  - Contractual agreements – are transactions consistent with the type of payments made and the payment terms stipulated in the agreements?
  - Regrossing of payments whereby the recipients receive the amounts paid net of tax whilst the withholding is borne by the payor.

- Loss making companies

  Loss making companies may also be picked for audits especially if they show losses over several consecutive years. In reviewing the losses, the IRB will particularly be interested on the following matters:–



- The profit margin for the taxpayer's business over several years to understand the fluctuations in the profitability of the business
- The breakdown of the cost and significant expenses
- Reasons or explanations behind the actions in any peculiar events that lead to the losses.
- Any major inter–company transactions and if yes, do they satisfy the arm's length principle.
- Documentation to support any of the points highlighted above

4. Discussion on issues

The length of time taken for taxpayers to discuss the issues raised and provide satisfactory responses to the IRB could vary significantly depending on the complexity of the issue at hand and the availability of the supporting documentation.

It should always be at the back of taxpayer's mind that the relationship with the IRB is a two–way relationship. Taxpayers will need to be diligent in his record keeping, able to substantiate the tax position adopted and is able to provide answers to the address the query by the tax authority. This step of the audit process is crucial as the progress of the case can turn to be satisfactory to the taxpayer or can result to disagreement between the IRB and the taxpayer.

The key point to note in achieving a satisfactory result from this step of the process is to understand the issues raised by the IRB and to provide the necessary information and documentation to address the specific matter raised. It is also very important to communicate the technical position adopted by the taxpayer supported with the relevant law, guidelines, public rulings and case law precedents.

5. Negotiation and settlement

An audit settlement involves a final evaluation of all the findings. If there are no adjustments, a letter will be issued to inform that the audit has been finalised and no adjustments will be made.

If there are adjustments, a tax computation with details of the proposed adjustments will be issued. This is usually done before an assessment is raised and the taxpayers will normally have approximately 14 days to revert on the issues raised in the tax computation, failing which the IRB will assume that the taxpayer is agreeable to the tax adjustments and an assessment will be issued together with the appropriate penalty.

If the taxpayer is not satisfied with the assessment raised, there is always the avenue to appeal against it. The appeal is made by filing a notice of appeal (ie Form Q) to the Special Commissioners of Income Tax within 30 days of the service of the notice of assessment or additional assessment. Notwithstanding the appeal, tax due as indicated in the notice of assessment or additional assessment must be paid within 30 days. Should the taxpayer disagree with the decision by the Special Commissioners, the case can be appealed to the High Court and subsequently to the Court of Appeal.

Other developments

Public Rulings

Public Rulings are issued by the IRB to provide guidance for the public and the officers of the Inland Revenue Board. It sets out the interpretation of the Director General of Inland Revenue in respect of the law and the policy and procedure that are to be applied. A Public Ruling may be withdrawn, either wholly or in part, by notice of withdrawal or by publication of a new ruling which provides an updated position.

In a tax audit, the IRB will adopt positions that are in accordance with the Public Rulings as the Public Rulings are binding on the IRB. Public Rulings are not legislation and therefore are not binding on the taxpayers. However, where taxpayers adopt positions which are different from that of the Public Rulings they should have reasonable legal grounds to support their position or be ready to defend the position in court.

Tax Audit Framework

The Tax Audit Framework was first issued on 1 January 2007. An updated framework was subsequently issued on 1 January 2009. The framework was introduced to address concerns and questions raised by the taxpayers on the reason and the way the IRB conducts a tax audit.

As stated in the Tax Audit Framework, generally the framework aims to:–

- Assist audit officers to carry out their tasks efficiently and effectively; and
- Assist taxpayers in fulfilling their obligations

The main content of the Tax Audit Framework includes the following:–

- Statutory provisions provided in the ITA which are relevant to tax audits;
- Criteria for audit selection;
- Methodology for a tax audit – how tax audits are carried out, the venue, commencement of an audit, the audit visit, examination of records, the duration for an audit, etc.;
- Rights and responsibilities of taxpayers, the tax agents and the IRB officers;
- Settlement process;
- Complaints procedure if taxpayers are not satisfied with the conduct of the tax audit;
- Offences and penalties;
- Procedure for payments on the settlement of additional tax liability;
- Penalties and offences; and
- Appeal procedure against assessment raised from the tax audit.

Penalties

Taxpayers may make errors in their tax returns due to ignorance or negligence and without any willful intent to under declare their taxes. The current practice by the tax administration is that upon submission of the tax return, any subsequent amendment which results to additional tax liabilities will mean a penalty will be imposed on the additional tax liability. As provided for under s 113(2) of ITA, a penalty equal to the amount of tax undercharged (100%) will be imposed if it is discovered during an audit that there has been an understatement or omission of income.

As stipulated in the Tax Audit Framework, the IRB in applying their discretionary powers may impose a lower penalty rate of 45% for the first offence. For any repeated offence, the penalty rate shall be increased by 10% as compared to the last penalty rate imposed for the previous offence but limited to a sum not more than 100% of the amount of tax undercharged. A penalty of between 10% to 30% may be imposed upon voluntary disclosure by the taxpayer prior to the case being selected for an audit and a penalty of 35% after the taxpayer has been informed but before the commencement of the audit visit.

The question here is whether penalty under s 113(2) of ITA should be imposed in instances where the taxpayer had acted in good faith. During a tax audit, the burden of proof is on the taxpayer. Therefore, it is important for taxpayers to show that they have acted in good faith on the position adopted in the tax returns and the availability of documentation to support the transaction.

The penalty rates are disclosed in the IRB's website at www.hasil.gov.my.

Five top audit survival tips

Thinking ahead and proactively dealing with the issue in a tax audit is vital in ensuring a desirable outcome. The following are the five top audit survival tips:–

1. A diligent taxpayer should be able to handle and manage tax audits themselves. Taxpayers may also consider engaging tax professionals who specialise in handling tax audits at the commencement of the tax audit as they will be able to guide the taxpayer on how to strategise the way forward in managing the tax audit, in particular when dealing with tax technical matters. The reason being, audit adjustments and penalties are becoming a regular occurrence.
2. Be ready to answer questions and providing the necessary information when requested by the IRB. Respond to the questions raised by the IRB but do not provide unnecessary or irrelevant information as it will only confuse the IRB.
3. Be polite and professional in dealing with the IRB officials. If the information requested is too burdensome, it should be discussed with the auditor and alternatives suggested.
4. Do not underestimate the IRB officials as they are professionals with the relevant knowledge, training and experience.
5. Finalise the tax audit within a short time and narrow down the list of issues to be dealt with so that it can be resolved quickly.

Conclusion

Tax audits are a regular every day event and they are conducted by the IRB in an orderly and organised way. The aim here is to ensure that taxpayers pay their correct taxes.

However, there are many instances where the tax adjustments imposed by the IRB can lead to differences in opinion resulting in appeals either to the IRB or ultimately to the courts. It is appreciated that it is the duty of the IRB to increase and improve the compliance through audits and enforcement activities, it would be preferable if they were to adopt greater flexibility to listen to the viewpoints expressed by the taxpayers on the interpretation of the law and to provide greater leeway in the level of documents / evidence to support the positions adopted by taxpayers. Taking a rigid position may result in greater tax collection but this could be detrimental in the long run as such actions could be viewed by business community and the general public negatively.

In conclusion, greater dialogue between the IRB and community is needed to strengthen this two–way relationship further. TG

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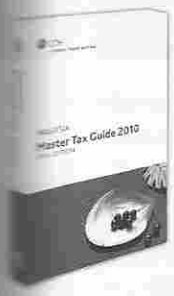

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New Challenges in Malaysian Transfer Pricing Audits

By Bob Kee and Chang Mei Seen

Transfer pricing dispute involving GlaxoSmithKline (GSK) in 2006 sent shock waves throughout the business world. It was reported that the settlement of this dispute between GSK and the US Internal Revenue Service (IRS) was the largest transfer pricing settlement in history with a total payment of USD3.4 billion[1]. More recently, UK based pharmaceutical firm AstraZeneca Plc (AZ) was also embroiled in a transfer pricing dispute. AZ announced on 23 February 2010 that it would pay some £505 million[2] (approximately USD780 million) to settle its transfer pricing dispute with H.M. Revenue and Customs. These cases sent out a strong signal to Multinational Corporations (MNCs) that tax authorities take transfer pricing very seriously. It also reinforces the fact that transfer pricing, if not managed properly, can be a very costly affair. For tax authorities, it is certainly a powerful revenue generating tool.

On the Malaysian front, there have not been any publicly reported transfer pricing disputes to date, and this is not really surprising since it has been only around seven years since the introduction of the Malaysian Transfer Pricing Guidelines (the TP Guidelines) in July 2003. These guidelines presented Malaysian taxpayers a significant challenge with far reaching implications. However, there is ambiguity in the application of the TP Guidelines and the Malaysian Inland Revenue Board (IRB) has not released any detailed rules on its application. Many Malaysian taxpayers also prefer to adopt the "wait and see" approach. The GSK and AZ cases did little to stir these Malaysian taxpayers who felt that the reality of what happened in the US and UK were far from happening in Malaysia.

Well, all these are expected to change. With effect from 1st January 2009, s 140A was introduced into the Malaysian Income Tax Act, 1967 (ITA), to give the MIRB the extra muscles it needed to tackle transfer pricing issues.

The Early Years of Transfer Pricing in Malaysia

As mentioned, transfer pricing prior to 1 January 2009 was governed by the TP Guidelines, which were largely based on the transfer pricing guidelines issues by the Organisation for Economic Cooperation and Development (OECD). The TP Guidelines serve to provide taxpayers with information on existing domestic legislation, methodologies acceptable to the IRB that can be used in determining the arm's–length price and administrative regulations, including the type of

records and documentation expected from taxpayers involved in transfer pricing arrangements.

However, the TP Guidelines did not have the force of law and the lack of a specific arm's-length provision in the ITA meant that the IRB had to rely on s 140, the general anti–avoidance provision, to make transfer pricing adjustments.

Section 140 (1) provides:

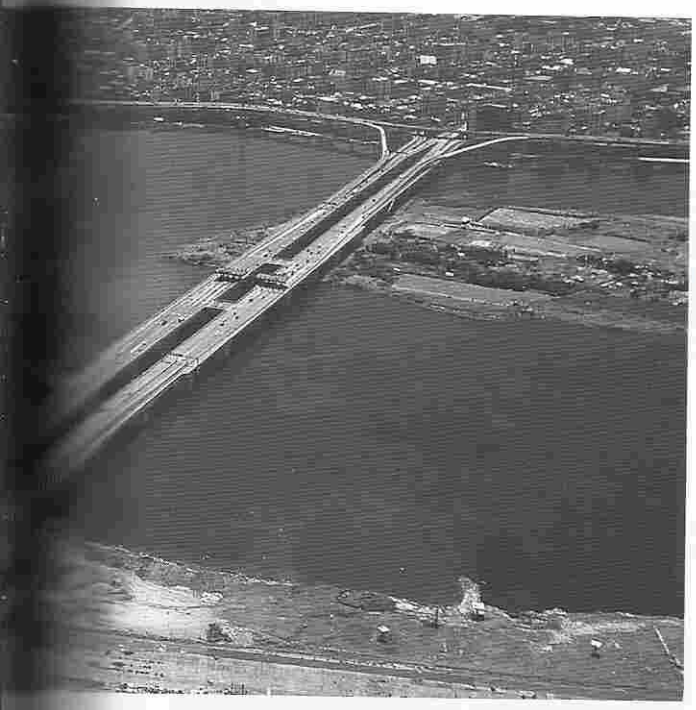
> "The Director General, where he has reason to believe that any transaction has the direct or indirect effect of –
>
> (a) altering the incidence of tax which is payable or suffered by or which would otherwise have been payable or suffered by any person;
> (b) relieving any person from any liability which has arisen or which would otherwise evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by this Act; or
> (c) hindering or preventing the operations of this Act in any respect,

1 David S. Hilzenrath. (September 12, 2006). "Glaxo to Pay IRS $3.4 Billion". Available: http://www.washingtonpost.com/wp-dyn/content/article/2006/09/11/AR2006091100429.html. Last accessed 20 April 2010.

2 Tamu N. Wright. (February 25, 2010). "United Kingdom: AstraZeneca Settles Transfer Pricing Dispute with U.K. Tax Agency for US$ 780 Million". BNA Tax Management Transfer Pricing Report. 18 (4), 8-9.

may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustments as he thinks fit with a view to counter–acting the whole or any part of such direct or indirect effect of the transaction."

In other words, to make adjustments, the IRB assumed that taxpayers who engaged in non–arm's–length transactions intended to avoid tax. As such, the IRB is using s 140 to counter–act the non–arm's–length transaction.



The Introduction of s 140A and the New Transfer Pricing Environment

With the introduction of s 140A, the MIRB now has a specific provision to rely on to make transfer pricing adjustments, rather than having to rely on the general anti–avoidance provision under s 140. Transfer pricing adjustments could now be made where the IRB believes that the taxpayer's transactions with associated persons were not at arm's–length. Whether the intent of the taxpayer was to avoid tax is no longer relevant.

Section 140A (2) provides:

"Subject to subsections (3) and (4), where a person in the basis period for a year of assessment enters into a transaction with an associated person for that year for the acquisition or supply of property or services, then, for all purposes of this Act, that person shall determine and apply the arm's–length price for such acquisition or supply."

Section 140A (3) further provides:

"Where the Director General has reason to believe that any property or services referred to in subsection (2) is acquired or supplied at a price which is either less than or greater than the price which it might have expected to fetch if the parties to the transaction had been independent persons dealing at arm's–length, he may in determination of the gross income, adjusted income or adjusted loss, statutory income, total income or chargeable income of the person, substitute the price in respect of the transaction to reflect an arm's–length price for the transaction."

Shortly after the introduction of s 140A, the IRB indicated through various tax seminars that formal transfer pricing rules (the Rules) would be released to guide taxpayers on the application s 140A. It has now been more than a year but the Rules have not yet been released. Until then, taxpayers will have to be guided by the existing TP Guidelines and the general principles drawn from the OECD Guidelines.

