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A CATALYST FOR CHANGE

– INTERVIEW WITH TAN SRI HASMAH

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Continuing Professional Development (CPD)

CPD EVENTS:
JANUARY – MARCH 20

Month/Event	Details				REGISTRATION Fee (RM)		
	Date	Time	Venue	Speaker	Member	Member's Firm Staff	Non-member
JAN 2011							
Workshop: Submission of Return Forms B or BE 2010	4 Jan	9am-5pm	Kuala Lumpur	Vincent Josef	330	380	440
Workshop: Corporate Tax Issues for YA 2011	7 Jan	9am-5pm	Ipoh	Chow Chee Yen	315	365	415
Workshop: Submission of Return Forms B or BE 2010	11 Jan	9am-5pm	Ipoh	Vincent Josef	315	365	415
Workshop: Tax Planning on Individual's Income from Employment and Investments	11 Jan	9am-5pm	Kuala Lumpur	Sivaram Nagappan	330	380	440
Workshop: Tax Planning for Mergers and Acquisitions	12 Jan	9am-5pm	Kuala Lumpur	Tan Hooi Beng	330	380	440
Workshop: Corporate Tax Issues for YA 2011	14 Jan	9am-5pm	Kota Kinabalu	Chow Chee Yen	315	365	415
Workshop: Tax Planning for Mergers and Acquisitions	17 Jan	9am-5pm	Penang	Tan Hooi Beng	315	365	415
Workshop: Tax Planning on Individual's Income from Employment and Investments	17 Jan	9am-5pm	Johor Bahru	Sivaram Nagappan	315	365	415
Workshop: Submission of Return Forms B or BE 2010	18 Jan	9am-5pm	Malacca	Vincent Josef	315	365	415
Seminar: Early Planning for the Year	18 Jan	9am-5pm	Kuala Lumpur	Various Speakers	Early bird 375 Normal 425	Early bird 425 Normal 475	Early bird 475 Normal 545
Seminar: Maximising Tax Incentives - A Practical Perspective	25 Jan	9am-5pm	Kuala Lumpur	Various Speakers	Early bird 375 Normal 425	Early bird 425 Normal 475	Early bird 475 Normal 545
Workshop: Corporate Tax Issues for YA 2011	27 Jan	9am-5pm	Johor Bahru	Chow Chee Yen	315	365	415
Workshop: Corporate Tax Issues for YA 2011	28 Jan	9am-5pm	Penang	Chow Chee Yen	315	365	415
FEB 2011							
Workshop: Corporate Tax Issues for YA 2011	16 Feb	9am-5pm	Malacca	Chow Chee Yen	315	365	415
Workshop: Submission of Return Forms B or BE 2010	17 Feb	9am-5pm	Penang	Vincent Josef	315	365	415
Workshop: Tax Planning on Individual's Income from Employment and Investments	17 Feb	9am-5pm	Ipoh	Sivaram Nagappan	315	365	415
Workshop: Corporate Tax Issues for YA 2011	18 Feb	9am-5pm	Kuala Lumpur	Chow Chee Yen	330	380	440
Workshop: Tax Planning for Mergers and Acquisitions	18 Feb	9am-5pm	Johor Bahru	Tan Hooi Beng	315	365	415
Workshop: Submission of Return Forms B or BE 2010	22 Feb	9am-5pm	Petaling Jaya	Vincent Josef	315	365	440
Seminar: Treatment of Benefits-In-Kind (BIK) & Latest Developments on Schedular Tax Deductions (STD) System	25 Feb	9am-5pm	Kuala Lumpur	Sakaya Johns Rani & Vincent Josef	Early bird 375 Normal 425	Early bird 425 Normal 475	Early bird 475 Normal 545
MAR 2011							
Workshop: Mastering International and Offshore Tax Planning Strategies	1 Mar	9am-5pm	Kuala Lumpur	Tan Hooi Beng	330	380	440
Workshop: Tax Planning on Individual's Income from Employment and Investments	1 Mar	9am-5pm	Penang	Sivaram Nagappan	315	365	415
Workshop: Submission of Return Forms B or BE 2010	2 Mar	9am-5pm	Johor Bahru	Vincent Josef	315	365	415
Workshop: Corporate Tax Issues for YA 2011	4 Mar	9am-5pm	Kuching	Chow Chee Yen	315	365	415
Workshop: Submission of Return Forms B or BE 2010	8 Mar	9am-5pm	Kota Kinabalu	Vincent Josef	315	365	415
Workshop: Submission of Return Forms B or BE 2010	9 Mar	9am-5pm	Kuching	Vincent Josef	315	365	415
Workshop: Tax Planning on Individual's Income from Employment and Investments	14 Mar	9am-5pm	Malacca	Sivaram Nagappan	315	365	415
Workshop: Practical Issues on Stamp Duty & Stamp Duty Relief (Exemption)	23 Mar	9am-5pm	Kuala Lumpur	Tan Sin Huat	330	380	440
Seminar: Updates on the Case Law Developments	30 Mar	9am-5pm	Kuala Lumpur	Various Speakers	Early bird 375 Normal 425	Early bird 425 Normal 475	Early bird 475 Normal 545

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 Ally or Ms Nur at 03-2162 8989 ext 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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Editorial Note

"For last year's words belong to last year's language and next year's words await another voice. And to make an end is to make a beginning."

–T. S. Elliot

As we usher in the year 2011, we look back on 2010 with a sense of accomplishment and great satisfaction. The Chartered Tax Institute of Malaysia (CTIM) welcomed a new President, Mr Khoo Chin Guan, a respected tax advisor and a well known figure in the tax fraternity. We highlighted the success of the National Tax Conference held in August 2010. We had received overwhelming support with more delegates from Malaysia and the region, as well as sponsors; recognising the NTC as a premier tax event.

The 2011 Malaysian Budget proposal saw the expansion of scope and an increase in service tax rate to 6%. Can this help in generating sufficient revenue in ensuring a strong and sustainable fiscal position to support long–term economic growth? The cover story, "Relying on Service Tax to Enhance Fiscal Position" seeks to address some of the challenges relating to service tax.

In our feature article, we bring to our readers an exclusive interview with Tan Sri Hasmah Binti Abdullah, Director General of the Inland Revenue Board of Malaysia (IRB). On behalf of CTIM, I would like to thank her for championing change by promoting efficiency as well as being an educator to the masses relating the need for tax collection so as to provide for the general public. Tan Sri Hasmah, we bid you farewell and best wishes to your future endeavours.

Next, the article, "Customs Valuation: Analysing The Condition Of Sale For Export To Malaysia Concept Under Regulation 5(1)(a)(iv)" aims to discuss Regulation 5(1)(a)(iv) in light of the *L* case. The issue was whether royalty paid by *L to A & Co* should form part of the value of the products imported to Malaysia for the purposes of assessing customs duties and sales tax. Read more about this interesting article in the feature section of this journal.

In addition, the article, "Withholding Tax and Double Taxation Agreements" by Nicholas Crist, Executive Director of KPMG Tax Services Sdn Bhd takes a selective look at how domestic law obligations in relation to certain categories of withholding tax are impacted by relevant Double Taxation Agreements.

Lastly, from all of us at CTIM, we'd like to wish you – A Merry Christmas and A Happy 2011!

To the Chinese readers, we wish you – A very delightful and harmonious Rabbit year ahead. Gong Xi Fa Cai!

Dato Raymond Liew Lee Leong
Chairman
Editorial Committee

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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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tax guardian

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Asia Oceania International Tax Consultants' Association (AOTCA) – Meetings and International Tax Conference

The President and the Executive Director of the Institute attended the AOTCA 18th General Council Meeting, 9th General Meeting and International Tax Conference in Sydney, Australia on 25 and 26 November 2010. The host organisation was the Taxation Institute of Australia. The meetings and conference were also attended by representatives of member bodies from Australia, India, Pakistan, China, Hong Kong, Indonesia, Japan, Korea, Philippines, Taiwan and Vietnam.

There were 10 topics presented at the International Tax Conference which was attended by 132 delegates. Amongst the topics presented were "Privacy and Confidentiality – the Rights of Taxpayers and their Advisors", "Emerging Trends in International Tax Policy" and "Interpretation of Double Tax Agreements – Recent Developments". The conference materials are available for reference at the Institute's resource centre.

Budget Hotline Jointly Operated by the Chartered Tax Institute of Malaysia (CTIM) and the Malaysian Institute of Accountants (MIA)

As in the past, CTIM collaborated with MIA to host the Budget Hotline service following the 2011 Budget Announcement, ie on Saturday, 16 October 2010, from 9.00 a.m. to 12.00 p.m. at the MIA premises. The hotline was conducted by a panel of experienced professionals from the major tax consultancy firms. The objective was to provide a convenient channel for dissemination and clarification of changes and proposals introduced by the 2011 Budget as well as the fiscal implications to members and the general public. Members and the general public benefited from this service.

> "A convenient channel for dissemination and clarification of changes and proposals."

Pre–2011 Budget Session with the Media

In a run–up to the 2011 Budget announcements by the Prime Minister and Minister of Finance on 15 October 2010, a pre–2011 Budget briefing session was held with the media on 4 October 2010. The briefing session provided the media with some insights on the 2011 Budget proposals submitted by the Institute in a memorandum to the Ministry of Finance in June 2010. The session was attended by reporters from the mainstream newspapers.

Budget Night: Preparation of the 2011 Budget Commentary & Tax Information

On 15 October 2010, members from various tax, accounting and auditing firms gathered together for an all–night session at the CCH's office in Kuala Lumpur to produce the 2011 Budget Commentary and Tax Information booklet which was published by the Chartered Tax Institute of Malaysia, the Malaysian Institute of Certified Public Accountants and the Malaysian Institute of Accountants. A lot of work and effort was put in by all involved and the Institute would like to express its sincere appreciation to everyone involved in the successful production of the booklet.

Budget Day Activities at CTIM

At CTIM, some Council members and practitioners gathered at the Institute to view the televised screening of the 2011 Budget announcement by the Honorable Prime Minister and Minister of Finance. A press statement stating CTIM's views on the 2011 Budget was prepared.

Memorandum of Understanding (MoU) with UTAR

CTIM and Universiti Tunku Abdul Rahman (UTAR) signed an MoU at the UTAR Petaling Jaya Campus on 9 November 2010.

With the signing of the MoU, UTAR and CTIM, formally agreed to collaborate in the promotion of the profession of tax specialists.

Professor Datuk Dr Chuah Hean Teik, Chief Executive Officer of UTAR, signed the MoU on behalf of UTAR, while Assistant Professor Dr Ong Seng Fook, Dean of Faculty of Accountancy and Management, signed as witness. The CTIM President, Mr Khoo Chin Guan, signed on behalf of CTIM and this was witnessed by CTIM's immediate past President, Dr Veerinderjeet Singh.

The representatives from CTIM who were present at the ceremony were Mr Lew Nee Fook (Council member), Ms Seah Siew Yun (Chairman of Education Committee) and Ms Ann Vong (Executive Director). From UTAR, the representatives were Associate Professor Dr Teh Chee Seng (Vice President of Student Development and Alumni Relations), Mr Ong Whee Tiong (Company Secretary of UTAR Education Foundation) and Associate Professor Dr Ooi Keng Boon (Dean of Faculty of Business and Finance).

Career Talk at TAFE College, Seremban

The Institute organised a career talk at TAFE College in Seremban on 27 October 2010. The presentation titled "A Career in Taxation" was delivered by Ms Nancy Kaaur (CTIM Education & Examinations Manager), to students to create awareness on Taxation as a career.

Memorandum of Understanding (MoU) with CPA Australia

CTIM signed an MoU with CPA Australia on 8 November 2010 for the delivery of a Malaysia tax segment as an elective paper for the CPA Program. CPA Australia and CTIM will work together to enable the Malaysia tax module to be developed to meet the requirements for Malaysian candidates undertaking the CPA Program.

In this arrangement, CTIM will design the syllabus, write the candidate learning materials, develop the examination and mark the examination for the Malaysia taxation segment for the CPA Program. The intention of this MOU is to advance the mutual interests of CPA Australia and CTIM in particular and the accountancy profession and education in general.

Career Talk at Curtin University School of Business, Sarawak

On 25 October 2010, Ms Regina Lau (Sarawak Branch Chairman) conducted a career talk at Curtin University School of Business in Miri, Sarawak. Mr Solomon Ong Chow Peng and Ms Tan Siew Bee, who are members of CTIM, were present at the talk. The talk was to create awareness among students on a career in taxation and provide background information on CTIM.

Career Talk at UiTM Shah Alam

On 14 July 2010, CTIM set up an exhibition booth at the Faculty of Accountin UiTM Shah Alam in conjunction with the signing of Memorandum o Understanding between the two organisations.

Students who visited the booth asked many questions regarding CTIM Professiona examinations. Ms Seah Siew Yun (Chairman of the Education Committee delivered a talk on "A Career in Taxation" to 300 students. A Question and Answe session was held after the talk.

Career Talk at INTI College Sabah

On 22 October 2010, CTIM Sabah Branch Chairman, Ms Teo Chew Hiong conducted a career talk at INTI College Sabah. Ms Teo spoke to the students on the various routes to becoming a Tax Consultant. The students viewed CTIM's corporate video and participated actively in the Question and Answer session. Mr Titus Tseu was also present to share his experience as a Tax Consultant.

CTIM looks forward to future collaborations with INTI College and would like to thank its Principal/CEO, Dr Alan Lim for the invitation and hospitality.

Courtesy Visit to Tunku Abdul Rahman (TAR) College

On 21 December 2010, CTIM paid a courtesy visit to TAR College. The representatives from CTIM were Mr Adrian Yeo (Chairman, Examination Committee), Ms Ann Vong (Executive Director) and Ms Nancy Kaaur (Manager, Education & Examination). Dr Tan Chik Heok (Principal of TAR College), Mr Chan Kum Wing (Vice Principal) and Ms Say Sok Kwan (Acting Head, School of Business Studies) welcomed the group from CTIM. There were discussions on how CTIM and TARC can work together to create awareness in taxation as a career for students of the college.

CPD News

2011 Budget Talk

On 20 October 2010, CTIM conduct its annual Budget Talk at the Berja Times Square Hotel, Kuala Lump Puan Khodijah binti Abdullah (Seni Deputy Under–Secretary, Tax Analy Division, Ministry of Finan Malaysia) gave an in–depth perspecti on the Budget proposals as well as the implications on the busine community. There was also a pan discussion where pertinent issues we discussed. Dato Dr Siti Mariam bin Che Ayub (Deputy Director Gener Tax Operations, Inland Revenue Boa of Malaysia) and Mr Lim Kah F (Chairman of Technical and Publ Practice Committee CTIM) were th panelists in the forum discussion whic was chaired by Mr Khoo Chin Gua (President of CTIM). The talk w attended by over 650 participan comprising tax practitioners an members from the commerci industries.

CTIM Professional Examination 2010

Evening Talks

On 4 October 2010, an evening talk titled "Green Taxation and Environmental Sustainability" was conducted by CTIM. The talk was held in the Universiti Tun Abdul Razak (UNIRAZAK) KL Campus. The speaker, Dr Jeyapalan Kasipillai who is the Professor and Chair of Malaysian Business at Monash University Sunway Campus explained about green taxation issues. The talk was chaired by Dr Veerinderjeet Singh (Council Member of CTIM).

On 10 November 2010, CTIM conducted an evening talk titled "Sales Promotion Expenses or Entertainment Expenses? Where do we go from there?" at the Universiti Tun Abdul Razak (UNIRAZAK) KL Campus. The speaker, Mr Anand Raj from Shearn Delamore & Co. shared his extensive experience.

On 29 November 2010, Mr Anand Raj also spoke on "Deductibility of Miscellaneous Borrowing Costs and Related Issues" at the evening talk. Both talks by Mr Anand Raj were chaired by Mr Lew Nee Fook (Council Member of CTIM).

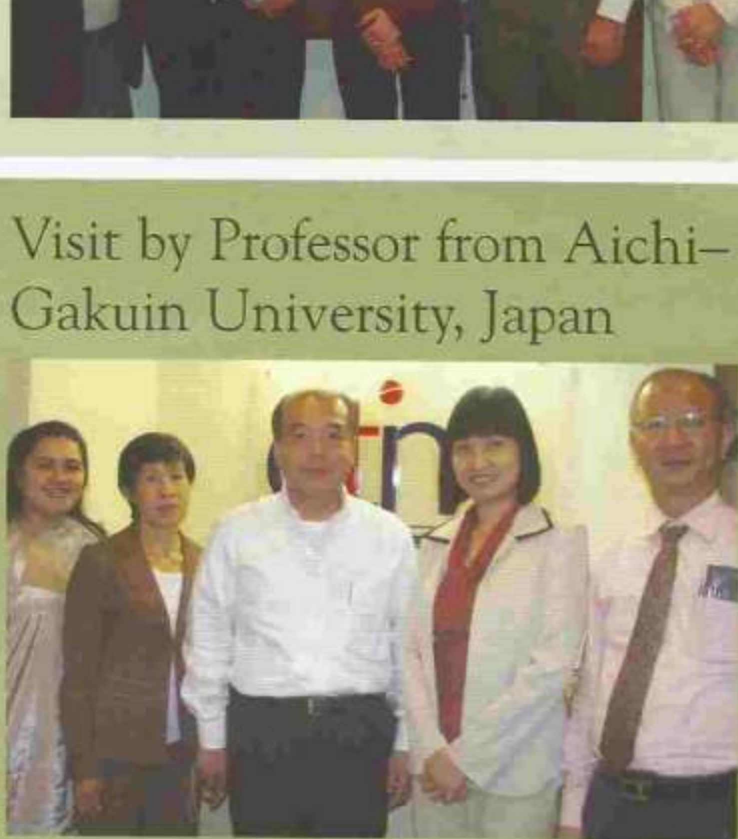
Participants were very happy as the talks had provided them with a better understanding of the issues discussed.

CTIM held its week long professional examinations for candidates in Kuala Lumpur, Pulau Pinang, Johor, Melaka, Perak, Kelantan, Sabah and Sarawak. A total of 210 candidates registered for the examination, which was conducted from 13 to 17 December 2010 in the nine centres nationwide.

Courtesy Visit by UCSI University

On 6 October 2010, Mr Chong Aik Lee (Head of Accounting and Finance) and Mr Sudesh Balakrishnan (Senior Director of Student Affairs) of UCSI paid a courtesy visit to CTIM. Ms Seah Siew Yun (Chairman of the Education Committee), Ms Ann Vong (Executive Director) & Ms Nancy Kaaur (Manager, Education & Examinations) welcomed them. Ms Seah gave a presentation on CTIM Professional Programme and shared information on CTIM Professional Examinations. Both parties look forward to working together to create awareness among students by organising career talks on taxation.

Visit by Professor from Aichi–Gakuin University, Japan



On 11 October 2010, Professor Hatsuyoshi Ichino (Professor of Accounting, Faculty of Commerce) of the Aichi-Gakuin University at Nisshin City in Japan, paid a friendly visit to CTIM. The Professor was briefed on the background, roles and responsibilities of the Institute. There was also a brief exchange of information on tax practices in both countries.

2011 Post–Budget Seminars

CTIM organised a series of 2011 Post-Budget Seminars at various towns, namely Kuala Lumpur, Petaling Jaya, Ipoh, Malacca, Seremban, Johor Bahru, Penang, Kuantan, Kuching and Kota Kinabalu. The speakers shared their views with the participants on the recent developments in tax, the implications of the Budget proposals and the various opportunities offered by the budget incentives.

The Institute, once again, has jointly collaborated with ACCA Malaysia to organise budget seminars at smaller towns, namely Kuala Terengganu, Kota Bharu, Labuan, Sibu and Miri. Members of both organisations benefited from the seminars in terms of technical knowledge sharing as well as meeting tax licensing requirements.

Workshops

A series of workshops titled "Analysis of Recent Tax Cases" were conducted at major towns such as Johor Bahru, Penang, Ipoh, Malacca, Kota Kinabalu and Kuching. The speaker, Mr Saravana Kumar from Lee Hishamuddin Allen & Gledhill highlighted recent tax cases and participants were exposed to actual case scenarios with discussion on tax cases on how to manage tax appeal effectively.

Relying on Service Tax to Enhance Fiscal Position

By Koh Siok Kiat and Eric Lee

The 2011 Malaysian Budget proposal saw the expansion of scope and an increase of service tax rate to 6%. Can the expansion of scope and an increase of service tax rate help in generating sufficient revenue in ensuring a strong and sustainable fiscal position to support long–term economic growth?

Introduction

The recent 2011 Malaysian Budget proposals saw service tax emerging as a key indirect tax focus. Whilst service tax has been in existence since 1975, its contribution to tax revenues has been indirectly undermined by the relatively low rate of 5% compared to other types of indirect taxes, namely sales tax (5% and 10%), import duty (ranging from 2% to 50%), and excise duty (ranging from 60% to 105%).

When it was first introduced, the Government set a modest service revenue target of RM5 million from the booming tourism industry (Ultimately, it collected RM8 million that year). Fast forward to current times, it is interesting to no[te] that service tax revenue collected for 2009 stands at RM3[.] billion, approximately a 400–fold increase from its initi[al] revenue collection.

The 2011 Malaysian Budget proposal to expand the sco[pe] of taxable services and increase the rate by 1% w[ill] certainly lift service tax to a higher level in terms [of] revenue collection.