Transfer Pricing Audits

An indication of the steely resolve of the IRB to protect what it considers to be its fair share of taxes can be seen in its redeployment of resources and expansion of its transfer pricing capabilities. In early 2009, the IRB undertook an internal restructuring and reorganisation exercise, and the "Multinational Tax" Department was established with four divisions as follows:

Within this new Multinational Tax Department, the Audit Division is the division responsible to carry out tax audits, and more specifically, transfer pricing audits on MNCs. The officers in this division have been well trained and they are experienced in dealing with transfer pricing matters. We also understand that they have experts from overseas providing training and guidance on transfer pricing approaches. The expertise and capabilities of these audit officers are certainly not to be taken lightly.

Since the inception of the TP Guidelines, the IRB has been aggressively conducting formal transfer pricing audits.

Among the characteristics that makes a company a high risk target and could potentially expose them to a transfer pricing audit are as follows:–

A company exhibiting one or more of the above characteristics and engaged in significant related party transactions run the risk of being selected for a transfer pricing audit. As such, such companies should be on high alert and ensure that the relevant transfer pricing documentation is in place.

Companies which are picked for tax audits face experienced tax auditors who are trained to pick up transfer pricing issues. As such, it is imperative that taxpayers prepare transfer pricing documentation on a timely basis to show that they have acted reasonably and in good faith to comply with the arm's–length requirement. In a worst case scenario, such contemporaneous documentation could provide an avenue to minimise penalties should the IRB impose transfer pricing adjustments.

It is also worthwhile to note that companies with local related party transactions are not exempted from complying with the transfer pricing provisions. Malaysia is a developing nation and offers a whole host of tax incentives for eligible companies. The IRB is casting a wider net in respect of its transfer pricing enforcement activities and would also audit companies with local related party transactions to ensure that there has been no shifting of profits to the tax exempt affiliate.

Challenges Faced by Taxpayers during Transfer Pricing Audits

Over the years, the level of transfer pricing sophistication within the IRB has increased significantly. As such, taxpayers may find it harder to win the transfer pricing battles with the IRB.

Transfer Pricing Documentation Requirements

The MIRB has been formally conducting transfer pricing audits since 2004 and if current trends are any indication, the IRB will only continue to intensify their transfer pricing audits. There is currently no force of law to compel taxpayers to submit transfer pricing documentation together with their tax return. Instead, the IRB would request for transfer pricing documentation during an enquiry or transfer pricing audits.

While the new s 140A does not require taxpayers to submit transfer pricing documentation together with their tax returns, it imposes on the taxpayer the requirement to ensure that their transactions with associated parties are at arm's–length. Under the new provision, taxpayers who transact with their associated companies must be able to prove that the pricing for transactions with associated persons is at arm's–length ie no different than what it would be if the transaction was carried out with third parties.

To show compliance with s 140A, the IRB has indicated that the preparation of contemporaneous transfer pricing documentation is the only way for taxpayers to demonstrate that reasonable efforts have been taken to ensure that its transfer prices are consistent with the arm's–length principle. Essentially, this means that where the status of transfer pricing documentation was once a "should have", with the introduction of s 140A, it is now a "must have".

As mentioned earlier, the competency of the IRB in dealing with transfer pricing issues has increased greatly due to experiences garnered from conducting numerous transfer pricing audits. Indeed, the IRB is now, more than ever, increasingly inquisitive and probes deeper with very specific questions. As a result, taxpayers may find it increasingly difficult to survive a transfer pricing audit unscathed if they do not have concrete documentation prepared on a timely basis.

Documentation Requirements Prior to 1/1/2009

- There is no specific legal provision to prepare transfer pricing documentation.
- Tax payers are encouraged to prepare contemporaneous transfer pricing documentation and are only required to submit it when requested by the IRB.

Documentation Requirements Effective 1/1/2009

- With the introduction of s 140A, transfer pricing documentation is the main tool for taxpayers to show that their transactions with associated persons are at arm's-length.
- The MIRB has grown in sophistication and are increasingly demanding with regard to transfer pricing matters. The level of documentation requested by the MIRB during audits has also become more onerous. As such, without proper transfer pricing documentation, taxpayers could be at the mercy of the IRB.

Specific Practices of the IRB during Transfer Pricing Audits

Chief among the reasons why the Rules are necessary is to ensure that there is clarity in terms of the approach when dealing with transfer pricing matters. Although the TP Guidelines are based on the OECD Guidelines, the IRB has specific practices which may not be known to all taxpayers. It is only in the course of a transfer pricing audit that these

practices become known and often the ambiguity in terms of approaches stems from the different interpretation that the MIRB has compared to the taxpayer. We cite two examples for discussion purposes:

Example 1: Selection of a Suitable Point within the Arm's–length Range

In our experience, the Transactional Net Margin Method (TNMM) is the most commonly used transfer pricing method during transfer pricing audits. In the application of the TNMM, the profitability of the taxpayer is benchmarked against the profitability of comparable companies. From the profitability results of these comparable companies, an interquartile range is constructed to represent the arm's–length range. Pursuant to para 1.48 of the OECD guidelines, any point within the arm's–length range is theoretically an arm's–length outcome. Where pricing falls outside the range and cannot be justified (eg special circumstances), the recommendation is to adjust to the most appropriate part of the range.

Paragraph 1.48 of the OECD guidelines provides:

> "If the relevant conditions of the controlled transaction (eg price or margin) are within the arm's–length range, no adjustment should be made. If the relevant conditions of the controlled transaction (eg price or margin) fall outside the arm's–length range asserted by the tax administration, the taxpayer should have the opportunity to present arguments that the conditions of the transaction satisfy the arm's–length principle, and that the arm's–length range includes their results. If the taxpayer is unable to establish this fact, the tax administration must determine how to adjust the conditions of the controlled transaction, taking into account the arm's–length range. It could be argued that any point in the range nevertheless satisfies the arm's–length principle. In general, and to the extent that it is possible to distinguish among the various points within the range, such adjustments should be made to the point within the range that best reflects the facts and circumstances of the particular controlled transaction."

During tax audits however, the practice of the IRB is to use the median as the starting point. Should the profitability of the taxpayer fall below the median (although within the interquartile range), failure to provide justification supportable by contemporaneous documentation may result in transfer pricing adjustments. This approach should be re–looked at since the interquartile range represents the arm's–length range, technically, where the taxpayer's results fall within the interquartile range, no adjustment should be imposed.

Example 2: Year on Year versus Multiple Year Analysis

Further to the above, pursuant to para 3.44 of the OECD guidelines, when applying the TNMM, multiple year data should be taken into consideration to account for the effects of product life cycles and short term economic conditions.

A practical application of this principle is to test the taxpayer's result against the interquartile range of results produced by the comparable companies on a weighted average basis.

Paragraph 3.44 of the OECD guidelines provides:

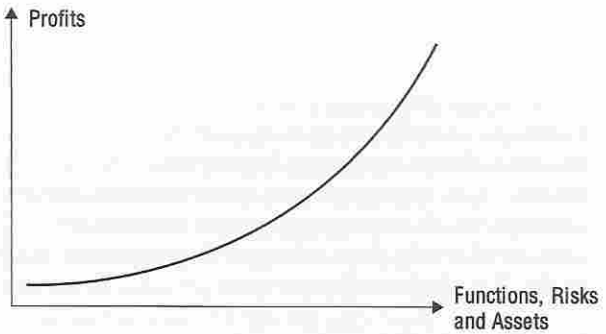
> "Multiple year data should be considered in the transactional net margin method for both the enterprise under examination and independent enterprises to the extent their net margins are being compared, to take into account the effects on profits of product life cycles and short term economic conditions. For example, multiple year data could show whether the independent enterprises that engaged in comparable uncontrolled transactions have suffered from the effects of market conditions in the same way and over a similar period as the associated enterprise under examination. Such data could also show whether similar business patterns over a similar length of time affected the profits of comparable independent enterprises in the same way as the enterprise under examination."

The approach adopted by the IRB during tax audits however, is to test the results of the taxpayer on a year by year basis. A tax audit typically covers six years and the IRB will look to test the results of the taxpayer for each year against the interquartile range of results produced by the selected comparable companies for that same year. The IRB will only accept a weighted average analysis if the taxpayer can prove that its profitability has been affected by business or product life cycles. Quite often, such proof is extremely difficult to obtain in practice.

The Functional Profile and Expected Profit Returns

Generally, economic theory purports that the level of return derived by an entity would be dependent on the functions performed, risks assumed and assets employed. Essentially, in the long term, taxpayers should be earning returns that correspond to their functional profile.

The graph below illustrates the relationship between profits and functional profile



Based on this theory, the IRB would expect in situations where a taxpayer makes changes to its transfer pricing, the taxpayers are able to substantiate the change in transfer pricing with a change in its functional profile. For example, if the profit margin earned by a Malaysian manufacturer in

its transaction with a related party is suddenly reduced in one year, the IRB would expect that the reduction in profit margin is supported by a corresponding reduction in functions performed, risk assumed or asset used by the Malaysian manufacturer. Otherwise, such reduction in profits may not be justifiable.

However, sometimes, the reduction in profits was a result of the company taking risk and these risks actually materialises, resulting in losses. Some taxpayers attempt to justify their poor profitability during a tax audit by citing economic forces or poor business conditions as the cause. It would be challenging indeed to convince the IRB of this without contemporaneous documentation as support. The taxpayer would need to demonstrate that the losses were attributable to non–transfer pricing factors and not as a result of non–arm's–length transfer prices.

Intra–group services

The IRB has been auditing payments made for intra–group services as many taxpayers usually have little or no documentation in this area. Intra–group services generally refer to activities that are performed for one or more related parties within a group of companies/businesses. It is common that related parties within a group would arrange for services to be furnished by one or more members of the group (usually the parent/holding company or a designated entity within a group of companies). Such arrangements cover a wide ambit of services including administrative, technical, financial, commercial, management, coordination and control functions.

The TP Guidelines addresses specific issues associated with intra–group services. According to the TP Guidelines, the two main transfer pricing issues to address with regards to the provision of intra–group services are whether the services have been rendered and confers a benefit of economic or commercial value to the recipient and if so, is the charge justified and at arm's–length. Further, from an arm's–length perspective, shareholder costs should not be charged out, but quarantined by the service provider. The company receiving the charge would also need to ensure that there is no duplication to the services performed by the company itself. Otherwise, the services would not generally be considered as providing a benefit.

The IRB expects the taxpayers to prove that services were rendered and there is a real commercial or economic benefit to the service recipient. As such, taxpayers are required to provide sufficient supporting documentation in the form of reports, email correspondences, internal memos, minutes of meetings, etc. In our experience, most taxpayers are unprepared for the sheer volume of documentation required by the IRB which can be onerous.

In addition, the IRB would expect that taxpayers are able to explain the basis of charge. The IRB typically scrutinises the basis of charge, especially where an indirect charge method is used. An indirect method would most often require the use of allocation keys which should commensurate to the level of service received.

Taxpayers frequently use turnover as an allocation key because turnover is a simple and practical key to apply. However, turnover is often regarded as being reflective of the ability to pay rather than reflective of the value of services received by the recipient.

Further, it is quite common for Malaysian service providers to operate on a cost recovery basis (ie costs are charged out at no mark–up). However, the IRB would expect the taxpayer to justify why a mark–up is not imposed since a third party service provider would normally seek to make profits for the services rendered. Currently, there are no safe harbour rules for the provision of intra–group services. However, a 5% mark–up is generally acceptable for routine or administrative services. Strictly, from a transfer pricing perspective, the mark–up to be imposed should be substantiated by a local benchmarking analysis.

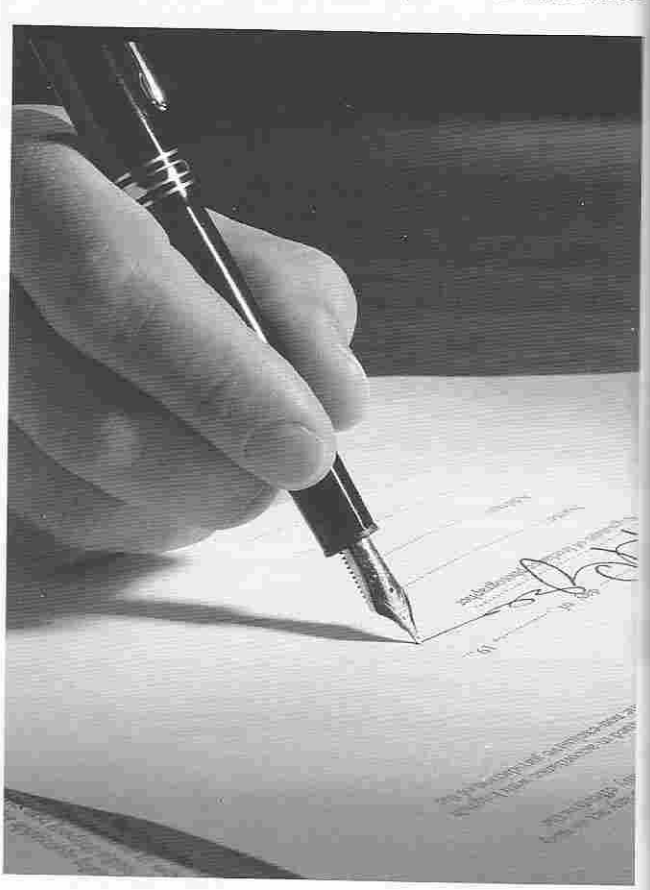
Other Developments

Thin Capitalisation (Thin Cap)

The concept of thin cap was introduced in s 140A (4) and generally aims to restrict the deduction of interest expenses on loans from related parties if deemed excessive in relation to its capital structure.

Section 140A (4) provides:

> " Where the Director General, having regard to the circumstances of the case, is of the opinion that in the basis period for a year of assessment the value or aggregate of all financial assistance granted by a person to an associated person who is a resident, is excessive in relation



to the fixed capital of such person, any interest, finance charge, other consideration payable for or losses suffered in respect of the financial assistance shall, to the extent to which it relates to the amount which is excessive, be disallowed as a deduction for the purposes of this Act."

The ratio is determined by comparing the ratio of associated party debt to the fixed capital of the taxpayer. Interest and other related charges in respect of the amount of associated party debt that is in excess of this ratio would be regarded as excessive and would be disallowed. At this stage, the IRB has not formally set an acceptable debt to equity ratio but the ratio of 3 to 1 has been mentioned on a number of occasions.