It is interesting to examine the pertinent changes and obser[ve] service tax revenue collection over the past 35 years, whic[h] despite its limited scope, has managed to achieve such [a] remarkable increase in revenue collection.

Service Tax Revenue

With the growing importance of the service sector th[at] accounted for a significant proportion of the Gross Nation[al] Product, the Government introduced the Service Tax Ac[t] in 1975 to tax the services sector. Since then, service ta[x] revenue has seen tremendous growth (*see Table 1*).

Table 1

Rate	Expansion of scope of tax	Service Tax Revenue (1975 – 2010)								
5%	Tourism related services including hotels, restaurants, bars, snack–bars, coffee houses, private clubs, night clubs, dance halls and cabarets, health centres and massage parlours, public houses and beer houses.	Year	1975	1976	1977	1978	1979	1980	1981	1982
		RM: Million	8	12	16	18	22	26	34	42
10%		Year	1983	1984	1985					
		RM: Million	108	114	107					
5%		Year	1986	1987	1988	1989	1990	1991		
		RM: Million	60	63	73	94	121	134		
5%	Professional services (including accounting, legal, engineering, architectural and consultancy), advertising and telecommunications services	Year	1992	1993	1994	1995	1996	1997		
		RM: Million	322	613	825	1,016	1,231	1,475		
5%	Management services, employment services and hire-and-drive car and hire–car services	Year	1998	1999	2000	2001				
		RM: Million	1,447	1,459	1,701	1927				
5%		Year	2002	2003	2004	2005	2006	2007	2008	2009
		RM: Million	2,214	2,038	2,350	2,582	2,685	3,013	3,345	3,344
5%	Credit cards and charge cards	Year	2010*							
		RM: Million	4,000							
6%	Paid television broadcasting	Year	2011*							
		RM: Million	4,902							

* Estimate

Source: www.treasury.gov.my

Service tax revenue collected in 1975 was RM8 million, exceeding its initial target by 60%.

20 years later, service tax revenue collected reached RM1 billion in 1995. It then doubled to RM2 billion in 2002 and exceeded RM3 billion in 2007. It is expected that the service tax revenue will exceed RM4 billion in 2010.

The amount of service tax revenue collected in 2009 was slightly more than the aggregate of import duty and export duty in the same period. Undeniably, service tax revenue has been recognised to contribute significantly to the national coffers throughout the years.

With the further expansion to include satellite applications such as paid television broadcasting services into the ambit of service tax in the 2011 Malaysian Budget proposal, the Government expects to collect an additional RM152 million of service tax revenue.

Revenue Increase with the Expansion of Scope

During the initial years of introduction, the scope of service tax mainly covered cash transactions at hotels, restaurants, bars, snack–bars, coffee houses, private clubs, night clubs, dance halls and cabarets, health centres and massage parlours, public houses and beer houses, all of which were associated with the tourism industry. Service tax revenue generated from the tourism industry was very encouraging and recorded a high level of RM134 million in 1991.

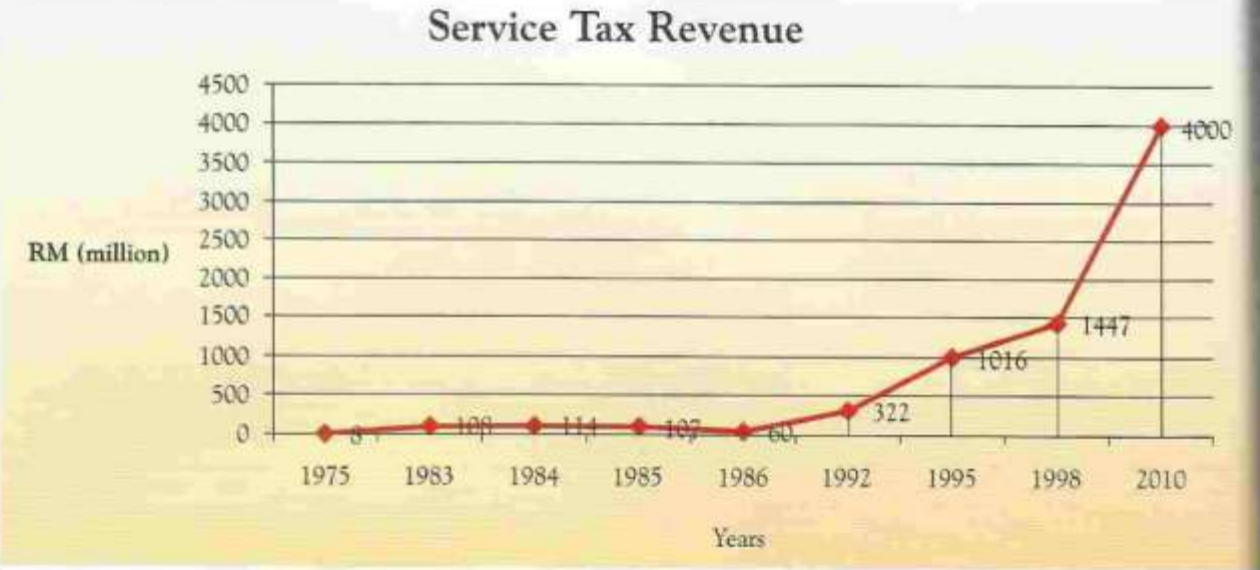
Recognising the importance of service tax revenue, the Government expanded the scope of service tax to include professional services (including accounting, legal, engineering, architectural and consultancy), advertising and telecommunications services in 1992. In that year itself, service tax revenue increased by almost one and a half fold to RM322 million *(see Table 2)*.

Besides increasing revenue, the expansion of the service tax scope was intended to pave the way for the Government to eventually bring in a broad-based consumption tax such as goods and services tax (GST)/value added tax (VAT).

The next round of expansion of scope in 1998 saw the inclusion of the provision of management services within the ambit of service tax. In the absence of a clear definition of what constitutes "management services", it has in practice led to various forms of services falling within the ambit of service tax. The service tax revenue collected in 1998 reached RM1.4 billion.

The service tax revenue in 2009 was RM3.3 billion and is estimated to be RM4 billion in 2010.

Table 2



Source: www.treasury.gov.my

Changes in the Rate of Tax
The service tax rate was at 5% when first introduced in 1975. Many people may not realise that the rate was later increased from 5% to 10% on 23 October 1982, riding on the buoyant tourism industry. Service tax collection immediately rose from RM42 million in 1982 to RM108 million in 1983 and the annual service tax revenue maintained at the level above RM100 million consecutively for a period of three years from 1983 to 1985.

However, when recession hit Malaysia in the 1980s, the service tax rate was revised downward to its original rate of 5% on 26 October 1985. It directly resulted in the service tax revenue plunging to RM60 million in 1986.

Since then, the Government has not revised t[he] service tax rate for the past 25 years. The proposal [to] increase service tax rate by 1% was tabled in the rece[nt] 2011 Malaysian Budget. With the 1% increase [in] service tax rate effective 1 January 2011, t[he] additional service tax revenue is likely to be arou[nd] RM750 million.

It is observed that many countries have increased [or] announced the increase in GST/VAT rate this ye[ar] *(see Table 3)* as a measure to enhance reven[ue] collection. Malaysia is following the trend, except t[he] increase of 1% is mild and not meant to burd[en] businesses and the *rakyat*.

Table 3: Selected worldwide VAT/service tax rate

Countries	Old rate (%)	New rate (%)	With effect from
Finland (Standard rate)	22%	23%	1 July 2010
Spain (Standard rate)	16%	18%	1 July 2010
Switzerland (Standard rate)	7.6%	8%	2011
New Zealand	12.5%	15%	1 October 2010
Thailand (standard rate)	7% (temporary reduction)	10%	30 September 2012
United Kingdom	17.5%	20%	4 January 2011
Romania	19%	24%	1 July 2010
Greece (Standard rate)	19%	21%	15 March 2010
Portugal (Standard rate)	21%	23%	1 January 2011

Source: Ernst & Young Global Indirect Tax

Service Tax or a Broad-based Tax?

Based on the service tax revenue growth throughout the years as summarised above and despite its limited scope, service tax has clearly performed very well as a revenue generator for the country. It will also be interesting to see if service tax can be effectively used to achieve the objective of generating more revenue on a long-term basis.

One may wonder why the expansion of scope is confined to paid television broadcasting services based on satellite applications. There are other paid television broadcasting service operators that use internet protocol for the television broadcasting services.

In line with the national ICT policy of encouraging the usage of internet broadband services, it was reported that the internet-based television broadcasting services are excluded from the scope of service tax.

Such an exclusion of a similar industry based on technology may pose an unfair disadvantage to operators who are within the service tax scope. Coming from the perspective of revenue collection and on the grounds of equity, service tax should be applied across all paid television broadcasting services.

Increasing the rate of service tax has proven to be an effective method of bringing a significant additional amount of service tax revenue collection from 1983 to 1985. As it is believed that the 1% rate increase in 2011 will bring an additional RM750 million in service tax, one may wonder whether the Government will continue to deploy the same approach to further enhance revenue in future Budget proposals or introduce a more equitable broad-based consumption tax.

Service tax is definitely a cost of doing business. Unlike GST, there is no mechanism to claim input tax credit on all direct acquisitions. As such, any further increase in the service tax rate would eventually translate to an increase in the cost of doing business, which may be passed down to the consumers via price adjustments.

Whilst service tax revenue can be increased by further expanding the scope and at the same time increasing the rate, this strategy has its limitation and may not be effective in generating a steady revenue stream. In comparison, a structured approach in taxing the transactions in the likes of GST would address the issue of a limited tax base and, most importantly, generate a continuous revenue stream in ensuring a strong and sustainable fiscal position to support long-term economic growth.

Addendum

One of the proposals announced in the 2011 Malaysian Budget was the increase in the rate of service tax from 5% to 6% with effect from 1 January 2011. This proposal has raised a number of transitional issues for taxable service providers.

The main issue faced by most taxable service providers is whether the new rate applies to invoices raised on or after 1 January 2011, or whether it should apply only to taxable services rendered on or after this date. In recognition of these uncertainties, the Royal Malaysian Customs Department has issued guidelines for the practical implementation of this proposal.