Although the implementation of thin cap has been deferred, taxpayers should be aware that IRB may still invoke s 140, the general anti–avoidance provision, should they believe that taxpayers are using inter–company financing as a means of avoiding tax. Thus, pending the issuance of the relevant rules, taxpayers should review their existing capital structure and interest rates on related party financing to assess the risk of having its interest expenses disallowed as a deduction.

Inter–company financial arrangements

Of late, the IRB has been actively pursuing the issue of financial assistance arrangements between related parties. Financial assistance arrangements are covered under the new arm's–length provision and taxpayers are required to ensure that such arrangements are arm's–length. Although the term "financial assistance" is not defined in the ITA, the IRB in its public seminars has indicated that financial assistance includes a loan, interest bearing trade credit, advance or debt and the provision of any security or guarantee.

It is very common for Malaysian companies to extend/receive interest–free loans or interest bearing–loans to/from other related entities at rates that are not usually supported by transfer pricing analysis. Further, the IRB would take the stand that an independent party would charge interest on financial assistance granted to third parties. As such, the provision of interest free loans is not regarded as arm's–length.

On a practical note, the requirement to apply the arm's–length methodology to all related party loans could result in additional compliance costs for the taxpayers. Conducting a study to determine the arm's–length interest for financial arrangements can be a costly exercise and taxpayers should weigh the cost against the potential tax exposure that may arise in a tax audit.

Advance Pricing Arrangement (APA)

An APA represents an agreement between a t axpayer and a tax authority with regard to the transfer pricing methodology to be applied on transactions between related parties. APAs have long been used as a tool for taxpayers in more advance tax jurisdictions to achieve certainty and reduce the risk of a transfer pricing audit. Up till the introduction of s 138C on 1 January 2009, Malaysian taxpayer could not initiate an APA with the IRB.

APA applications are now handled by the APA division under the Multinational Tax Department. The IRB encourages taxpayers to apply for APAs and has promised to keep the information submitted confidential. In fact, the IRB has indicated its willingness to hold pre–filing meetings on an anonymous basis if taxpayers have a genuine interest in pursuing an APA.

Having said that, there are numerous issues related to APAs that have not been clarified by the IRB. For example, a critical issue is that of "rollback" where an APA is applied to past years. In such situations, it is unclear if there will be any sort of penalty protection since the taxpayer did "voluntarily" apply for the APA. Without some certainty on the mitigation of penalties, taxpayers may not consider embarking on an APA for fear of potential tax exposure in the past years.

Similar to the Transfer Pricing Rules, the APA Rules have also not been released by the IRB. Many taxpayers may put off applying for an APA until final clarification has been obtained.

Summary

The transfer pricing environment has undergone rapid changes in the time since the TP Guidelines were first introduced in July 2003. The introduction of s 140A on 1 January 2009 has strengthened the position of the IRB in enforcing transfer pricing in Malaysia and as a result, the MIRB has been expanding its resources and stepping up efforts in carrying out transfer pricing audits.

Taxpayers will find transfer pricing audits difficult to manage as the IRB becomes increasingly sophisticated. Lately, the IRB has also been extremely demanding with regard to transfer pricing documentation and supporting source documents. Taxpayers who are not prepared will find it an uphill battle to defend their transfer prices owing to the lack of documentation. Hence, it is more critical than ever for taxpayers to ensure proper transfer pricing documentation is in place to serve as the first line of defense in the event of an audit.

Indeed, taxpayers can no longer plead ignorance nor can they afford to adopt a "wait and see" approach as doing so would leave them in a vulnerable position in the event of an audit by the IRB. Taxpayers need to be aware that the IRB is taking transfer pricing seriously and taxpayers would not be able to "hide" behind the excuse that there is a lack of rules. The transfer pricing provisions are already in place and the IRB has shown every indication that they have no hesitation in enforcing them. Surely, no taxpayer would like to be subject to a transfer pricing adjustment like those faced by GSK and AZ. TG

Bob Kee *is a partner and* **Chang Mei Seen** *is a director in KPMG's global transfer pricing services group in Malaysia. The content of this article represents the authors' personal views and not that of KPMG Tax Services Sdn Bhd.*

Do Business Promotion Expenses Amount to Entertainment Expenses? An Analysis of the *SM* Case

By Dato D. P. Naban & S. Saravana Kumar

Every year, businesses allocate substantial sums of money to promote their business by way of branding, marketing and advertising. The promotion strategies may also regularly involve the marketing of promotional items to customers and potential customers. From a corporate tax perspective, the issue is whether such business promotion expenses are deductible against the gross income in determining the chargeable income of the business.

Section 33(1) of the Income Tax Act 1967[1] (ITA) states that outgoings and expenses wholly and exclusively incurred in the production of income are deductible from the gross income. However, as recognised by the Federal Court in *Director General of Inland Revenue v Rakyat Berjaya Sdn Bhd*[2], s 33(1) must be read in light of s 39 of ITA, which expressly prohibits the deduction of certain expenses. Among others, between 1989 and 2003, s 39(1)(*l*) prohibited the deduction of entertainment expenses unless these fell within one of the provisos to that provision where deduction was permitted[3].

The word "entertainment" is defined under s 18 of ITA to include:

(a) the provision of food, drink, recreation or hospitality of any kind; or
(b) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in paragraph (a),

by a person or an employee of his in connection with a trade or business carried on by that person.

In recent years, the Inland Revenue Board (IRB) has taken the view that some types of business promotion, like the provision of complimentary items, are entertainment and subject expenses incurred in that respect to the provisions of s 39(1)(*l*) of ITA.

This issue was resolved in *Aspac Lubricants (Malaysia) Sdn Bhd v Ketua Pengarah Hasil Dalm Negeri*[4], where the Court of Appeal held that the complimentary mugs, T–shirts and umbrellas given away by the taxpayer to their customers did not constitute entertainment.

1 [*Act 53*]
2 [1984] 1 CLJ 219
3 Section 39(1)(*l*) was inserted by s 6 of the Finance Act 1988 [*Act 364*] and took effect from the year of assessment (YA) 1989. The subsequent amendment by s 9(a) of the Finance Act 2003 [*Act 637*] allows for half of the entertainment expenses to be deductible expenses from the YA 2004.
4 [2007] 5 CLJ 353

The *IRB* had rejected the expenses incurred for the promotional items on the basis that they were entertainment. The Court of Appeal, however, held otherwise. In determining whether the expenses were entertainment or otherwise, the court was of the view that one must examine the true nature of the transaction between the taxpayer and its customers. If the taxpayer had incurred the expenses for the sole objective of promoting its business, then these could not be described as entertainment.

Despite the decision in *Aspac Lubricants*, the IRB has continued to maintain its position that expenses incurred to provide complimentary promotional items are entertainment expenses.

Recently, in *SM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri*[5], the IRB insisted that the airfares and accommodation expenses incurred by the taxpayer in sponsoring doctors to medical conferences constituted as entertainment expenses, the sponsorship being a form of entertainment.

As the burden is on the taxpayer to establish the nexus between the business promotion strategy and the production of income and appreciating that this may not be an easy task, this article highlights the grounds argued in *SM* and the lessons to be learnt from that case. Upon examining the arguments of the taxpayer and the IRB, the Special Commissioners of Income Tax ("Special Commissioners") in *SM* unanimously ruled in the taxpayer's favour and held that the sponsorship of the doctors was not a form of entertainment[6].

SM's case

In *SM*, the issue was whether the airfares and accommodation expenses incurred by a pharmaceutical company were entertainment expenses. Among others, the taxpayer distributed specialist medications, which could only be sold to the public with a doctor's prescription.

The taxpayer was also prohibited by law from advertising those medications to the public. In light of these restrictions, the taxpayer developed a strategy to promote its products. As the sale of the taxpayer's medications depended on doctor's prescriptions, the promotion strategy was to approach doctors and educate them on the medical benefits of these medications. The taxpayer sponsored senior doctors to medical conferences that featured the taxpayer's medications. Most of the conferences were held abroad and were organised by the taxpayer's related companies.

Upon returning from the conferences, the senior doctors were invited to comment on the taxpayer's medications at similar conferences organised by the taxpayer in Malaysia. The local conferences were attended by other doctors who were not sponsored to attend the medical conferences held abroad. At the conferences, the taxpayer's medical representatives interacted with the doctors and impressed upon the doctors the effectiveness of the taxpayer's medications. The doctors were given brochures and posters of the taxpayer's medications, which in turn were placed by the doctors in the clinics and hospitals. This strategy enabled the taxpayer to promote its medications to the doctors and to the public through the doctors.

In sponsoring the doctors to the conferences organised abroad and locally, the taxpayer incurred airfare and accommodation expenses. The taxpayer treated the said expenses as deductible expenses under s 33(1) of ITA. However, subsequent to a tax audit, the IRB treated the expenses as entertainment expenses and rejected them by virtue of s 39(1)(*l*) of ITA. The IRB was of the view that the taxpayer entertained the doctors by sponsoring them to the conferences. The taxpayer, on the other hand, argued that the expenses were incurred solely to promote its business and thus, were deductible expenses under s 33(1).

In advancing the taxpayer's case in *SM*, the authors raised the following four grounds to establish that the airfare and accommodation expenses were not entertainment expenses:

(a) promotion of business;
(b) increase in sales;
(c) prohibition from selling and advertising to the public; and
(d) inconsistent approach by the IRB.

(a) Promotion of business

In *Aspac Lubricants*, the Court of Appeal applied the following paragraph from the English Court of Appeal case of *Bentleys, Stokes & Lowless v Beeson*[7]:

> "Entertaining involves inevitably the characteristic of hospitality. Giving to charity or subscribing to a staff pension fund involves inevitably the object of benefaction: an undertaking to guarantee to a limited amount a national exhibition involves inevitably supporting that exhibition and the purposes for which it has been organised. But the

5 Rayuan No PKCP(R) 26/2008
6 The authors represented the taxpayer in the *SM* case.
7 [1952] 2 All ER 82

> question in all such cases is: Was the entertaining, the charitable subscription, the guarantee, undertaken solely for the purposes of business, that is, solely with the object of promoting the business or its profit–earning capacity?"

Following *Aspac Lubricants* and *Bentleys*, the question is whether the airfare and accommodation expenses were incurred by the taxpayer for the sole purpose of promoting the taxpayer's business. By sponsoring the doctors to the conferences and organising the local conferences, the taxpayer in *SM* successfully promoted and sold its medications.

During the trial, the taxpayer's marketing manager testified that the taxpayer did not intend to entertain the doctors by sponsoring them to the conferences. The taxpayer's experience has shown that upon participating in the conferences, the doctors prescribed the medications to their patients as the doctors appreciated the effectiveness of the taxpayer's medications. The prescriptions issued by the doctors inevitably increased the sale of the taxpayer's medications. According to the taxpayer, the doctors became the "ambassadors" of their medications, a finding endorsed by the Special Commissioners.

The taxpayer also established that the conferences were related to the medications sold by them and the doctors attending the conferences were in the field of medicine, which was related to the medications sold by the taxpayer. The exposure to the taxpayer's medications from the conferences held abroad resulted in the senior doctors playing an influential and meaningful role in facilitating the registration of the taxpayer's medications with the Drug Control Authority of the National Pharmaceutical Control Bureau. The registration enabled the taxpayer to sell its medications in Malaysia.

Further, the senior doctors were also instrumental in the listing of the taxpayer's medications with the Ministry of Health, Malaysia. The listing resulted in the Ministry purchasing huge volumes of the taxpayer's medications for the public hospitals in Malaysia.

(b) Increase in sales

Consequent to sponsoring the doctors and organising the conferences, the taxpayer saw a tremendous increase in the sale of its medications, especially between the years 2001 and 2007.

In 2001, the taxpayer's total sales were worth RM37,405,000. By 2007, this figure had risen to RM61,352,000. It is notable that the taxpayer's evidence that its sales had increased between 2001 and 2007 as a direct result of the promotion strategy was not challenged by the IRB during the trial.

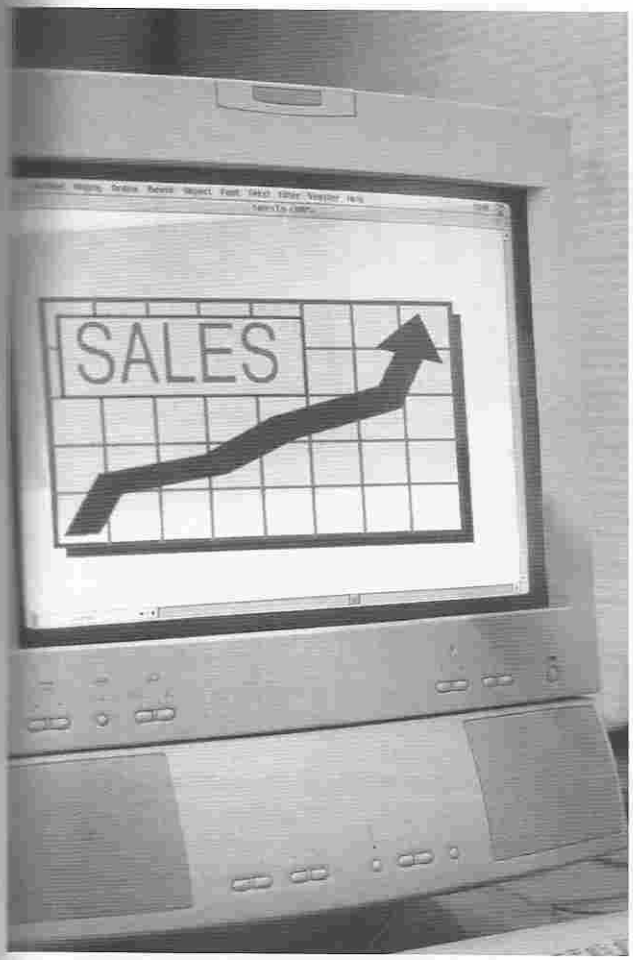
(c) Prohibition from selling and advertising to the public

The taxpayer adopted this promotion strategy as the law[8] prohibited the taxpayer from selling its medications to the public without a doctor's prescription. Further, the taxpayer was also prohibited from advertising its medications to the public[9]. However, despite operating in an environment where it cannot sell and advertise its medications to the public, the conferences enabled the taxpayer to indirectly reach the public through the doctors, who attended the conferences.