In general, the following points were covered in the guidelines:

- Taxable services rendered prior to 1 January 2011 will be subject to service tax at the rate of 5%, notwithstanding that the invoices for these services are raised on or after this date.
- Detailed guidance was also provided on the applicable service tax rate where services are provided after 1 January 2011, but full or part payments were made before this date. For example, advance or mobilisation fees billed in 2010 for services to be rendered in 2011 will be subject to service tax at 5% if payment for these fees is received in 2010. However, if these fees are billed in 2010 but payment is only received in 2011, then the amounts billed will be subject to service tax at 6%.
- Specific transitional rules were also provided for insurance and telecommunication companies.
- The applicable returns to be submitted such as normal service tax return (for service tax at 6%) and supplementary service tax return (for service tax at 5%)

The service tax guidelines are available for download from the Royal Malaysian Customs website:
http://www.customs.gov.my/index.php/en/component/content/article/187-berita-terkini/555-panduan-cukai-perkhidmatan

Outstanding issue to be discussed further with Treasury/Customs

There is an issue on advance fee/mobilisation fee billed under normal billing terms with 5% service tax in 2010 and which remains unpaid on 31 December 2010. The taxable service provider would need to top up the service tax payable by 1% so that the service tax is imposed on the billed amount at the rate of 6%. This being the case, the taxable service provider will need to incur an additional service tax liability, besides incurring the tedious effort of apportioning the fee between services rendered in 2010 and 2011.

This issue will be discussed further between the professional bodies/trade associations and Treasury/Customs. TG

***Koh Siak Kiat** and **Eric Lee** are Directors of Ernst & Young Tax Consultants Sdn Bhd.* *The information contain in this article is intended for general guidance only. It is not intended to be a substitute for a detailed research or the exercise of professional judgement. On any specific matter, reference should be made to the appropriate advisor.*

A Catalyst for Change

– Interview with Tan Sri Hasmah

Tan Sri Hasmah, a woman of substance, has humbly served the country for more than 37 years and has led th[e] organisation with integrity and accountability. Currently the Director General/Chief Executive Officer of Inlan[d] Revenue Board Malaysia (IRB), we bid her farewell as she will be retiring on 7 January 2011. We spoke to Ta[n] Sri Hasmah to find out more about her passion for tax and the contribution she has made over the years.

CTIM: ***How did you start your career in tax?***

DGIR: It wasn't really by design because at that time, I went for the public services department interview prior to graduation and subsequently on 9 March 1973, about 50 of us, was selected to join the IRB then. We still had to go through the official process of recruitment and interview before we were appointed, backdated to the date of our graduation on 2 April 1973. As tax officers, we were required to undergo internal courses and examinations that included getting a basic knowledge in accounting as well as tax laws to understand the principles of taxation. Perhaps it was because of my inclination towards mathematics that I took to accounting and motivated my interest in tax. At that time, I had no idea which career path to take. There were no career development talks held at the university, neither was there anyone to provide advice on career direction. However, I am glad that I was selected to join the IRB. I was not only learning something new like disciplines [illegible] which were totally different from what I had studie[d] in the university, but also found it to be challengin[g]. After I cleared the advance level course in 1975, [I] was also offered to do part time tutoring in th[e] Economics Faculty of the University of Malaya as th[e] university was in need of tutors to teach the taxati[on] course. Later, I was also lecturing part time on tax a[t] Universiti Kebangsaan Malaysia. I stopped my pa[rt] time tutoring/lecturing after my marriage due t[o] family commitments.

CTIM: ***Given the long period of service (from 1973 ti[ll] present) you have had in the field of taxation, wha[t] drives your interest in taxation?***

DGIR: It is difficult to pinpoint as the passion for tax cam[e] naturally. Not to mention the encouragement [I] received from senior officers as well as my grou[p] leaders. That certainly helped to boost m[y] confidence and that is how I became "stuck" in tax. When I was transferred to the technical division and given the trust to administer the Investment Incentives Act 1969, I became a 'specialist' in tax incentives and often sent by IRB to give talks at seminars on various incentives such as pioneer status, investment tax allowance, etc. I developed a lot of networking relationships with external parties and widen further my horizons on tax. I was also deeply involved in the drafting committee for the then newly proposed Promotion of Investments Act 1986 and if I may add almost single handedly drafted the technical circular on the new act, under the supervision and advice of the then Deputy Director General, Mr (now Dato') S. Sivalingam. That drafting experience was totally exhilarating for me and I guess that is one of the reasons why I continued my profession and decided that this was the chosen career for me.

CTIM: ***We understand that you will be retiring on 7 January 2011. Does this mean that Tan Sri will now be fully retiring or will you still be present in the tax sphere (in another Government position perhaps)?***

DGIR: At this present moment, I do not have any fixed plan. I may continue to do tax, but I am keeping my options open. Upon retirement, the thought of perhaps taking a break comes to mind, but after awhile I might feel bored and may want to do something. Hence, it's really difficult to say. However, I have been invited to be involved with the setting up of an association for retired and former tax officers. The association would help to bring together all retired staff of IRB and also help to foster the relationship between them and the present staff of the IRB as well as serve as an avenue to stay current on taxation matters. I have also been offered to be one of the trustees of the proposed Malaysian Tax Research Foundation being set up by the Chartered Tax Institute of Malaysia (CTIM).

CTIM: ***During your service as the Director General/CEO of the IRB, what are the three main areas which you feel have been your major contributions to the Board in its drive to be a service oriented agency.***

DGIR: Ever since we started self-assessment in 2001, beginning with the corporate sector, the delay in tax refund had been a serious issue. When we developed the system, we prioritized and built the collection system first to receive payments which are being paid in advance based on an estimation of profits for the current accounting year. When returns were received the following year, the system was still in stages of development and therefore not ready to process refunds yet. It was only in 2003 that we started to refund the 2001 and 2002 payments. However, the backlog which accumulated over that three years, compounded further by the fact that some of the refund claims need to be audited, spill over into the next three years. The same was true for self-assessment for individuals which commenced in 2004.

Again in 2006, we had introduced electronic filing or e-filing for individuals. However, e-filing then was encouraged for fast, efficient and secured filing of returns. We were not ready then for processing of refund. When I took over as CEO/DG on 19 October 2006, there were already numerous complaints about our late refund, not only at the office counters but also in the press, which badly affected the image of IRB. Immediately, my focus was on the improvement of the refund process to not only repair IRB's image but also to boost the morale of the staff who were similarly badly affected by public criticisms and sarcasms of our efficiency. Apart from getting my IT and operational staff to develop programs to identify and extract overpaid tax accounts for purposes of refund, I made a bold decision to change a very time immemorial policy to refund overpaid taxes in the current year without taking into account assessments or additional assessments that may not have been raised, such as on back pay and bonuses received for prior years.. We went ahead despite concerns that doing so may invite more complaints, as we would be issuing additional assessments following the refunds. We did receive complaints especially from taxpayers who were not aware of the new policy on refunds released in the media. However, the positive feedback and outcome from those who got their refund had more than made up for the complaints, which incidentally were responded to and resolved quickly, too. I felt a sense of accomplishment as the new policy on tax refunds greatly improved the image of the IRB, turning angry taxpayers to delighted taxpayers. With the much improved delivery system now, we also went all out to promote the newly improved e-filing system to facilitate early refunds. However, Malaysians need to get rid of the last minute syndrome, even in e-filing, as the volumes received last minute affect processing of refunds within the time prescribed in our Client Charter.

Last but not least, our approach to taxpayers' education is to make the public realise why they must pay their taxes. We pay taxes so that our children and grandchildren can continue to enjoy the benefits of development just as we are presently enjoying the fruits of development contributed through taxes paid by our fathers, mothers and forefathers. Also, the Government requires funds to provide and maintain facilities for the general public who, unlike the well to do, can ill afford to pay for private sector services, such as medical and educational services provided by private institutions. These are among the three significant areas in which I feel I have contributed to improve the image and delivery service of the IRB.

CTIM: ***Two areas which you have focused on during your tenure as the DG/CEO of the IRB have been the speeding up of tax refunds and promoting electronic filing of tax return forms. Are you satisfied with the progress achieved to date? What else should be done to enhance these aspects?***

DGIR: I am quite happy with the reducing number of complaints. However, there is still a lot more that can be done. For instance, improving further the time it takes to refund taxpayers. It could still be faster if taxpayers co-operate and submit their returns early. With regard to e-filing, presently the overall take-up rate is about 50% after 4 years of it being introduced, and for individuals i[t] about 60%. I am more concerned with the 40 that still uses the manual system to file and st many more that do not make use of the e-payme system to pay taxes. I sincerely hope that in t next 2 or 3 years, the overall take-up rate w reach more than 90%.

CTIM: ***What are your thoughts on the success of th voluntary self-assessment programme? Has it l to greater compliance and better reven generation? What initiatives could the IR implement in the future to improve tax complian and collection?***

DGIR: One of the good points of the self-assessme programme is that the IRB is able to go down taxpayers' premises to audit and verify the accoun and receipts to see if the claims are in order and accordance with the provisions of the law. To answ your question on greater compliance and bett revenue generation, definitely, the self-assessme system, supported by audits had generated mo revenue for the Government. As for compliance, th issues with corporate organisations are mo technical in nature. On the other hand, for th sole-proprietors or the non-incorporated businesse therein lies the problem as they do not general maintain proper accounts. More often than no there will be additional assessments issued. Under th self-assessment system, penalties are imposed whe there are findings that tax is under-assessed/paid. T improve compliance, the IRB had undertaken form business support unit in every branch to he small and medium sized businesses, where taxpaye are invited for education on what records they shou keep, how they should keep the records, what are th things the IRB looks for such as receipts, et However, the response to date has not bee encouraging. This is because, to the businessme time is money. And if you call them to the IRB, the generally feel they would lose about 2 to 3 hours o their time and that inadvertently means loss o business sales. We have also worked, and st continue to so, with the Business Associations an the Chambers of Commerce to arrange time and da for us to meet with the SMEs instead.

CTIM: ***Moving on from what you mentioned, in th next few years, which particular area(s) of ta administration should the IRB focus on?***

DGIR: I found that apart from the business grou we also have to audit the salaried group (i.e employees). This is because there is a tenden among some taxpayers to exaggerate their claim There are quite a number of cases that have bee audited. I feel that taxpayers ought to be honest. you wish to be refunded, you should only claim ba what you have paid in excess and not more th that. When you claim relief that is unsubstantiate then you are actually over claiming your tax refu or under paying your tax. We have to address this and that can only be done by way of carrying out tax audits. These leakages can be minimised if we replace all the basic deductions with a standard deduction so that no one can claim more or less. Also, with a standard deduction, generally there is no need to file in the return. If the Government wishes to provide a relief over and above the standard deduction, then the taxpayer, who is claiming such a relief, would then be required to submit a tax return to claim back the excess tax overpaid as a result of the additional relief. Under those instances, it would be easy to monitor and the taxpayer would have to be very careful about making a claim as he would have to substantiate to get the refund. This would definitely improve compliance. So that is an area I hope the IRB will look into for policy decision.

CTIM: ***On the topic of Goods & Services Tax (GST), what are your thoughts on GST being a significant contributor towards the tax revenue of the Government?***

DGIR: I am not in a position to comment on this area. Looking at several countries that have already introduced GST, it would seem to be a major contributor to revenue and it would help the Government in considering the reduction of direct taxes. However, one would need to look at an appropriate rate to compensate for the loss in direct taxes.

CTIM: ***Given that the UK, Australia and Canada basically have a single agency collecting direct taxes and GST/VAT, what are your views on the position in Malaysia in the years to come?***

DGIR: This is a Government decision and it would not be appropriate to comment on the position in years to come. My view is that if there is any review arising from the need for a single collecting agency, it will depend on how effective the current administration is and the extent of leakages, if any, arising therefrom.

CTIM: ***With regard to corporate tax, based on our understanding, there seems to be a global trend of lowering the direct corporate tax rates to entice companies to locate their operations in a particular country. What are your personal thoughts on this?***

DGIR: Tax is not the only factor in bringing investments into the country. Companies also look at standard of living as well as facilities available in the investing country. You have countries with higher rate of taxes like China and India but people still go there since there is a big market and cheap labour, etc. Investors are looking at cost efficiency as well as lower costs of production. I think the question should really be about how to make the multinationals stay. There are a lot of areas the Government is looking into to facilitate them to stay. For instance, allowing their spouses to work here, giving them free visas for a period of five years and improving the standard of living to suit their lifestyle. So there are many factors other than tax. We have also provided a two-tiered rate for the small and medium sized enterprises to enable them to grow.

CTIM: ***In your opinion, do you feel that Malaysia's corporate tax rate is competitive with other countries? Why so?***

DGIR: I think 25% is competitive. But again, this is a policy decision because every country has to look at their tax rate in terms of their Budget. At present, our petroleum resources have helped us a lot in terms of keeping the rates at the present level. However, once our resources are depleted, then we would really need to look at other sources of revenue in order to maintain the rate at 25%.

CTIM: ***Can you share with us your thoughts on how the tax profession has developed in the country?***

DGIR: There is a reasonable amount of interaction between the tax authority and the tax professionals to help understand some of the issues faced by taxpayers and the tax profession. There are audits, technical and operational dialogues and even when there are changes/enhancements to our IT system, the IRB would invite tax professionals to be briefed on the new system. This will help the tax profession to understand the requirement of our system and inform their members as such. What is important is that we should work together and although we may not agree on certain things but at least we can come up with a workable solution.

CTIM: ***As a member of the Chartered Tax Institute of Malaysia, are you pleased with how CTIM has progressed as a professional body? Have you any suggestions on how CTIM can continue with its work to further improve the overall tax system in Malaysia in collaboration with the IRB?***

DGIR: The new name is certainly more prestigious and augurs well as a professional body. CTIM has helped members to put their views across as well as helped to disseminate information from the IRB. Within CTIM, there is a technical committee which looks into issues and eventually brings it to the IRB's attention. We do collaborate in terms of finalising the rulings, etc. We may not agree on certain suggestions but we do take these into account and if there are areas that could lead to problems for the taxpayers, we then try to resolve it amicably to make it easier for taxpayers to comply. Presently, there are frequent dialogues held between CTIM and the other professional bodies; and the relationship between the professional bodies and IRB is warmer than before. Going forward, we hope to maintain the cordial and good working relationship. TG

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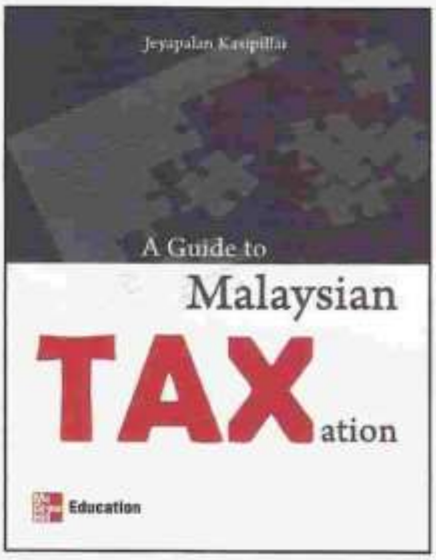

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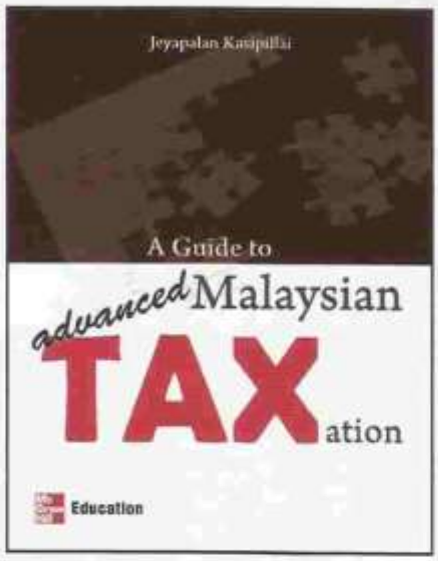

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ABOUT THE AUTHOR

Dr. Jeyapalan Kasipillai is a professor and Chair of Malaysian Business, School of Business, Monash University, Sunway Campus (MUSC).

Jeyapalan graduated from the University of Malaya and started his career in the New Straits Times as a journalist. He subsequently joined the Inland Revenue Board and spent almost 14 years doing assessment and investigation work while also teaching in public universities. He completed his Masters degree from the University of Stirling, Scotland. He joined University Utara Malaysia (UUM) as a full time lecturer in 1991. Soon thereafter, he completed his doctorate at the University of New England, Australia and became an Associate Professor and Deputy Dean of the Faculty of Accountancy at UUM. He was awarded a full Professorship in 2003. In August 2006, Jeyapalan joined MUSC.

Jeyapalan is a fellow member of three professional bodies: Chartered Institute of Secretaries & Administrators (UK), the Chartered Tax Institute of Malaysia (CTIM) and Certified Practising Accountants (CPA) (Australia). Currently, he is a Council Member of the CTIM. He acts as a consulting editor for The Malaysian Tax Reporter, and is involved in the editorial committees of e-Journal of Tax Research published by the Australian Taxation Studies Program and the University of New South Wales, Australia; Asian Journal of Business and Accounting; and the Tax Guardian. He is also the official tax correspondent for Tax Notes International, USA.

Jeyapalan has spoken on tax matters extensively both locally and internationally at seminars, workshops and conferences. Since January 2007, Jeyapalan is a member of the Taxation Law and Policy Research Institute, Monash University, Melbourne. In October 2007, Jeyapalan was appointed as an external examiner by Multimedia University, Cyberjaya. In February 2008, he was appointed as Deputy Head of School of Business, Monash University, Sunway Campus. In August 2008, Jeyapalan was conferred the Monash Pro-Vice Chancellor (PVC) Award for excellence in research. In August 2009 and in March 2010, he was again awarded the PVC Awards for excellence in research. In April 2010, Jeyapalan was appointed as a Professorial Visiting Fellow by UNSW, Sydney. Jeyapalan supervises higher degree doctoral students and has been an external examiner for numerous doctoral theses.

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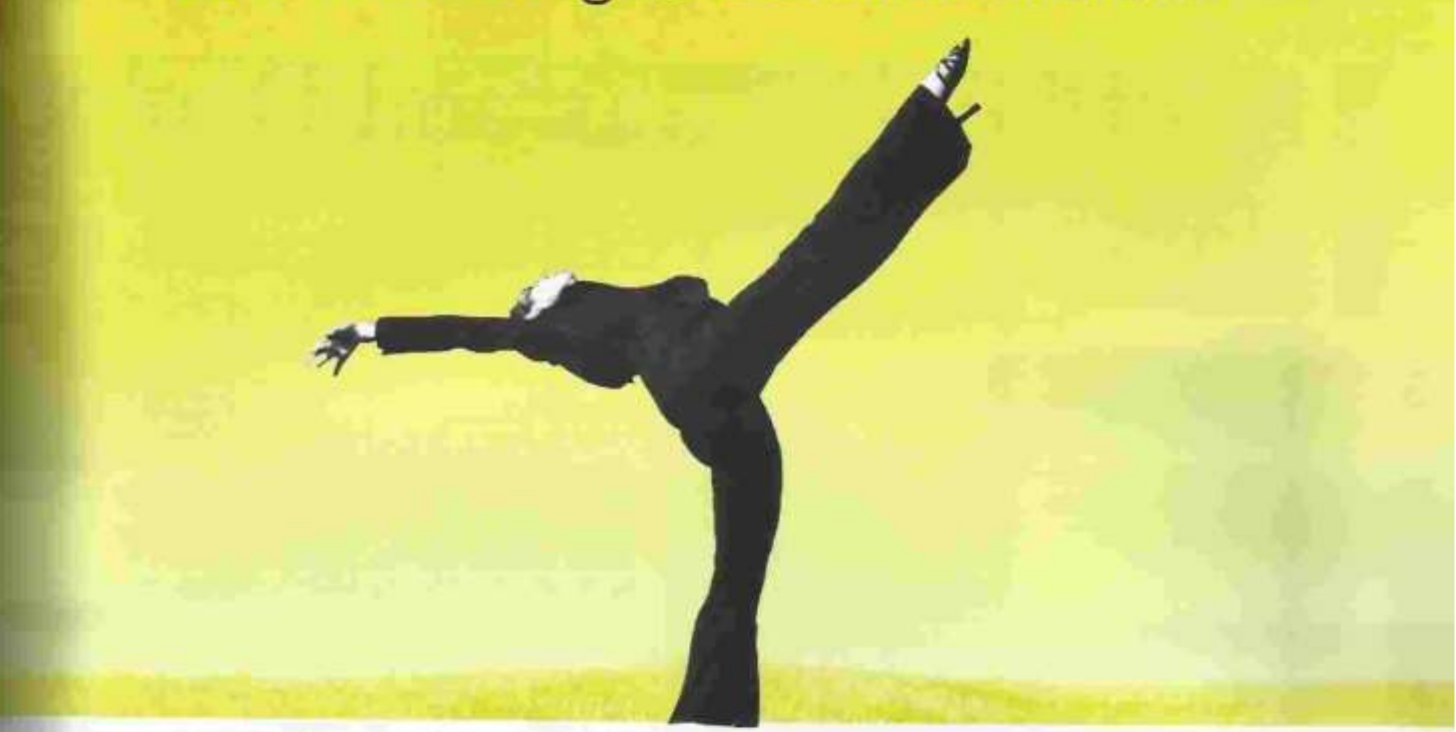

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Withholding Tax and Double Taxation Agreements

By Nicholas Crist

Introduction

Malaysia has a broad based Withholding Tax (WHT) system which imposes tax at rates of up to 15%. Where affected payments are made to non–residents, it is appropriate to consider how withholding tax obligations arising under the Income Tax Act 1967 (ITA) are impacted by Double Taxation Agreements (DTAs). As with most things in life, a systematic approach to the application of DTAs must be taken.

Rationale for DTAs

While DTAs may come in a variety of shapes and sizes, their rationale is eloquently stated in their preambles. For instance, the preamble to the Malaysia/UK DTA states that it is for "the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income". Other DTAs adopt similar wording.