(d) Inconsistent approach by the IRB

The IRB has also been inconsistent in its approach as it had allowed the deduction of the registration fees incurred to register the doctors for the conferences but rejected the airfare and accommodation expenses. Likewise, the IRB had allowed the deduction of "hotel conference package" expenses, such as hall rental and meals. Further, in the past,

8 Section 18 of the Poisons Act 1952 [*Act 366*]
9 Section 3(1) of the Medicines (Advertisement and Sale) Act 1956 [*Act 290*]



the IRB had allowed the taxpayer to deduct the airfare and accommodation expenses incurred. There was no explanation from the IRB with regard to its inconsistent approach, although the nature of the conferences and expenses remained the same.

Conclusion

The grounds discussed above clearly illustrate that the taxpayer in *SM* incurred the airfare and accommodation expenses as part of its business promotion strategy. The conferences worked as an effective business strategy for the taxpayer to promote its medications, given the restrictions that it faced.

The doctors were not sponsored to the conferences because the taxpayer wanted to entertain or be hospitable to them, but for the sole purpose of promoting its medications. This strategy had increased the taxpayer's sales over the years as more and more doctors were prescribing its medications. It had also resulted in the Ministry of Health purchasing its medications in bulk. During the trial, the IRB was unable to challenge the nexus between the taxpayer's business promotion strategy and the increased sales. The decisions in *Aspac Lubricants* and *SM* illustrate that the provision of promotional items or sponsorships do not necessarily amount to entertainment.

Having said that, the authors wish to highlight that early this year, the High Court in another case held that the medical congress expenses incurred by a taxpayer were entertainment expenses[10]. Unfortunately, no further comments can be made at this stage as the written grounds of the High Court's decision have yet to be made available.

Nonetheless, in light of the High Court's decision, there is a compelling reason for taxpayers to provide sufficient evidence to convince the IRB (or the courts, as the case may be) that the provision of promotional items or sponsorships was for the purposes of business promotion strategy. Among others, the following documents and information may assist taxpayers in establishing this:

(a) The brochures circulated to the public help to indicate the taxpayer's intention in organising the promotion strategy;
(b) Internal discussion papers and business proposal papers highlighting the need for the provision of promotional items or sponsorship;
(c) Some details of the competition faced by the taxpayer from competitors and the promotion strategy adopted by the competitors;
(d) Photographs evidencing the success of the promotion strategy; eg the taxpayer in *SM* exhibited photographs to establish that the conferences were successful as the events attracted a large number of doctors; and
(e) Audited accounts to establish that the taxpayer's sales, turnover and profit had increased over the years as a direct result of the promotion strategy.

At the same time, the authors urge the IRB to examine the taxpayer's intention in providing promotional items or sponsoring customers or potential customers. The IRB should not adopt the blanket approach of categorising such expenses as entertainment expenses. For taxpayers, proper tax planning and documentations are vital to establish that the expenses incurred by them in providing promotional items or sponsorships were for the sole purpose of promoting their business. TG

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10 *Ketua Pengarah Hasil Dalam Negeri v ELM Sdn Bhd R1-14-02-09*

TECHNICAL UPDATES

These technical updates are summarised from selected Government Gazettes published between 19 February and 18 May 2010 and includes Public Rulings and guidelines issued by the Inland Revenue Board (IRB), the Malaysian Industrial Development Authority (MIDA) and other regulatory authorities during the same period.

Income tax relief on interest from housing loan
The IRB issued a media release on 9 April 2010 which clarified s the conditions under which a relief of up to RM10,000 per year (for 3 consecutive years) may be claimed in respect of interest on housing loan taken by a resident individual.

Income Tax (Exemption)(No.5)(Revocation) Order 2010 [P.U.(A) 72/2010]
The Order was recently gazetted to revoke Income Tax (Exemption) (No. 5) Order 1989 [P.U.(A) 295/1989] with effect from the year of assessment 2004.

The 1989 Order stipulates that 70% of the income remitted from a construction project outside Malaysia which commenced after 21 October 1988 by a Malaysian resident company is exempt from Malaysian income tax. The revocation of the 1989 Order is necessary due to the amendment to Paragraph 28, Schedule 6 of the Income Tax Act 1967 (as introduced by the Finance Act 2003) to exempt the income of any person, other than a resident company carrying on the business of banking, insurance or sea or air transport, derived from sources outside Malaysia and received in Malaysia with effect from the year of assessment 2004.

Income Tax (Industrial Building Allowance)(Building under Privatisation Project and Private Financing Initiatives) Rules 2010 [P.U.(A) 119/2010]
The Rules were recently gazetted and are effective from the year of assessment 2009.

The Rules provide that the following qualifying building expenditure incurred by a resident is eligible for Industrial Building Allowance of an initial allowance of 10% and annual allowance of 6%:-

- a building constructed under a privatisation project and private financing initiatives approved by the Privatisation/PFI Committee, Public Private Partnership Unit, Prime Minister's Department; and
- a building constructed pursuant to an agreement entered into between a resident person and the

Government of Malaysia or statutory body on a build–lease–maintain–transfer basis and for which no consideration will be paid by the Government of Malaysia or statutory body.

Stamp Duty (Exemption) Order 2010 [P.U.(A) 120/2010]

The Order is effective from 1 January 2010. It provides for stamp duty exemption on the instruments specified in the Schedule of the Order for the purchase of a flat under the Program Perumahan Rakyat Majlis Tindakan Ekonomi Negara and Perumahan Awam Dewan Bandaraya Kuala Lumpur executed from 1 January 2010 to 31 December 2011.

Fourth addendum to Public Ruling No.2/2004 on Benefits–in–Kind

The addendum provides clarification in relation to tax exemption on benefit of free petrol received by employees. A copy of the Public Ruling may be downloaded from the IRB's website, http://www.hasil.gov.my, under "Laws and Regulations – Public Rulings".

Public Ruling No.1/2010 on Withholding Tax on Section 4(f) Income

This Public Ruling was issued on 19 April 2010 and is effective from 1 January 2009. It provides clarification on various issues in relation to withholding tax on Section 4(f) income received by non–residents. A copy of the Public Ruling may be downloaded from the IRB's website, http://www.hasil.gov.my, under "Laws and Regulations – Public Rulings".

Guidelines for service tax on charge cards and credit cards

The Guidelines clarify various issues in relation to the imposition of service tax on charge cards and credit cards. The Guidelines also clarify that service tax will not be imposed on debit cards, petrol cards, closed community charge cards, loyalty cards and virtual money cards.

Guidelines on Real Property Gains Tax (RPGT)

With effect from 1 January 2010, the Real Property Gains Tax (Exemption) (No. 2) Order 2007 has been revoked. To enhance the quality of compliance, IRB has issued guidelines on 2 February 2010 to clarify RPGT issues in respect of acquisitions or disposals of chargeable assets made on or after 1 January 2010.

The guidelines are available on the IRB's website http://www.hasil.gov.my.

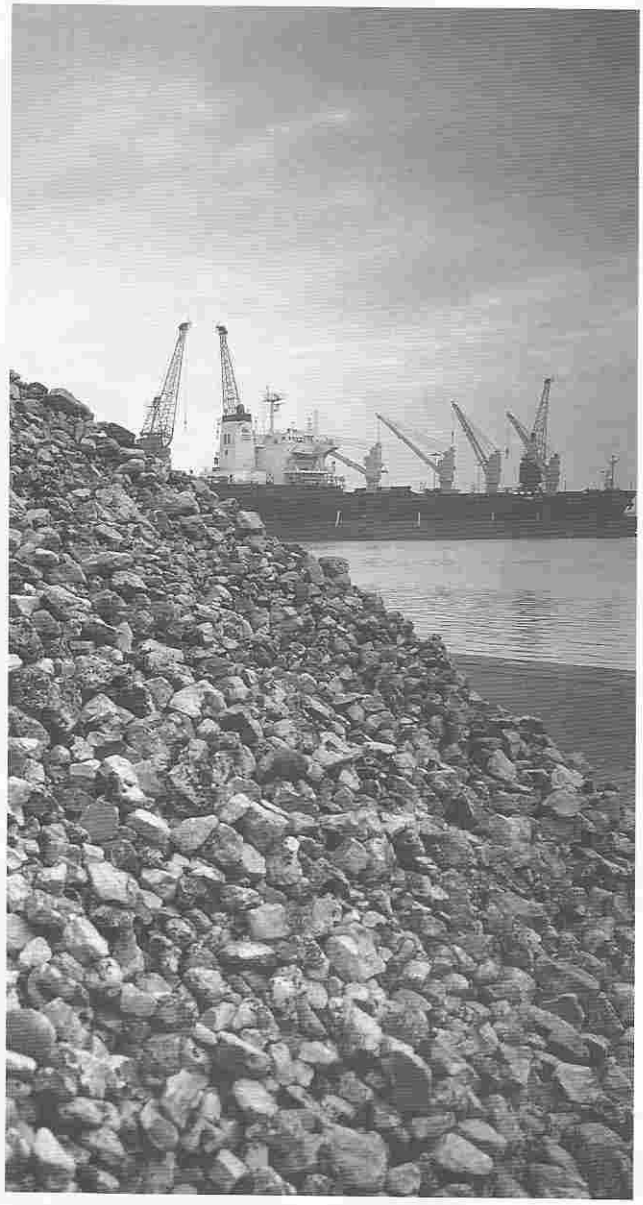
Guidelines in relation to income tax exemption on grants and subsidies received and income of statutory bodies

The IRB has issued the above guidelines on 26 January 2010 to explain the income tax exemption on grants and subsidies received from the Federal or State Government as well as the income of a statutory body pursuant to Income Tax (Exemption) (No.4) Order 2003 [P.U.(A) 33/2003] and Income Tax (Exemption) (No.22) Order 2006 [P.U.(A) 207/2006].

The guidelines are available on the IRB's website http://www.hasil.gov.my.

Case Commentaries

By Francis LK Tan and Cheh Keng Soon



LFC Sdn Bhd v KPHDN
Appeal No. 54 of 2007
(2009) MSTC 3917

The appellant is in the business of provision of public transport service via sea route for passengers, vehicles and vehicles with cargo between Labuan Jetty and Menumbuk Jetty in Sabah. The appellant leased three vessels belonging to the Sabah State Government to provide its service.

The appellant sought exemption from income tax under s 54A of the Income Tax Act (ITA) on the basis that the vessels used by the appellant were "Malaysian ships" within the meaning of s 54A.

Generally, s 54A of the ITA talks about the exemption of shipping profits.

Section 54A defined "Malaysian ship" as a see-going ship registered as such under the Merchant Shipping Ordinance 1952 (the Ordinance), other than ferry, barge, tug-boat, supply vessel, crew boat, lighter, dredger, fishing boat or other similar vessel. In this case, the vessels were not registered under the Ordinance as they belonged to the Sabah State Government.

The issue for determination in this instance was whether the vessels used by the appellant falls within the meaning of "Malaysian ship" under s 54A although the vessels were not registered under the Ordinance.

The Special Commissioners of Income Tax (SCIT) held in favour of the appellant by adopting purposive approach in interpreting the said provision and determined that the purpose of s 54A is to provide exemption for shipping profits arising from the operation of Malaysian ships. Although the vessels were not registered under the Ordinance, the appellant had been using the vessels for public transport service via sea route for passengers, vehicles and vehicles with cargo between Labuan jetty and Merubuk Jetty in Sabah, therefore such vessels can be considered as "sea going" and falls within the meaning of s 54A.

Further, the SCIT held that although the vessels were not registered under the Ordinance, they were still Malaysian ships as they belonged to the Sabah State Government.

The principle of law that a purposive approach in the interpretation of law, including tax law, is laid down by the Federal Court in the case of Palm Oil Research and Development Board v Premium Vegetable Oils Sdn Bhd [2005] MLJ 97.

SE Sdn Bhd v KPHDN
Appeal No. PKCP (R) 33 of 2004
(2009) MSTC 3912

The appellant is in the business of property development and investment. The appellant has been granted the absolute right to construct a mixed development project comprising apartments, a shopping complex and a hotel. The apartments were sold to individual buyers but the shopping complex was held as an investment for rental purposes.

The appellant later sold the right to construct a hotel above the air space over the shopping complex to its wholly owned subsidiary.

The purpose of the appellant for selling such right was to apply for an exemption pursuant to para 17(1)(a), Sch 2 of the Real Property Gains Tax Act 1976 (RPGT) and for the special investment allowance under the Promotion of Investment Act 1986 (PIA).

The Inland Revenue Board of Malaysia (IRB) contended that the appellant's disposal of right was disposal of the appellant's stock-in-trade thus the receipts were taxable under s 24(2) of the ITA.

However, the appellant argued that the receipts from the disposal were capital in nature hence it would be taxable under RPGT not ITA.

The issue for determination by SCIT was whether such right to construct the hotel formed part of the appellant's stock-in-trade and the gain from the sale are taxable under s 24(2) of the ITA or it is a capital gain taxable under RPGT.

The SCIT held in favour of the appellant that the shopping complex and the proposed hotel project were investments of the appellant for the purpose of deriving rental income and therefore it should form part of the appellant's fixed asset. Any gain derived from the disposal of fixed asset should be taxed under RPGT.

XT Club Pte Ltd v Comptroller of Income Tax Singapore
Appeal Nos. 5 to 10 of 2005
(2009) MSTC 5741

The appellant is in the business of building and operating the XT Club as a proprietary club which consist of various facilities including restaurant, spa, swimming pools and etc. One interesting point in this case was whether the geomancy fees or commonly known as "feng shui" fees for the advice on the construction of club and facilities were deductible expenses.

It was contended by the appellant that the cost of obtaining advice on "feng shui" is revenue in nature as good "feng shui" might lead to better business and therefore is an expense wholly and exclusively incurred for the purpose of generating income.

Income Tax Board of Review of Singapore (ITBRS) held that such "feng shui" fees were capital in nature and not deductible as expenses. ITBRS ruled that the expenses related to "feng shui" advice on the construction of XT Club and facilities, all of which constituted fixed assets and were of a capital nature and therefore the expenses so incurred would also be of a capital nature being a one-off expense. The ruling of the ITBRS is tantamount to saying that "feng shui" is an asset or an advantage for the enduring benefit of a trade. See **Atherton v British Insulated and Helsby Cables** (1925) 10 TC 155. TG

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International News

By Rachel Saw

The column only covers selected developments from countries identified by the CTIM and relates to the period 11 February 2010 to 1 May 2010.