It is apparent from the preamble that the primary purpose of a DTA is the avoidance of double taxation. It therefore follows that a DTA cannot impose tax. Consequently, the starting point for a systematic approach to the application of DTAs is to determine whether under domestic law there is a liability to, for present purposes, withholding tax.

If there is no liability under domestic law, a liability cannot be created by a DTA. This point can be illustrated in relation to dividends where a number of Malaysia's DTAs impose a limit on withholding tax. For instance, under the Malaysia/Singapore DTA withholding tax on dividends is limited to 5% or 10% depending on the percentage of the share capital held by the shareholder. However, under Malaysian domestic law (as well as that of Singapore) there is no withholding tax on dividends. Clearly, therefore, it would be incorrect to deduct withholding tax on dividends paid by a company resident in Malaysia to a Singapore resident shareholder.

If there is no withholding tax under domestic law, why confuse the position by putting withholding tax rates in DTAs? The reason for this is that domestic tax laws typically change annually, if not more often. However, the process of negotiating a DTA can be protracted and it would be impractical to renegotiate these each year. Therefore, a "what if" approach is often adopted in drafting to make provision in *the event of future domestic law changes.* This underlines why it is important to begin with Malaysia's domestic law in relation to withholding taxes.

Domestic Withholding Taxes

For payments to non–residents, domestic withholding tax obligations can be summarised as follows:

Relevant Section of the ITA	Nature of Payment	Rate of Withholding Tax
107A	Contract payments	10% + 3%
109	Interest Royalty	15% 10%
109A	Public Entertainer	15%
109B	Section 4A income	10%
109D	Distribution by REITS/PTF	10%, 25%
109E	Distribution by family funds, etc	8%, 25%
109F	Section 4(f) income	10%

This article takes a selective look at how domestic law obligations in relation to certain categories of WHT are impacted by relevant DTAs.

Section 107A – Contract Payments

Pursuant to s 107A, contract payments to a non–resident contractor in respect of services under a contract in relation to any contract project in Malaysia are subject to a 10% + 3% WHT. On the basis that such amounts represent business profits of the non–resident, Malaysia would impose withholding tax pursuant to s 107A where the non–resident of a treaty country has a Permanent Establishment (PE) in Malaysia. Accordingly, regard must be had to the PE Article of the relevant DTA to determine if a PE exists. If the conditions for a PE are not met, withholding tax should not be levied under s 107A, although liabilities under s 109B may be relevant.

Where a PE exists, the effect of a DTA is to make the PE subject to Malaysian income tax on its attributable business profits. It follows that, as Malaysia is competent to tax such profits, it can impose WHT pursuant to s 107A. Consequently, Malaysia's DTAs do not reduce the rate of s 107A withholding tax as the tax collected under s 107A is simply an advance collection of the Malaysian tax ultimately due in respect of the attributable profits of the PE.

Section 109B – Section 4A Income

While DTAs do not modify s 107A WHT obligations, this is in contrast to WHT obligations under s 109B which are impacted by DTAs. DTA protection is often afforded through a reduction in the 10% domestic withholding tax rate where the relevant conditions are met. Typically, to benefit from reduced DTA rates, the payee is required to be the beneficial owner of the income and must produce a certificate evidencing residence in a relevant treaty country. However, where the payee is a resident of Australia, withholding tax is not levied under s 109B as a result of Government to Government negotiations.

Section 109B WHT has attracted criticism on the international scene and this has centred around the Business Profits Article, the argument being that for many payees the income they receive is part of their normal business profits. Consequently, as has been seen above, business profits of a non–resident should not be taxed in the absence of a PE. However, the Malaysian Inland Revenue Board (MIRB) appears to be of the view that income to which s 109B applies falls outside the scope of the Business Profits Article.

The MIRB's approach was severely tested in the High Court's decision in SGSS (Pte) Ltd v Ketua Pengarah Hasil Dalam Negeri (2000) MSTC 3814. Subsequently, the scope of s 109B was effectively reduced through an amendment to s 15A such that WHT is only due in respect of income falling under s 4A(i) or (ii), where and to the extent that the services are performed in Malaysia. This change is effective from 21 September 2002.

Section 109 – Interest Income

Historically, DTAs have played a significant role in reducing WHT on interest from the domestic rate of 15%. Indeed, on a global scale, the savings offered by Interest Articles can be viewed as one of the factors giving rise to "Treaty Shopping". As a result, Interest Articles contain built in anti avoidance/treaty shopping provisions. Although varying from DTA to DTA, these anti avoidance provisions which restrict or deny DTA relief, apply:

- Where the amount of interest is excessive in view of a special relationship between the payer and payee [eg Art 12(8) of the Netherlands/Malaysia DTA]; or

- If a main purpose of the creation (or assignment) of a loan was to take advantage of the Interest Article [eg Art 11(7) of the UK/Malaysia DTA]; or

- Conduit arrangements; this is the treaty shopping Article and although not found in Malaysia's DTAs, it is found in Art 26 of the US/Netherlands DTA.

In addition to the above, the Interest Articles in Malaysia's DTAs require that the payee must be the beneficial owner of the interest income [eg Article 11(2) of the Singapore/Malaysia DTA].

Beneficial Ownership

The requirement of "beneficial ownership" is capable of different interpretations. It is, however, relevant to refer to the decision of the UK's Court of Appeal in Indofood International Finance Ltd v JP Morgan Chase (JPMC) ([2006] STC 1195). The facts of the case can be summarised as follows. Indofoods, an Indonesian resident company, wished to borrow money from a non-resident lender. Having regard to Indonesian WHT, the funds were lent to Indofoods via its Mauritian subsidiary (M Co) in order to benefit from the WHT savings offered under the Indonesia/Mauritius DTA.

After some time, Indonesia terminated its DTA with Mauritius. From Indofoods' perspective, the terms of the loan allowed its early repayment if, as a result of a change in Indonesian law, the rate of interest WHT increased beyond 10%. Repayment was an attractive proposition to Indofoods as interest rates had fallen in comparison to that under the existing loan arrangement. However, the ability to repay was denied if the increase in WHT could be avoided by Indofoods taking reasonable measures available to it. JPMC therefore objected to repayment on the grounds that a reasonable measure available would be to restructure the loan through a Dutch company and apply interest WHT at the rate of 10% under the Indonesia/Netherlands DTA.

The thrust of Indofoods' counter argument was that a Dutch company, if used, would not meet the beneficial ownership requirement in respect of the interest received from Indofoods. This was on the basis that the Dutch company would be obliged to pay on to the lender any interest it received from Indofoods. Therefore, the proposed Dutch company route was not a reasonable method and Indofoods was of the view that it should be allowed to repay the loan.

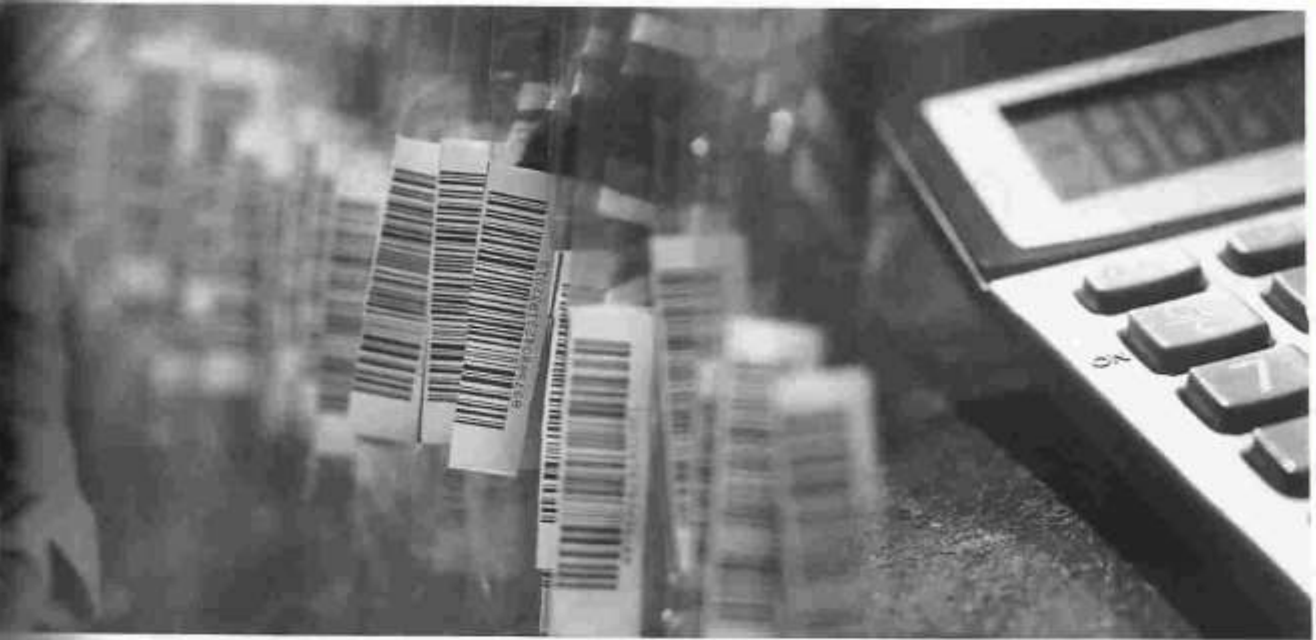
Having failed to reach an agreement, Indofoods and JPMC went to court. The UK's Court of Appeal ruled in favour of Indofoods on the basis that the beneficial ownership requirement would not be met. This was on the grounds that the proposed Dutch company would only receive the interest on a set day and, on the following day, would be bound to pay on the interest it received. The Dutch company would not have had the full privilege to directly benefit from the income, and this, the Court held was incompatible with beneficial ownership.

Although the Indofoods case did not strictly involve a tax dispute and is not a Malaysian case, tax practitioners would be wise to consider the comments made in respect of the "beneficial ownership" requirement. Similar observations apply from a Malaysian perspective in relation to Royalty and Technical Fees Articles where the requirement for beneficial ownership is also prevalent.

Section 109F – Section 4(f) Income

The obligation under domestic law to deduct a 10% withholding tax on income falling within s 4(f) which is paid or credited to a non-resident is effective from 1 January 2009. Section 4(f) charges to tax "gains or profits not falling under" the other charging provisions of s 4.

It is necessary to determine whether the relevant payments fall within s 4(f), which can be challenging, given the lack of defined scope for this provision. Guidance can, however, be



obtained from the MIRB's Public Ruling No.1/2010 Withholding Tax on Income Under Para 4(f).

In a situation where the payee is a resident of a treaty country, the above Ruling directs that regard should be had to the Other Income Article of the relevant DTA to determine taxing rights. A typical Other Income Article provides:

"Items of income of a resident of a contracting state which are not expressly mentioned in the foregoing Articles of this agreement shall be taxable only in that contracting state except that if such income is derived from sources in the other contracting state, it may also be taxed in that other state". (Art 22 of the Malaysia/Ireland DTA).

There is therefore a requirement to determine whether the item of income in question is expressly mentioned elsewhere in the DTA before regard can be had to the provisions of the Other Income Article. In the writer's opinion, this determination could be fertile ground for dispute particularly in view of the breadth of the Business Profits Article.

The Business Profits Article in many DTAs makes reference to "the profits of an enterprise". It was decided in an Australian case (Gunter Thiel v Federal Commissioner of Taxation 90 ATC 4717), that the existence of an "enterprise" may not necessarily refer to something which requires continuity or repetition, but may also result from the conduct of a single activity. In Thiel's case, once an "enterprise" was found to exist, the court proceeded on the basis that its profits could be sheltered from Australian tax in the absence of a PE, by the Business Profits Article.

Although Thiel's case is an Australian case, if the same principle is adopted in Malaysia, it implies that the threshold for determining whether a non-resident has an enterprise may be met relatively easily, including in the case of single activity. Subject to the terms of the particular DTA, it may be arguable that the profits of the enterprise are sheltered from Malaysian tax in the absence of a PE in Malaysia notwithstanding that the transaction is an isolated one.

If the above analysis is not adopted, the Other Income Article is likely to support the view that Malaysian WHT should be levied on the income in question. In this respect, while the Other Income Article allocates taxing rights to the country of residence of the payee, this is, in general, only if the income is not derived from sources in the other contracting state, ie Malaysia. On the presumption that the source of such income is not determined in the DTA, regard would normally be had to domestic law [eg see Art 3(2) of the Malaysia/Ireland DTA]. In this respect, s 15B ITA provides a statutory definition of when s 4(f) income is deemed to be derived from Malaysia.

Conclusion

Where it can be established that a payee is resident in a country with which Malaysia has a DTA there may be scope to reduce withholding tax costs. However, while through the general adoption of the OECD model convention DTA's may have a similar format, it is imperative that the detailed requirements of the Article through which relief is being claimed are determined. As a pre-condition the DTA and the relevant Article must be in force although their effective dates may not be the same and this can be a trap for the unwary. TG

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A Review of Corporate Governance in Retrospect

By Andrew Ewe

In the days when companies were owned and run by the same persons or family, there were hardly areas of conflicts of interest between what the owner had wanted to achieve and what the manager was trying to do. Their objectives were identical and hence situations involving conflicts of interest did not or seldom arise. However, as the owners and managers become separate as in the case with most listed companies with dispersed individual and sophisticated institutional shareholders, the problem of agency arises. The directors are under obligations to run the company in a way that will maximise returns to the shareholders in the long run and this involves issues of transparency, accountability and avoidance of conflicts of interest and ethics on the part of the managers and directors. Clearly, there arises a need to have good corporate governance practice in order that the shareholders' interest can be safeguarded.

The US has experienced a spate of corporate collapses of magnitude and nature that was never seen before. Often, greed and over–indulgence by management were seen as the cause and the parties held responsible for these failures were the company directors, executives, and external auditors. The financial havoc and adverse social repercussions of the Enron debacle and the like, have hastened society awareness and keenness to pursue good corporate governance practice. With US$62.8 billion in assets, the collapse of Enron Corporation in 2001 was the biggest bankruptcy case in the history of US (Gerald Vinten, 2002). The bankruptcy of Enron wiped off billions in market capitalisation, a sum greater than the GNP of many under–developed countries. Many employees of Enron lost their life–savings and tens of thousands of investors lost billions. No doubt the rules–based accounting practice of the US was a contributing factor in the fraudulent accounting practices that led to the collapse of Enron and WorldCom, the issue stops being one of purely accounting and becomes one of corporate governance, when one considers the unethical involvement of some directors and the non–involvement of the others in their oversight duties. The scandals of Enron, WorldCom, Tyco and others in the US in early 2000s were indeed a corporate governance wake–up call not only for corporate America but the rest of the world as well. It is therefore not surprising that a governance revolution is underway in most parts of the world.

In a sense, the response by most companies to the adoption of good corporate governance practice is more reactive than is proactive. As various rules and regulations get introduced in various countries, they impose obligations on companies to reform and adopt good corporate governance practice. But it will be erroneous to say that prior to the Enron scandals, no company practised good corporate governance. Many companies did and still do, for they are keenly aware that investors particularly the mutual fund companies look for good companies to invest in and one of the criteria is a company with good corporate governance practice. General Electric and Pfizer are examples of companies that have consistently been voted as having the best Boards (John A. Byrne et al, 1997). Such companies need no prompting. They are aware that having good corporate governance means enhanced shareholder values in the long run. This is consistent with the results of a study by Governance Metrics International (GMI), an independent governance rating company, that the shares of [illegible] companies that scored highest in their survey in 2004 for best governance practice outperformed the S&P 500 index by [illegible]% over five years (Dan Roberts, 2004). The analysis of the results by GMI also confirmed recent academic studies showing a correlation between share price performance and adherence to corporate governance best practice.

The 1992 Cadbury Report of UK laid the foundations of a set of corporate governance codes, not just in the UK but also in countries as diverse as Russia, India and Malaysia. These countries have incorporated the Cadbury Report's main principles into their own corporate governance codes. Although the term 'corporate governance' has almost become an accepted and known phenomenon, it is nevertheless a term that is hard to define as it has many facets. Sir Adrian Cadbury (2002, p. 11) defined corporate governance as "the system by which companies are directed and controlled". The OECD (2004, p11) defined corporate governance as "a set of relationship between a company's management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interest of the company and its shareholders and should facilitate effective monitoring". From the definitions, it is clear that corporate governance involves both the internal aspects of the company, such as internal control and board structure and the external aspects such as the relationship with the shareholders and the stakeholders. Importantly, it also provides the mechanism through which corporate objectives may be set, monitored and achieved.

While corporate governance in essence has a multi-faceted meaning and encompasses a wide range of subjects which goes beyond this discussion, in practice, references to corporate governance tend to be simplistic and are generally discussed in relation to the board structure, power, independence and issues of conflicts of interest. The discussion that follows will also be restricted to these areas.

Although, there have been subsequent reports such as Ruttleman, Greenbury, Hampel and Turnbull, that eventually culminated in the Combined Codes, the Cadbury code, published in 1992 still forms the basis for what is regarded as good corporate governance by the world over, not only in the UK. The key recommendations of the Cadbury codes were:

- Separation of the roles of chairman and chief executive;
- At least three independent non-executives on the board;
- Audit, remuneration and nomination committees, comprising mainly of non-executives; and
- Directors to report on internal controls.

Since the publication of the Cadbury report, there have been profound changes in British boardrooms but no change has been more important than the move away from the single autocratic figure at the head of the public corporation. Companies are increasingly separating the role of chief executives and the chairman are increasingly taking a backroom role for the good reason they are more able to discharge their principal function of handling and managing crisis and change when required. Today, a full 95% of the top 1000 UK companies split the roles of the chief executive and chairman. (Stephen Davies, 2004). Although this does not mean that 950 UK firms are flawless, it does indicate that the UK boards have notched up progress in developing a culture of independent oversight that is necessary to ensure balance of corporate power that could advance shareholder interest. Perhaps for this reason, UK has seen nothing like the scandal exemplified by Enron in the US.

In US, companies are often led by powerful dynamic executives – as was the case with both Jeffrey Skilling at Enron and Ebbers at WorldCom – and the same person is often chairman. There is no one on the Board that can stand up to them. As late as March 2004, CEOs in the US directly run the board at no fewer than 76% of the S&P 500 companies (Stephen Davies, 2004). But the trend in US is also changing towards one of split roles between the chairman and the chief executive. Michael Eisner, chief executive of Walt Disney, was shocked at not being elected as the chairman for the first time at the 3 March 2004 annual general meeting. He had exclaimed that there was a movement in America to separate the non-executive chairman and the CEO.

The Cadbury report also saw the independent non-executive directors as the principal instruments for better corporate governance. The code calls for non-executive directors of sufficient calibre and number for their views to carry significant weight. They are expected to bring independent judgement to bear on issues of strategy, performance, resources including key appointments and standards of conducts. The non-executive directors' independence is questionable if they allow themselves to be in a position of conflict of interest. The non-executive directors are also to form the audit, remuneration and nomination committee.

For most of the 1990s, **Walt Disney Co.** had occupied a prominent place in Business Week's rankings of America's worst corporate boards. There was plenty that needed changing at Disney. While the company had a healthy balance sheet, straightforward accounting and an admirably diverse board, CEO Michael Eisner hand-picked most of the directors himself and installed some in roles for which they are ill-suited. He had elementary school principal Riveta Bowers and actor Sidney Poitier sitting on the compensation committee. Eisner also permitted and in some instances promoted conflicts of interest involving directors. George Mitchell, the co-chairman of the governance and nomination committee had a $50,000 a year consulting contract with Disney and he is the chairman of a law firm that represented Disney. Stanley Gold, the other co-chairman of the governance and nomination committee, was also in conflict under Disney's governance rules. He had a daughter who worked for Disney's consumer division and earned $85,000 a year. Besides, John Bryson, another director on the governance panel had his wife on the board of Lifetime TV that is 50% owned by Disney. Director Robert AM. Stem, a celebrated architect, had an insurmountable problem because Disney had been one of his most important clients for years. Eisner is known as a CEO who received excessive remuneration and he cashed in $750 million in share options during 1990s. Such were the credentials of Disney's board members. No wonder it was consistently rated to have the worst board and was consistently a target of shareholders activism.

Mounting pressure from shareholders, particularly institutional shareholders, was mainly responsible for many of the governance changes that have taken place in US and UK. Companies that once ignored fair criticisms of their weak boards from disgruntled investors could no longer do so. So was the case with Disney, whose shareholders had demanded for separation of the office of the chairman and the chief executive, solicitation of director nominees from major investors, set financial benchmarks, detailed succession plans (Mark Gunther, 2002). Under shareholder pressure, Eisner recruited governance guru Millstein as adviser and in April 2002 announced a series of changes. Post-Enron, Disney was among the first companies to prohibit its external auditors from providing consulting services. Robert AM Stem, the architect and George J Mitchell, whose law firm had a $1.3 million in Disney billing, severed their business ties with the company. And the company came clean about four directors whose family members had previously undisclosed Disney jobs. With oversight from governance guru Ira Millstein, Disney restricts key audit and compensation committee to independent directors. Independent directors hold meetings away from management and they are restricted in the number of boards they can sit on. Directors must own at least $100,000 in company stock, giving them direct stake in the company's performance (Business Week, 2002).