China (People's Republic)

Tax treatment of representative offices (ROs)
The State Administration of Taxation (SAT) issued a Notice on the tax treatment of ROs of foreign enterprises on 20 February 2010 (Guo Shui Fa [2010] No. 18), which retroactively applies from 1 January 2010.

Tax liability
The Notice states that foreign ROs are subject to enterprise income tax, business tax and value added tax (VAT) according to the relevant laws and regulations.

Tax registration
After obtaining a business licence, a RO is required to register with the local tax office within 30 days and submit documents such as the business licence or permit, code of organisation certificate, proof of registration of business address, copy of chief representative's passport, etc. The tax office must be informed on any alteration or liquidation of the RO.

Accounting records
A RO is required to maintain (i) accounting records in accordance with relevant accounting laws and regulations; (ii) calculate the income subject to tax and taxable income by reference to its functions and risks borne; and (iii) file the income tax, business tax returns on a quarterly basis and returns of VAT within the statutory time limit.

Assessments by tax authority
Where the RO is unable to calculate the accurate income, costs and expenses due to incomplete accounting records, the tax authority is authorised to determine the taxable income by using one of the following two methods:

(a) Cost-plus method: *Income = expenses of the current period / [1 – (deemed profit rate + business tax rate)]*
The enterprise income tax amount = gross income x deemed profit rate x rate of enterprise income tax
The expenses is taken in account in determining the income include wages and salaries, rents, general administrative expenses, purchases of fixed assets, tendering and moving costs. Interest income may not be set off against the aforementioned expenses. Additionally, monetary donations to charities and aid organisations, late payment fees, fines and payments for the head office, which are not part of the business expenses of the RO, are not regarded as expenses in determining the taxable income.
(b) Total income method: *The enterprise income tax amount = gross income x deemed profit rate x rate of enterprise* income tax.

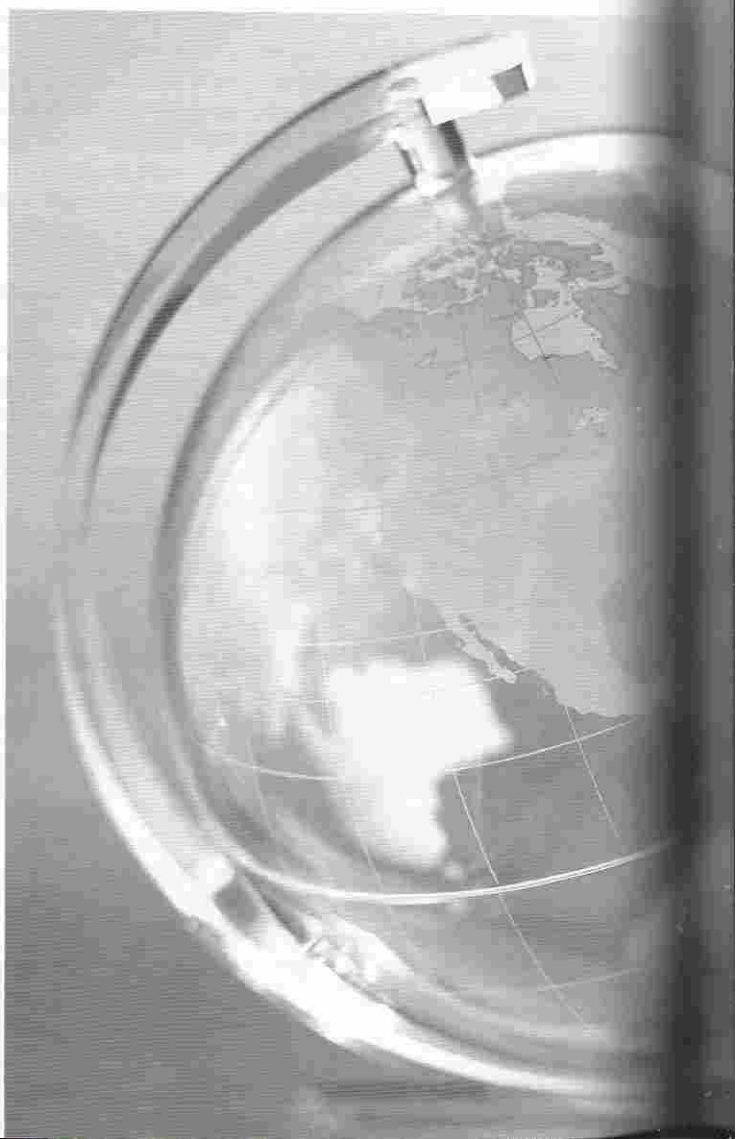
Deemed profit rate
For both methods, the deemed profit rate may not less than 15%.

Treaty benefits
A RO may apply for tax treaty benefits in accordance with the provisions of an applicable tax treaty and the Notice (Guo Shui Fa [2009] No.124.

Taxation of non-resident enterprises on deemed profit basis
The SAT issued a Notice on the tax treatment of non-resident enterprises on the deemed profit basis on 20 February 2010 (Guo Shui Fa [2010] No. 19). The notice applies with immediate effect.

Scope of application
The Notice applies to non–resident enterprises referred in Art 3 Para 2 of the Enterprise Income Tax (EIT) Law, and the representative offices of foreign enterprises.

Accounting records
Non–resident enterprises are required to (i) set–up and maintain accounting records in accordance with the



relevant laws and regulations; (ii) calculate the taxable income based on the functions and risks borne; and (iii) file the EIT return.

Taxation on a deemed profit basis
Where the accounting records are incomplete and there is insufficient information to carry out a tax audit, or where there is an inability to calculate taxable income accurately, the tax authority is authorised to determine the taxable income on a deemed profit basis by using the following methods:

(a) Total income method. This method applies where the non–resident enterprises can calculate the total income correctly, but are unable to determine the costs and expenses. The formula of the calculation is: taxable income = total income x the approved deemed profit rate.
(b) Cost–plus method. This method applies where the non–resident enterprises can calculate the costs correctly, but are unable to calculate the total income. The formula of the calculation is: taxable income = total amount of costs / (1 – the approved deemed profit rate) x the approved deemed profit rate.
(c) Expenses–plus method. This method applies where the non–resident enterprises can calculate the total amount of the operating expenses correctly, but are unable to accurately calculate the total income and costs. The formula of the calculation is: taxable income = total amount of expenses / (1– [approved deemed profit rate + business tax rate]) x the approved deemed profit rate.

Standard deemed profit rates
The deemed profits rates are determined by the tax authorities at standard rates are as follows:

–	15% – 30% for the construction, design and consultancy sectors;
–	30% – 50% for management services; and
–	more than 15% for other labour services or other business activities.

The tax authority is authorised to adopt rates higher than those above, where it deems appropriate.
Deemed fees on services pertaining to sale contracts
Where fees are not specified, or the fees for services provided are unreasonable, in a sale contract between a non–resident enterprise and a resident enterprise for supplying machinery or goods (and services such as installation, assembling, technical training, technical instructions and supervision are provided) the tax authority is authorised to deem the service income by reference to prices in same or similar businesses. If there is no reference available, at least 10% of the total contract value must be taken as income of the non–resident enterprise.

Proportion of income on services provided within and outside China
Income on services provided by a non–resident enterprise to its Chinese client in China must be apportioned according to the place where the services are provided, if the services are provided both within and outside China, and report the portion of income attributable to China. Documents to justify the apportionment may be requested and if not produced, it will be assumed that all the services are provided within China.

Separating income subject to different deemed profit rates
If a non–resident enterprise derives income subject to different deemed profit rates, it has to calculate the income separately for the income tax purposes. Otherwise, the highest standard deemed profit rate will apply to the entire income.

Order on administration of foreign invested partnership enters into force
On 1 March 2010, the Order (Ling of the State Council No. 567) issued on 25 November 2009, on the administration of foreign invested partnership came into force. The Order, is a supplementary rule based on the Law of Partnership and introduced, in addition to Chinese–foreign equity joint venture, Chinese–foreign cooperative joint venture and wholly foreign–owned enterprise.

Enterprise income tax – issues re income recognition, tax base: clarified
The SAT issued a ruling on 22 February 2010 clarifying several issues related to enterprise income tax (Guo Shui Han [2010] No. 79).

Recognition of rental income
Rental income derived by an enterprise from the leasing of

fixed assets, packing materials and other tangibles must be recognised on the date of the rental payment as specified in the contract or agreement. If a rental contract or agreement runs over a calendar year and a one–off payment for the rental has been made in advance, the recognised rental income may be attributed in accordance with accounting standards. An establishment of a foreign enterprise which reports income on an actual profit basis is to attribute the income in the same manner.

Recognition of income from debt restructuring
In case of debt restructuring, the income must be recognised when the contracts or agreements on debt restructuring come into force.

Recognition and calculation of gains on equity transfer
Gains on equity transfer must be recognised at the moment that the contract of transfer becomes effective and the transfer of the ownership of equity is completed. The gain is the income received less the costs of acquiring the equity. In arriving at the gains on transfer, the retained earnings attributed to the shares transferred may not be deducted.
Recognition of dividends, profits and other investment income
Investment income such as dividends and profits must be recognised on the date that the general meeting of shareholders decides to distribute dividends or profits. Share premiums converted into capital are not considered as dividends or profits and do not increase the tax base of shareholder's investment.

Tax base of fixed assets after putting into use
In cases where a fixed asset is put into use while the invoice for the construction or installation has not been settled and received, the depreciation of the fixed asset (i) may be based on the amount agreed in the contract and (ii) may be adjusted, if necessary, after the invoice has been received. However, the adjustment must take place within 12 months of putting of the asset into use.

Treatment of pre–incorporation expenses
The year in which an enterprise starts production or business operation counts as the financial year for profits and losses. The expenses incurred in the set–up period are not considered as losses in the current period, but must be either deducted in the first year of the production or business operation or brought forward into account and amortised over the coming years.

Treatment of entertainment expenses of investment companies
Subject to the statutory limit, the enterprises engaged in equity investment (including group holding companies and venture capitals) may deduct entertainment expenses from received dividends, profits and capital gains on share transfer.

Hong Kong

Budget for 2010/11

The Budget for 2010/11 was presented by the Financial Secretary on 24 February 2010 and, unless otherwise indicated will apply from 1 April 2010.

Direct taxation
(a) Corporate tax

–	accelerated 100% tax deduction for capital expenditure on environmentally–friendly vehicles;
–	extension of tax deduction for capital expenditure to include registered trademarks, copyrights and registered designs;
–	extension of concessionary profit tax rate at 50% of the normal rate applicable to interest income and profits derived from qualifying debt instruments, to include those with a maturity period of less than three years, and relaxing of requirements that such debt instruments be issued to the public in Hong Kong; and
–	extension of tax exemption to offshore funds engaged in futures trading.

(b) Individual tax
A one–off reduction of 75% of the 2009/10 final tax liability in respect of salaries tax, and tax under personal assessment, is proposed. The reduction is subject to a ceiling of HKD 6,000.

Indirect taxation
(a) Stamp duty

–	increase in the stamp duty rate on transactions of properties valued over HKD 20 million from 3.75% to 4.25%. Buyers will no longer be allowed to defer stamp duty payment on such transactions; and
–	extension of the stamp duty concession in the trading of exchange traded funds to cover funds that track indices comprising not more than 40% of Hong Kong stocks.

(b) Other taxes

–	waiver of property rates for 2010/11, subject to a ceiling of HKD 1,500 per quarter for each rateable tenement; and
–	waiver of business registration fees for one year.

HKIRD issues revised DIPN 21 – Locality of Profits: details

The revised DIPN2 takes account recent significant court decisions on the Locality of Profits, and states what the HKIRD considers to be the general principles laid down by the Privy Council and the Court of Final Appeal. Specific examples are also provided.

Broad guiding principle
In determining the locality of profits under Hong Kong's territorial system, the broad guiding principle remains as "one looks to see what the taxpayer has done to earn the profit in question and where he has done it".

Antecedent and incidental activities
The focus is on establishing the geographical location of the taxpayer's profit–producing transactions as distinct from activities antecedent or incidental to those transactions.

Trading profits
Although the locations where the contracts of purchase and sale are effected are still important factors, the HKIRD will

take into account all the relevant operations carried out to earn profits, including the "solicitation of orders, negotiation, conclusion, trade financing, shipment and performance of the contracts" in determining the locality of profits.

Re–invoicing centre
The earlier version contained a so–called "safe–harbour rule" whereby a re–invoicing centre that undertook only invoicing, operation of bank accounts, payment and collection functions in Hong Kong generally would not be subject to tax.

This "safe–harbour rule" is now withdrawn and the HKIRD will examine the nature of the operations and the types of risks in question to determine whether they constitute the provision of services or trading. Profits derived from services will be taxable if they are rendered in Hong Kong, while the source of trading profits will depend on the locality of the trading operations.

Buying office
The revised DIPN 21 provides for the treatment of a branch, subsidiary or agent of a trading company, carrying on business outside Hong Kong, which acts as a buying office for the purpose of purchasing goods or merchandise, or collecting information. As long as they are not involved in the sale of goods in or outside Hong Kong, they will not be taxable. However, any commission or other remuneration earned for the services rendered in Hong Kong are fully taxable.

Contract processing and import processing
The revised DIPN 21 clearly distinguishes between contract processing and import processing arrangements for the purposes of their entitlement to a 50:50 apportionment. The HKIRD restricts 50:50 apportionment to situations where the underlying arrangement is a contract processing arrangement, while profits derived from import processing arrangements are treated as trading profits and subject to normal sourcing rules.

Other profits

(a) Purchase and sale of listed shares/securities. The revised DIPN 21 adds that where the purchase and sale of the shares/securities took place over–the–counter, the place where the contracts of purchase and sale are effected determines the locality of profits.
(b) Royalties. In the earlier version, the basis for determining the locality of royalties was the same as that for trading profits. The revised DIPN 21 specifically states the place of acquisition and granting of the license or right of use as determining factors.

Apportionment of profits
The revised DIPN 21 maintains that manufacturing profits and service fee income may be apportioned if appropriate, but not trading profits. However, the HKIRD has removed its earlier view that a 50:50 apportionment of profits would be adopted in the vast majority cases. In contract processing cases, the 50:50 apportionments will be applied as the norm, while for other cases the revised DIPN 21 states that the HKIRD "will consider any rational basis put forward by the taxpayer concerned".

Sales or purchase commission
Under the revised DIPN 21, if an agent performs substantial business activities in Hong Kong for and on behalf of principal incorporated overseas, in particular in a no– or low–tax jurisdiction, the HKIRD will scrutinise the case more thoroughly to determine whether the principal has any profits tax liability.

Processing of offshore claims
The revised DIPN 21 adds a new section whereby the HKIRD has the authority to make enquiries and seek full information under s 51(4) of the IRO in respect of a taxpayer's offshore source claim. A request for detailed information about the "operations" of a transaction in an enquiry would constitute a reasonable demand as required by public interests.

India

Budget for 2010/11

The Budget for 2010/11 was presented by the Government on 26 February 2010. The tax proposals are to take effect when ratified by the Parliament. The main proposals are highlighted below:

(a) Direct Tax

–	The corporate income tax rates remain unchanged;
–	The income tax brackets for individuals have been narrowed from, INR160,000 – INR500,000 to INR160,000 – INR300,000, and INR500,000 – INR800,000 to INR300,000 – INR500,000. With the top band reduced to INR500,000.
–	Deduction of an additional amount of INR 20,000 are allowed, over and above the existing limit of INR 100,000 on tax savings, for investment in long–term infrastructure bonds as notified by the Government;
–	Contributions to the Central Government Health Scheme are allowed as deduction from taxable income for individuals;
–	Surcharge on domestic companies is reduced to 7.5% from 10%;
–	Rate of Minimum Alternate Tax (MAT) is increased from 15% to 18% of book profits;
–	Limits for turnover, above which accounts need to be audited, are enhanced to INR 6 million for businesses and to INR 1.5 million for professions;
–	Limit of turnover for the purpose of presumptive taxation of small businesses is enhanced to INR 6 million;
–	Interest charged on tax deducted, but not deposited by the specified date, is increased from 12% to 18% per annum; and
–	To facilitate the conversion of small companies into Limited Liability Partnerships, transfer of assets as a result of such conversion is not subject to capital gains tax.

(b) Indirect tax

–	The standard excise duty rate on all non–petroleum products is enhanced from 8% to 10% ad valorem;

–	The ad valorem component of excise duty on large cars, MPVs and SUVs is increased to 22%;
–	Full exemption from customs duty on refrigeration units required for the manufacture of refrigerated vans or trucks; and
–	Rate of service tax is retained at 10% to pave the way forward for Goods and Services Tax (GST)

Indonesia

VAT– zero–rated services

Under regulation 70/PMK.03/2010 of 31 March 2010, the following export services are zero–rated for VAT purposes:

–	toll manufacturing services under certain conditions;
–	repair and maintenance services that are related to services or movable goods utilised outside the Indonesian customs area; and
–	construction services (consultation on construction planning, construction work, and supervision) that are related to services or immovable goods located outside the Indonesian customs area.

Deductibility of promotional expenses – retroactive guidance

The Minister of Finance issued regulation 2/PMK.03/2010 and circular letter SE–9/PJ/2010 dated 1 February 2010, on the deductibility of promotional expenses. The rules apply retroactively from 1 January 2009.

Pursuant to the rules, all taxpayers can deduct promotional expenses such as advertising expenses, product exhibition costs, costs incurred to introduce a new product, and sponsorship expenses related to the promotion of a product. In the case of samples, the production costs of the sample are deductible provided the cost was not included in the calculation of costs of goods sold.

Non–deductible promotional expenses are (i) compensation provided in the form of money and/or facilities to another party that is not directly related to the promotional activities; and (ii) promotional expenses incurred in the course of earning, collecting and maintaining income that is exempt or that has been subjected to final tax.

Qatar

Foreign Capital Investment Law – amended to relax restrictions on foreign ownership

Law No. 13 of 2000 concerning Organisation of Foreign Capital Investment in the Economic Activity has been amended by way of Law No. 1 of 2010 dated 1 February 2010 to extend the list of sectors where 100% foreign ownership may be allowed.

Foreign investors may invest in all economic sectors (subject to a few exceptions, see below) provided that they have one or more Qatari partners who own at least 51% of the capital. Thus, foreign ownership may not, in principle, exceed 49%. As a result of the relaxation, the Minister of Business and Trade may permit, by a ministerial resolution, foreign ownership to exceed the 49% limit (and be as high as 100%), in the following sectors (i) agriculture; (ii) industry; (iii) health; (iv) education; (v) tourism; (vi) development and exploitation of natural resources, energy and mining; (vii) consultancy and technical services; (viii) Information Technology (IT) services; (ix) services related to sports, culture and entertainment; and (x) distribution services.

Banking, insurance, commercial agencies and trading in real estate are still prohibited to foreign investors.

Singapore

Budget for 2010

The Budget for 2010 was presented to the Parliament by the Finance Minister on 22 February 2010 and its key points are summarized below:

Corporate taxation

–	The Industrial Building Allowance (IBA) will no longer be allowed on capital expenditure on the construction or purchase of industrial buildings or structures which are incurred after 22 February 2010, except in specified scenarios.
–	Ship management fees derived on or after 22 February 2010 from the rendering of ship management services to related qualifying special purpose vehicles (SPVs) will be treated as exempt income, subject to conditions.
–	The 250% tax deduction on donations made to Institutions of Public Character (IPCs) and other approved recipients will be extended to include donations made during 1 January 2010 to 31 December 2010.

Tax incentives

–	Beginning 1 July 2010, a Land Intensification Allowance will be available on qualifying capital expenditure incurred for the construction of a qualifying building or structure.
–	A Productivity and Innovation Credit (PIC) will be available from YA 2011 to YA 2015, at 250% for the first SGD 300,000 of qualifying expenditure per YA for investments in (i) research and development (R&D) done in Singapore; (ii) registration of Intellectual Property (IP); (iii) acquisition of IP; (iv) eligible design done in Singapore; (v) automation equipment or software; and (vi) training. The balance of the expenditure will be eligible for a 150% in the case of R&D, and 100% for the other activities. In addition, businesses which have at least 3 local employees can convert up to SGD 300,000 of the tax benefits into a maximum of SGD 21,000 cash per YA.
–	A new Merger and Acquisition (M&A) allowance will be granted to qualifying M&As executed from 1 April 2010 to 31 March 2015. The allowance is given at 5% of the value of the acquisition, subject to a cap of SGD 5 million per YA, which is written down equally over 5 years. Stamp duty on the transfer of unlisted shares for qualifying M&A deals will also be remitted, subject to a cap of SGD 200,000 per year.

–	Approved angel investors that make qualifying investments from 1 March 2010 to 31 March 2015 and who invest a minimum of SGD 100,000 into a start–up in a YA can enjoy a tax deduction at 50% of their investment at the end of the second year of holding of the investment. The deduction is capped at SGD 500,000 per YA.
–	For the period 1 April 2010 to 31 March 2015, companies carrying out solely ship broking and/or forward freight agreement traders in Singapore are eligible for a concessionary tax rate of 10% for a period of 5 years, subject to conditions.
–	The Development and Expansion Incentive (DEI) scheme will be extended to cover income from the provision of international legal services by law practices registered in Singapore as a company or a branch. Under the incentive, approved law practices will enjoy a 10% concessionary tax rate on incremental income from qualifying international legal services for 5 years beginning from 1 April 2010 to 31 March 2015.
–	Enhancements are also made to other existing incentives such as the Financial Sector Incentive (FSI) scheme, real estate investment trusts, offshore insurance businesses and the Maritime Finance Incentive.
–	The following incentives are discontinued: (i) the tax incentives for futures members of the Singapore Exchange (SGX) and Singapore Commodity Exchange Limited (SICOM) will cease to apply from 1 January 2011 onwards; and (ii) the Approved Start–up Fund Manager scheme ceased on 17 February 2010.

GST

–	Beginning 1 July 2010, zero–rating is extended to include pleasure and recreational ships, goods supplied for use on board or installation on a qualifying ship or aircraft and the transport of goods or passengers via a ship to or from international waters. The IRAS issued an e–Tax Guide on 1 April 2010, which provides further details.
–	Beginning 1 October 2010, a new scheme will be introduced to allow approved GST–registered businesses to defer import GST that is payable on their goods at the point of entry into Singapore for at least one month.

Property tax

A progressive property tax will apply to owner–occupied residential properties from January 2011, as follows:

–	0% for the first SGD 6000 of the annual value;
–	4% for the next SGD 59,000 of the annual value; and
–	6% for the balance of the annual value in excess of SGD 65,000.

Thailand

Supreme Court – Marketing fee paid pursuant to international franchise agreement constitutes "royalty"

The Supreme Court recently issued a judgment that the marketing fee paid by a Thai franchisee would be subject to Thai withholding tax as the fee constituted royalty income. In a typical international franchise scheme, the foreign franchisor would charge the Thai franchisee a franchise fee, which typically consists of a royalty for the intellectual property and a marketing fee. It is common practice for the franchisor to ensure that any marketing activity undertaken by the franchisee is in line with the franchise's international standards, and for the marketing fee to be computed based on net sales.

From a tax perspective, there remains no question that the franchise fee is categorised as royalty income, which would be subject to Thai withholding tax at the rate of 15% under Sec. 70 of the Revenue Code. However, the marketing fee incurred by the Thai franchisee via payments made to Thai advertising companies had largely gone unnoticed for Thai withholding tax purposes.

The Supreme Court has now held that marketing fees paid in Thailand to Thai advertising firms would be subject to 15% Thai withholding tax as royalty, as if it had been paid to the foreign franchisor. The Court based the judgment on the following:

–	the fee is deemed to be the additional income of the franchisor, as it directly, or indirectly, benefits the brand as well as the trademark of the franchisor;
–	the franchisor effectively has control over the advertising activities; and
–	this fee is calculated in a similar manner to franchise fee, ie. based on sales.

It appears that the court has ruled in this manner so as to prevent tax planning by a foreign company (which was not carrying on any business in Thailand) from avoiding withholding tax under s 70 of the Revenue Code. This judgment is expected to have a huge impact on audits carried out by revenue officers with revenue officers raising more assessments on the franchisee in Thailand for past payments.

Malaysia – treaty developments

- **The following income tax treaties (and protocols) were signed**
  - Senegal and Malaysia on 17 February 2010
  - Germany and Malaysia on 23 February 2010
  - Brunei and Malaysia
- **The following amending protocols to existing tax treaties were signed**
  - Kuwait and Malaysia on 25 January 2010
  - Japan and Malaysia on 10 February 2010
  - Australia and Malaysia on 24 February 2010
  - Turkey and Malaysia on 17 February 2010 TG

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Deciding Factors for Tax Talent

By Ronnie Lim

What do you disclose when you seek to impress a prospective employer? The vast majority of talented people I have met have sought to impress me in their curriculum vitae and at interviews by highlighting their tax advisory or compliance experience. At times, with a little probing, I have found such experience to be shallow. If technical ability extends to the provision of solutions, then I begin to get excited.

I consider that talent should focus more on the outcomes their enabling skills have produced, rather than the skills themselves. Thus, for example, revenue generated may be cited together with the innovative solutions involved.

If entrepreneurial skills are present, then selling results may be emphasised. Similarly talent with good networking and relationships can state that fact and reveal the outcomes produced.

Talent with leadership skills are sought after people. Leadership roles and styles with an emphasis on past achievements as leader should be communicated, remembering that diagnostic tools are easily available to verify leadership styles.

Other valuable information would include efficiencies which have been devised and implemented and the results produced. Talent gained and coached with resultant capabilities built would also be of interest.

More mature talent may refer to their eminence and activities in that realm as well as the results thereof. Their vision for the organisation they seek to be part of and their goals for themselves would be no doubt pertinent. This may be, for example, to contribute to the prospective organisation becoming the clear leader in Malaysia. Such a stance would obviously be visionary.

Some talent have a real passion for tax. They live and breathe tax. Some self-invest in expensive publications or conferences or devote hours of their personal time to tax. Passion for tax is noteworthy but once again it is the results generated which count. I know of some people who acquire expensive tax publications but their performance is mediocre.

What about technical knowledge and experience? Technical competence should be a given. It is certainly an asset to be technically superlative. Such skills are excellent at universities and colleges particularly if accompanied by a passion for nurturing people plus competence in communication. Within the context of a tax practice or department, I have met tax gurus who are loners at events. There are also people who are unable to apply their vast knowledge and experience in the creation of solutions. Technical knowledge and experience must create outcomes and thus, I suggest that the focus should be on that ultimate stage. Preparedness in this regard would assist talent respond

to questions arising from competency-based interview techniques which some organisations adopt.

An interview should be an opportunity for a two–way open communication. It is a getting to know you and more about you session and should be treated as such. In this connection, a colleague of mine once met a prospective employer and received an offer articulated on a take it or leave it basis. Being the person he was, and still is, to the astonishment of the interviewer, my colleague walked away. There was no two–way communication. It was a pure top–down approach. He later joined a smaller organisation which offered a far more open and communicative environment. Organisations controlled by people who lead in a dictatorial style are still present today. Talent should be aware of such organisations and try to ascertain their character, whether through intelligence or at an interview or both.

Have you heard of the dictatorial CEO who wanted to vividly demonstrate to his people that he had an open door policy? One day he took an axe and before his staff, destroyed the door to his room. He then declared, "I practice an open door policy – look, no door! Anyone is welcome to come and meet me." After some time, it was noticed that no one had taken advantage of his offer. They saw the absence of the door but they all still feared the axe.

I am amazed that very few whom I have met seek to know more of the vision and culture of the prospective organisation. It may be that through superior intelligence, such information has already been gained. On the other hand, it would be that talent relies more on the brand than the culture behind the brand. In recent years, several Malaysian tax and accountancy firms have sought to re–brand or associate with western brand names. In many cases, culture is not altered by the brand. I thus suggest that more attention should be paid to the culture of organisations to ascertain whether they suit the prospective entrant.

Whilst the short term considerations like salary, leave and medical benefits are pertinent, I suggest that the longer term issues are of greater importance. Issues like the vision and growth rate of an organisation are vital. A high growth environment generally affords more opportunity for advancement. Conversely, where growth is low, the opportunity to become a tax manager or partner may not arise until a resignation or retirement takes place. Talent should seek environments where they may attain tax

partnership or the equivalent within 10 to 13 years from the point of a fresh graduate entry. A firm of opportunity is an attractive place to be in.

The criterion for advancement adopted by the organisation should be ascertained. Is meritocracy strictly adopted? Are there other criteria and, if so, why? Someone I met recently told me of how he could see, soon after joining an organisation, that promotion was based on being well connected to the right people rather than on performance and merit. If that is the case, would you want to be part of that organisation?

Another factor worth considering, with due respect to colleagues in legal, boutique tax and commercial firms, is the key performance indicator, scale of tax to audit revenues. Audit is the substantial service of most accountancy practices, thus making scale of tax to audit a global KPI. There is nothing to get excited over if the scale is about 30%. When the scale reaches 60% that would be more in line with global norms. The real excitement arises when scales exceeding 100% are identified – these tax practices are worth considering. They tend to have an entrepreneurial profile.

Some organisations operate and nurture very competitive work environments and achieve results through open competition. For example, if a manager there, Ruby, perceives that another manager, Nadia, is superior to her in one way or another, Ruby, will immediately begin to strategise how she can surpass Nadia and implement her strategy. On the other hand, other organisations foster a more collaborative and caring culture marked by coaching, teaming and common pursuits, rather than self–help. Both competition and collaboration are qualities which may be evident in varying degrees within organisations and talent has the opportunity to select the environment they prefer.

Some organisations invariably charge significantly less for tax services and thereby aim to win more projects. They then try to be more efficient on the single highest cost in any tax practice, staff costs. It is well known that the tax profession demands more time than the official hours. Several speak of 20% extra time being a norm. However, some organisations require far more and are pressure cookers of overtime work each evening and over weekends. There are people who appreciate such environments because they can then gain more knowledge and experience over a limited period of time while others do not view such environments as sustainable.

How much does an organisation spend on learning? How rigorous are their training programmes? Are they conducted on the orthodox and staid classroom fashion or is learning spiced with innovation and fun? How well have their learning programmes been rated by their learning faculties? Can learning be flexibly carried out according to one's own schedule? Recognising the importance of learning, here is another factor in organisations which talent should consider.

Some firms are very much family controlled or adopt a family environment. At the other extreme, other organisations are centrally controlled globally and local partners merely carry out the dictates of the global leader. In such situations, it is often a case of one size fits all irrespective of geography as opposed to the far more personal touch of a family environment. In between these two extremes, some organisations have developed regional clusters which enable the creation of certain efficiencies like the sharing of an expensive resource. Whatever the structure adopted, culture–wise some firms adopt a consultative approach to management thus making any change a slower process but one with more united support. Talent should consider the type of culture they prefer in this respect.

A valid issue which may be raised at an interview is how employee–friendly the organisation is. Does the managing director have time for talent? Does he mix and converse with his people? Are there special work hours for mothers or is it a case of one size fits all? Does the organisations have space for those who are competent but do not wish to climb the ladder? Do the tax leaders court talent to join the organisation in the same way as they do with potential clients – dining, Power Point slides and the like? Where there is a difference of opinion, does the superior invariably prevail? I recall an occasion when a staff member was most upset over a charge levied on her and others. She issued a strongly worded email to several people. What was the reaction of management? Management complimented her on her action and encouraged her to continue to appropriately voice objection wherever there was any perceived wrong or shortcoming. Is that the kind organisation you would like to be part of?

Opting for a position in the tax department of a commercial company is another avenue available. In this connection, some MNCs are currently using Malaysia as their shared service centre for tax compliance for Australia, USA, Singapore, etc and thus providing foreign tax exposure. I will always remember what the tax head of a well–known foreign company told me. He said, "The engineers call the shots in my company. They are the important people and we in tax are mere cost centers." I believe that there is much truth in his candid statement and talent joining commercial organisations must be prepared to accept that there will only be one tax director, if there is one at all. In contrast, flourishing tax practices need a larger number of tax partners in line with growth.

I encourage more open communication at job interviews and better preparedness plus a focus on aspects of greater importance. Over and above basic points like being punctual, extending a warm handshake and establishing eye contact, ask the right questions and that will impress interviewers. Rest assured that heaven will not be found on earth – every organisation will have areas for improvement. It is the values and shared beliefs of those organisations which will shape their culture in their quest for excellence. Whether through an interview or through research, both parties should get to know and assess each other with a view to a good fit should a relationship ensue. TG

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Deduction for Interest Expense – Part II

By Siva Subramaniam Nair

This article continues the discussion on the deductibility of interest expense for business purposes. Let's start by looking at an interesting issue in this area:

Where a first loan is taken for business purposes and a second loan is taken to settle the first loan; would the interest on the second loan be deductible?

This was the crux of the matter in RB S/B v KPHDN *[1995] 2MSTC 2360.*

Facts of the Case
A timber company took a loan to pay outstanding timber royalty to the state Government. Later, it took a second loan to settle part of the first loan. The Revenue disallowed deduction for the interest on the second loan and the taxpayer appealed against the decision.

Decision of the Courts
The Special Commissioners, in dismissing the appeal, stated that interest on money borrowed to settle an existing debt is not allowed, as the payment of the debt does not relate to the production of the income because the income would have already been produced when the debt was incurred.

BUT

The High Court, *[1999, MSTC 3731]* however, reversed the decision of the Special Commissioners. Charles Ho J, commented "as a matter of logic and common sense ... since interest payments on the first loan were deductible [as agreed by the Revenue's Counsel] because they fall within the provision of s 33(1)(a) of the Act, interest payments on the second loan would also be deductible for income tax purposes."

Another issue deals with acquisition or construction of a business asset.

Where a loan is taken for the construction of a business asset; would the interest on the second loan be deductible?

This was considered in the case of **Travelodge Papua New Guinea Ltd. v Chief Collector of Taxes** *[85 ATC 4432].*
Facts of the Case

Taxpayer borrowed funds to finance the construction of a hotel and claimed a deduction for the interest expense.

Decision of the Courts
Bredmeyer J, in finding for the taxpayer, opined that "...the [outgoing] of interest [was] incurred in the course of gaining or producing assessable income. The interest paid was a payment made for the use of money borrowed to build the hotel, or money paid to service the loans used to build the hotel."

He differentiated the interest from the capital repayment by recognising that the latter was "essential to the erection of the capital asset" whereas the interest "is not, of itself, essential to the creation of the asset, because if the company had sufficient funds it could build the hotel without borrowings." He also noted that the "payment of interest does not enhance the value of the asset."

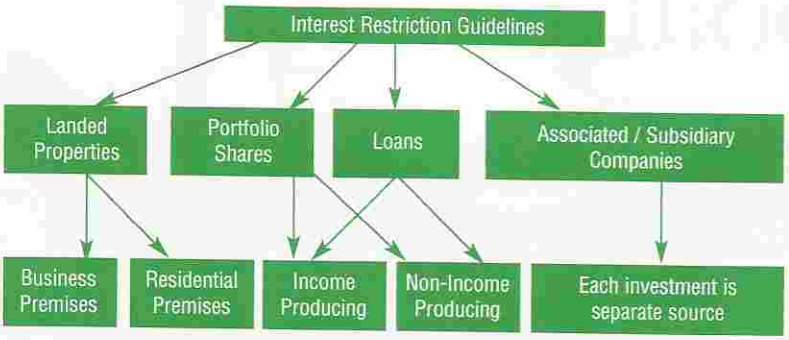
Also, generally accepted accounting principles do permit the capitalising of interest as part of the cost of the asset but as indicated in my previous articles, accounting evidence may be persuasive in tax decisions but not necessarily conclusive. Therefore, even if the interest expense is capitalised, for tax purposes it can qualify for a deduction.
The third issue for discussion involves the guidelines issued by the Revenue (as stated in my last article).

The guidelines provide that the allocation of the interest expense (which was restricted against business income) against investment income.

Generally for loans & portfolio shares (excluding associated or subsidiary companies), the investments must be split into income producing and non-income producing and only interest applicable to the income producing investment will be deducted from the interest income from those investments. However, for associated or subsidiary companies each investment is treated as a separate source. In the case of landed properties, the Revenue has indicated that the grouping will be made according to their usage, eg shop-houses, factories and business premises will be grouped to form a single source whilst houses, flats or residential premises will be grouped to form a separate source.

This is summarised in Figure 1 below.

Figure 1



However, the two landmark cases have challenged the Revenue's right to allocate the interest in accordance with the above guidelines.

P Securities Sdn. Bhd. v DGIR *[(1995) 2 MSTC 2256]*

Facts of the Case

The taxpayer had borrowed funds to finance the acquisition of shares. The dividends from these shares were subject to income tax on the basis that each share investment constituted a separate business source. The Revenue contended that the interest on the borrowings relating to the shares which produced dividend income was deductible in ascertaining the adjusted income from dividends. The balance of the interest expense did not rank for a deduction. The taxpayer appealed against the stand taken by the Revenue.

Decision of the Courts

At the Special Commissioners, it was held that:

1. Based on the true and [proper construction of s 33(1) and for the purposes of s 4(c) of the Act,] each counter of share investment does not constitute a separate source of income; and
2. Since dividend income was the company's only source of income it was erroneous for the tax authorities to apportion the interest payable on the loan to acquire the share investment between those that produced income and does that did not.

This followed the precedent established in **Merrifield v The Wallpaper Manufacturing Ltd.** *(16 TC 40)* where Rowlett J, commented "...the tax being in the first instance upon profits and gains, one ought not to disintegrate the grouping of the profits and gains according to the sources, FURTHER THAN THE ACTS AFFIRMATIVELY REQUIRED." (Emphasis added).

The High Court confirmed the decision of the Special Commissioners and the Revenue made no further appeal.

This was followed by another case; **Multi-Purpose Holdings Bhd v KPHDN** *[(2000) MSTC 3115]* where again the Special Commissioners held that the Revenue cannot further sub-divide each source by treating each counter of share investment as a separate source or apportion the dividend income producing and the non-income producing investments.

The Revenue's appeal to the High Court met with the same fate as the *P securities* case. KC Vohrah J, examined sections 4 and 5 and pointed out that the Act *[Income Tax Act 1967]* only identifies the subject matter of taxation as "dividend" and "interest" and concluded [in following the principle enunciated by the judge in the Merrifield case] that there is no justification for the Revenue to disintegrate the groupings of profits and gains according to sources.

The final issue that I wish to highlight is interlinked with the topic of withholding taxes. As students will be aware, where interest derived (or deemed to be derived) from Malaysia is paid or credited to a non-resident, a 15% (or an abated rate as per Double Tax Agreements) should be withheld at source under s 109(1) and this amount has to be remitted to the Revenue within one month from the date of payment or crediting. Non-compliance will result, in addition to a penalty, a disallowance of the whole interest expense in ascertaining the adjusted income from that source. This is illustrated in the example below.

Example

Ariaty S/B incurred interest of RM800,000 which was paid to a non resident on 5/5/2009. The payment was net of 15% withholding tax but the withholding tax and penalty have not been settled although accrued for under operating expenses.

Commencing from net profit as per accounts, students should add back the whole interest expense of RM 800,000. In addition, the penalty, which is not allowable irrespective of whether the withholding tax is settled or not, should be added back? This is computed as follows:

RM 800,000 X 15% X 10% + RM 12,000

With this we conclude our discussion on the deductibility of interest expense. In the next article, I will discuss other expenses under s 33(1). TG

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Notice Board

New RPGT forms available for disposal of real properties and shares in a real property company on or after 1 January 2010

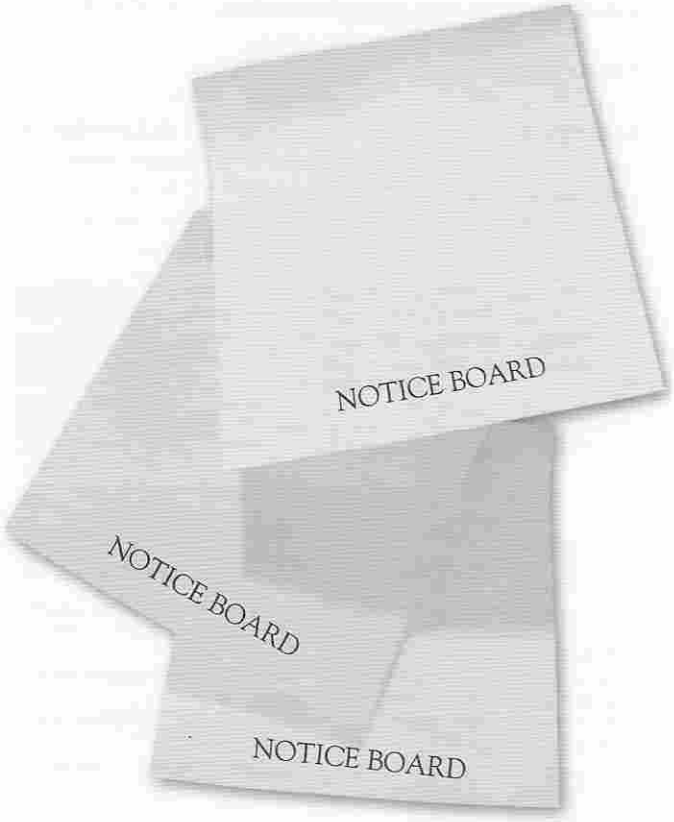
With the recent amendments to the Real Property Gains Tax (RPGT) Act, 1976, the Inland Revenue Board (IRB) has introduced a new set of RPGT forms for disposals and acquisitions of chargeable assets on or after 1 January 2010. The set of forms consists of the following:

- RPGT 1A Disposal of real properties;
- RPGT 1B Disposal of shares in a real property company;
- RPGT 2A Acquisition of real properties or shares in a real property company;
- RPGT 3 Notice for obtaining information pertaining to a chargeable asset; and;
- Declaration Form for election for tax exemption (in respect of private residence) under para 9 Sch 3 of RPGT Act 1976.

Members may view the forms at the website of the IRB at http://www.hasil.gov.my/lhdnv3/index.

Joint Tax Working Group on Financial Reporting Standards (JTWG-FRS)

Please be informed that following the establishment of the JTWG-FRS has reviewed the following Financial Reporting Standards (FRS) and has circulated to members for comments the draft Discussion Papers on tax implications related to the implementation of the FRS:



- FRS 2 Share–based Payment
- FRS 5 Non–Current Assets Held for Sale and Discontinued Operations
- FRS 102 Inventories
- FRS 116 Property, Plant and Equipment
- FRS 117 Leases
- FRS 121 The Effects of Changes in Foreign Exchange Rates
- FRS 139 Financial Instruments: Recognition and Measurement
- FRS 140 Investment Property

The JTWG–FRS has now finalised the Discussion Papers and it can be downloaded from the Institute's website at http://www.ctim.org.my/technical_pracstatement.asp.

Minutes of Dialogue on Post 2010 Budget Issues

The minutes of the dialogue have been released by the Inland Revenue Board, and can be viewed at the website of the Institute at http://www.ctim.org.my/technical_techdev_direct.asp.

Minutes of Operations Dialogue 1/2010

The IRB has released the minutes of the Operations Dialogue held on 8 February 2010. You may download the minutes at the Institute's website at http://www.ctim.org.my/technical_techdev_direct.asp.

Minutes of Filing Programme Working Group (DESIRE) Meeting No. 1/2010

The minutes of the DESIRE meeting No. 1 of 2010, held on 30 March 2010, has been released. Members can also view the information from the website of the Institute at http://www.ctim.org.my/technical_techdev_direct.asp.

Availability of e–filing of tax returns from 1 March 2010

The IRB has informed the Institute that the e–filing facility for non–company income tax returns will be available from 1 March 2010 onwards.

Additional information on filing programme for year 2010

The IRB has issued a circular which provides additional information on the filing programme for year 2010. Based on the circular, a grace period of 7 days is allowed for paper filing of Return Forms BE, B, M, P, TP, TJ and TF by hand and by post. This grace period is also applicable to payment of tax under s 103(1) of the Income Tax Act 1967. The grace period does not apply to e–filing of these returns. You may download the circular at the IRB's website at http://www.hasil.gov.my/lhdnv3/documents/maklumat_terkini/Tamb.%20kpd%20Program%20Memfailkan%20Borang%20bagi%20Tahun%202010.pdf.

Customs – Minutes of Customs Private Sector Consultative Panel Meeting (CPSCP) 01–2010

The minutes of the CPSCP meeting held on 15 January 2010 are available on the Institute's website at http://www.ctim.org.my/technical_techdev_direct.asp

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Service tax – Customs Positive and Negative List for service tax

The Royal Malaysian Customs (RMC) has recently issued a revised "Positive and Negative List" for the purpose of service tax. Members may view the revised list at the website of the Institute at http://www.ctim.org.my/technical_techdev_indirect.asp or at the website of the RMC at http://www.customs.gov.my/index.php/bm/component/content/article/193.

Mandatory application and renewal of tax agent licence

The Ministry of Finance (Mof) has issued a letter dated 26 March 2010 informing that with effect from 1 July 2010, applications and renewals of tax agent licence are required to be made online through Sistem Maklumat Pengurusan Cukai (SMPC). Members are reminded to renew their licences four months before the expiry date. You may view the letter at the IRB's website at http://www.hasil.gov.my/lhdnv3/documents/maklumat_terkini/SMPC.pdf or the Institute's website at http://www.ctim.org.my/technical_pracstatement.asp.

User Manuals for Online application/renewal of tax agent licence

We are pleased to advise that MOF has issued user manuals for online application/renewal of tax agent licence. The user manual for new application and renewal of tax agent licence can be downloaded at http://www.treasury.gov.my/pdf/percukaian/usermanual_pemohonBaru_ver1.4.pdf and http://www.treasury.gov.my/pdf/percukaian/usermanual–pembaharuan_ver.1.4.pdf respectively. Members can also view the manuals from the website of the Institute at http://www.ctim.org.my/technical_pracstatement.asp.

New Tax Agent Approval Number

Please be informed that the format of new tax agent licence number has been changed to xx/xxxx/xx/xxxx (ie 12 digits). For Tax Return Forms C, TA, TC and TR, the relevant boxes for tax agent approval number have 13–digit space. However, in the Tax Return Forms B, BE, M, P, TF, TJ and TP only provide 10–digit spacing for the tax agent to fill in. The Institute has sought clarification from the IRB on the issue and was advised as follows:

- For Form BE & B 2009 – Write the additional 2 digits below the box provided and ensure that it does not go beyond the border indicated by the adjustment mark.
- For Forms C1, M, P, TP, TJ and TF 2009 – Write the additional two digits to the right of the box provided.

Members may view the reply from IRB at the website of the Institute at http://www.ctim.org.my/technical_pracstatement.asp.

Workshop on "Goods & Services Tax" in Petaling Jaya

We regret to inform that there was a typo error in the attached brochure. The correct date for the above workshop is 14 July 2010 and not 14 June 2010. We apologise for the inconvenience caused by the error. Please logon to www.ctim.org.my for the latest updates on the events or contact the CPD Secretariat, Ms Latha/Ms Ally/Ms Nur at 03–2162 8989 ext 108/113/106 for further information. Alternatively, you can email your enquiries to cpd@ctim.org.my.

Change of address – IRB Petaling Jaya branch.

The IRB, Petaling Jaya branch has moved its office to:
Menara HASiL, PJ Trade Centre
No. 8 Jalan PJU 8/8A
Bandar Damansara Perdana
47820 Petaling Jaya.

MAICSA Annual Conference 2010

The Malaysian Institute of Chartered Secretaries and Administrators (MAICSA) is organising the MAICSA Annual Conference for 2010 with the theme 'Governance & Ethical Practices in the Boardroom'. The Conference will be held at Hilton Kuala Lumpur on 19 & 20 July 2010. CTIM is a supporting body to this Conference. Members of CTIM who register for the Conference will enjoy a preferential registration fee. For further information on the Conference programme and registration details, please click here: http://www.maicsa.org.my/training_conference.aspx.

List of 2009 Gazette Orders

The Royal Malaysian Customs has recently compiled a list of 2009 Gazette Orders. Members may view the list at the Institute's website at http://www.ctim.org.my/technical_techdev_indirect.asp.

Membership Services

Gentle reminder on outstanding membership subscription

We will be most grateful if you could kindly settle your membership subscription fee for 2010 at your earliest convenience.

Application fee for reinstatement of membership

Kindly be informed that the reinstatement fee for members who resigned is RM100. The fee for those whose membership status has been struck off is RM500.Arrears for both categories will have to be paid.

Email broadcast for members

We are pleased to inform you that we provide email broadcasting for tax related matters. For more information, kindly email secretariat@ctim.org.my.

CTIM corporate DVD

We wish to inform you that the CTIM Corporate DVD will be made available to members upon request. For those who are interested, kindly complete the requisition form and post it to the Secretariat for processing. The processing period is two weeks.

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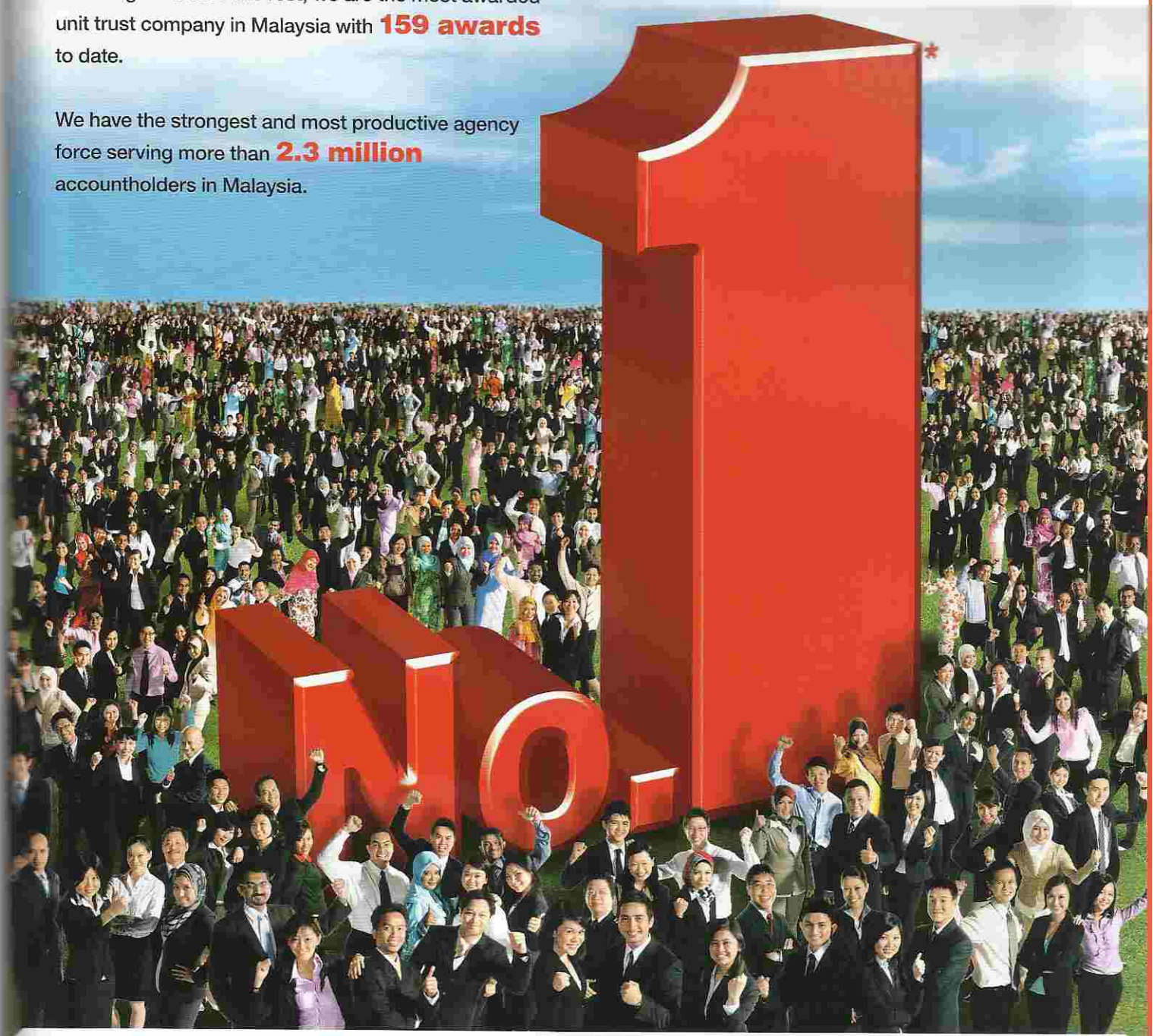

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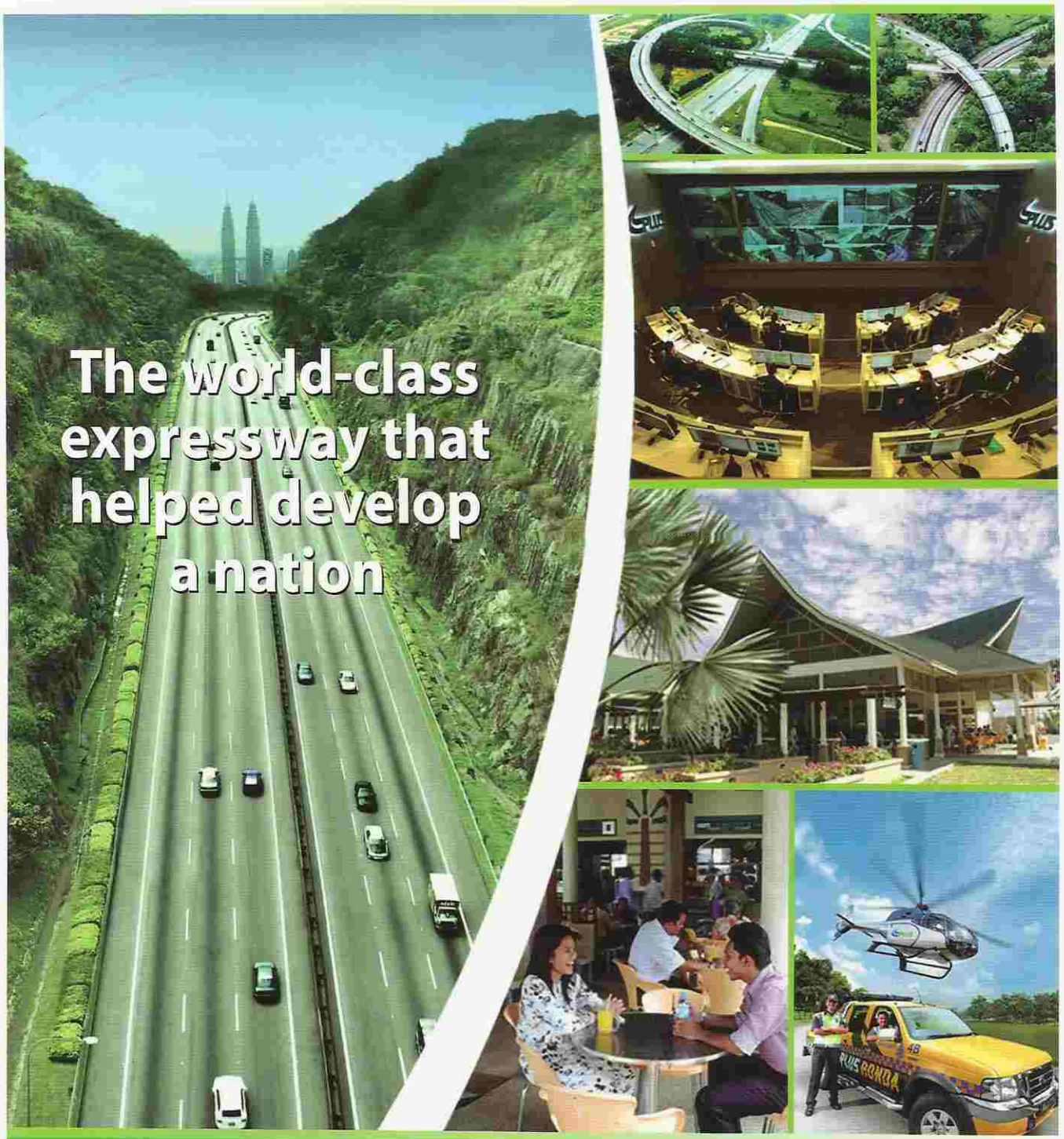

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