Besides, Disney also bolstered the credibility of its financial reporting by using different firms for auditing and consulting. Such were the sweeping changes and improvements in Disney compared to the past. "The goal is to end up with a board and a set of governance rules that goes a long way toward growing investor confidence", said Robert A. Iger, Disney's chief operating officer (Louis Lavelle, 2002). This, the shareholders of Disney eventually did, by casting a no-confidence vote against Eisner at the March 3, 2004 annual meeting. The strong 43% non-confidence vote stripped him of the role as chairman (John Plender, 2004) leading to his eventual resignation as chief executive a year

later (Eric Dash, 2005). Some observers commented that the no-confidence vote against Eisner by the institutional investors was the result of a ruling by the Securities and Exchange Commission requiring all mutual funds companies starting from 31 August 2004, to disclose how they voted their stock holdings on proxies (Peter J Howe, 2004).

The changes in Disney typify the response of most poor corporate governance companies in US, to the various enactments and requirements such as the Sarbanes-Oxley Act 2002, the SEC requirement, the New York Stock Exchange and the Nasdaq's listing standards requirements. However, the changes taking place in these laggard companies appear to be driven less by the threat of government sanctions and intervention than by the stigma of being branded an unethical enterprise. "Social sanctions may eclipse the law in imposing penalties for misconduct and mischief." (John A. Byrne, 2002)

Meanwhile, companies with good corporate governance practice such as General Electric (GE), 3M and Intel continue to uphold and improve on their already commendable good governance practice, in response to the Sarbanes-Oxley Act which requires greater accountability

[illegible] the New York Stock Exchange's proposals for its member companies. GE added more directors without ties to the company. It enforces its corporate ethics by classifying directors as independent if they do not work for GE and if the sales to and from companies of which they are executives total less than 1% of revenue. Board members serving on the audit committee must not receive more than their directors' fees from GE. The responsibilities of the audit committee have also been extended to include review of public financial disclosures and practice, as well as auditing principles and decisions. Directors of GE will have to visit two of the corporate giant's business units a year accompanied by corporate executives, under a new governance plan revealed in November 2002 (Pam Hawkins, 2002). To ensure compliance with s 404 of Sarbanes–Oxley Act 2002, GE spent $30 million to have their internal controls revamped, properly documented and tested (Dan Roberts, 2004 April). GE has gone well beyond the minimum required by Sarbanes–Oxley and the NYSE, commented Brennan, the CEO of Van Guard Funds, GE's very large shareholders. (Pam Hawkins, 2002)

Notwithstanding all the regulatory reforms and the rush by companies to ensure compliance with the various acts and codes on good corporate governance, there can be no assurances that there will not be anymore scandals of the Enron kind. Many of the US companies that ran into trouble had all their corporate governance mechanism in place, at least on paper. Enron's board was a model board and it had truly independent board members. In 2002, the Enron Board was judged as one of the five best boards in the US by the Chief Executive magazine. Yet it went kaput. It appears that audit committees, compensation committee, codes of ethics and regulatory requirements are of not much use in preventing corporate governance failures. Ultimately, it is dependent on the individual integrity of those in office, in control and in power. People who have integrity are invariably ethical. While the Sarbanes–Oxley Act is not an ethics warranty, integrity is. But the sad truth is, integrity cannot be legislated. TG

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Customs Valuation: Condition Of Sale For Export To Malaysia

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

Recently, in *L Sdn Bhd v Ketua Pengarah Kastam, Malaysia*[1], the High Court examined the phrase "condition of sale for export to Malaysia" under Regulation 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999. The issue in that case was whether royalty paid should be part of the customs value of the products imported to Malaysia. This article discusses the said phrase in light of *L Sdn Bhd*.

Introduction

The historical origin of Regulation 5(1)(a)(iv) could be traced to the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (GATT) which is presently known as the World Trade Organisation Agreement (WTO) Valuation Agreement. This agreement establishes a customs valuation system that primarily bases the customs value on the transaction value of the imported goods, which is the price actually paid or payable for the goods when sold for export to the country of importation, plus certain adjustments. The spirit of this agreement is to provide a single system that is fair, uniform and neutral for the valuation of imported goods for custom purposes, conforming to commercial realities and, outlawing the use of arbitrary or fictitious customs values.

Valuation Regulations

Regulation 4(1) of the Valuation Regulations states that the customs value of imported goods shall be their transaction value. Transaction value is the price paid for the goods when sold for export to Malaysia. However Regulation 5(1)(a)(iv) allows the transaction value to be adjusted by adding the royalty paid in respect of the goods if the royalty was a condition of the sale of the goods for export to Malaysia. The elements of Regulation 5(1)(a)(iv) are:

1 The decision was delivered on 8 December 2010 by the Appellate & Special Powers Division Court 2, High Court, Kuala Lumpur. The authors successfully represented L Sdn Bhd before the High Court, where the Customs' decision to impose additional customs duties and sales tax amounting to RM5.9 million was quashed.

(a) there must be royalty payment;
(b) royalty must be in respect of the goods imported to Malaysia;
(c) royalty must be paid by the buyer directly or indirectly, as a **condition of the sale of the goods for export to Malaysia**; and
(d) exclude royalty for the rights to reproduce the goods in Malaysia.

In *L Sdn Bhd*, the taxpayer contended that the phrase "condition of sale" has a settled meaning in common law and urged the Court to adopt that meaning. Meanwhile, the Customs proposed that the Court applied the economic reality test.

The Common Law Meaning

In 2009, our Court in *Nike Sales Malaysia Sdn Bhd v Jabatan Kastam DiRaja Malaysia & Others* (R3(1)–25–03–2004), adopted the unanimous landmark decision of the Supreme Court of Canada in *Canada (Deputy Minister of National Revenue) v Mattel Canada Inc.* 2001 SCC 36 by applying the common law meaning of "condition of sale". The Court was guided by Professor P.S. Atiyah's work, which is as follows:

> *"...in its usual meaning a condition is a term which, without being a fundamental obligation imposed by the contract, is still of* ***such vital importance that it goes to the root of the transaction*** *and the importance of a condition in contracts for the sale of goods is that* ***its breach, if committed by the seller, will give the buyer the right to reject the goods completely and to decline to pay*** *the price, or if he has already paid for it, to recover it."*

The taxpayer in *L Sdn Bhd* explained that the royalty was paid to exploit the trademarks and trade names granted by the licensor. The taxpayer was entitled to manufacture its products on its own or outsource it to a third party. There was no contractual requirement on the taxpayer to appoint related parties to manufacture its products. Further, the taxpayer had the option to determine how it intended to source its products, whereby it had sourced its products from third parties and related parties.

The Economic Realities Test

On the other hand, the Customs advanced the economic realities test, which was developed by the New Zealand Court of Appeal's decision in *Chief Executive of NZ Customs Service v Nike New Zealand Ltd* [2004] 1 NZLR 238. According to this test, the condition of sale requirement is satisfied when:

(a) The royalty is payable to the manufacturer or to another person *as a consequence* of the export; and
(b) The party to whom the royalty is payable must have *control beyond the rights of an ordinary licensor* of intellectual property and giving it the ability to determine whether the export to New Zealand can or cannot occur.

This test was applied by the Customs Appeals Tribunal in *Colgate-Palmolive Marketing (M) Sdn Bhd v Ketua Pengarah Kastam* (No Rayuan TRK(J) 2–2008).

Two Schools Of Thought

There are clearly two different schools of thought in interpreting the phrase "condition of sale". In this regard, the issue simply is, which is the preferred approach?

Like the Supreme Court, the Federal Court of Appeal of Canada ("FCA") in *Mattel* also concluded that the royalties paid by the taxpayer in that case was not a condition of sale. However, the FCA did so for different reasons. The FCA clarified that not every payment of royalties was or was intended to be dutiable and held that the royalties were paid as a condition of sale if:

(a) the contract of sale between the vendor and the importer makes the sale of goods contingent on royalties being paid; or
(b) the importer's ability to import products for failing to pay royalties may be prevented or seriously comprised either (i) because the licensor owns or controls the vendor or (ii) because the vendor holds the trademark or copyright.

The FCA added that the payment of royalties does not be expressly stipulated in the sale contract and that the word "condition" was not a term of art which carries the meaning generally ascribed to it in the law of sales. Rather, the word "condition" was used in its ordinary and common sense way to mean that the payment of royalties has to be made as a prerequisite or requirement for the export of the goods.

Interestingly, the FCA's approach was not favoured by the Supreme Court, which held that rather than create a

complex series of tests not strictly based on the settled legal meaning of words, it was preferable to rely on the common law and sale of goods law to determine whether royalties were paid as a condition of sale. According to the Supreme Court, the FCA's control test would capture virtually all royalties by the mere existence of remedies afforded to trademark owners under the Canadian Trade–marks Act, RSC 1985. The Supreme Court held that the phrase "condition of sale" was clear and unambiguous and in such circumstance, it was not necessary to resort to an analysis of economic realities of a transaction.

On the other hand, the New Zealand Court of Appeal in *Nike* was not in favour of the *Mattel* approach on the basis that it was inappropriately technical and narrow in the context of the interpretation of an international agreement. The *Mattel* approach was held to have effectively introduced the words "of contract of" before the "sale of the goods". The Court of Appeal in *Nike* held that the expression "as a condition of the sale of the goods" was necessarily wider than "as a condition of the contract of sale of the goods". In fact, *Nike* found the approach taken by the FCA in *Mattel*, which suggested the word "condition" is used in its ordinary and common sense way, to be more convincing.

In determining which is the preferred approach, one must re–consider the spirit of Article VII of GATT, which was provide a single system that is fair, uniform and neutral for the valuation of imported goods for custom purposes, conforming to commercial realities and, outlawing the use of arbitrary or fictitious customs values. In this regard, to ensure the valuation code is applied harmoniously among member countries, it is vital that the phrase "condition of sale" is applied objectively. If this is case, then the Mattel approach seems to be more appropriate because the phrase "condition of sale" has a settled legal meaning in common law, which is essentially an objective test, i.e. whether the condition is a term of fundamental obligation imposed by the contract and is of such vital importance that it goes to the root of the transaction.

On the other hand, the economic realities test as propounded in *Nike* is a subjective test, which requires one determine whether royalty is payable as a consequence of the export and whether the recipient of the royalty has control beyond the rights of an ordinary licensor of intellectual property. The application of the *Nike* approach is subjective and may not achieve the spirit of ensuring the valuation code is applied harmoniously. As appreciated by our High Court in *Nike Sales*, it might be difficult to ascertain in any fact–situation what is connoted by "control beyond the rights of an ordinary licensor". With respect, the *Nike* approach does not create certainty for businesses and has the danger of subjecting wherever, whenever and however royalty as an item for adjustment for the purposes of customs valuation. However, if the member countries intended to apply the economic realities approach in interpreting the valuation code, then perhaps it is advisable to amend the wordings of Article VII accordingly to achieve this.

Nonetheless, for the reasons explained above and by our High Court in *L Sdn Bhd*, the authors prefer the *Mattel* approach in determining the phrase "condition of sale".

L Sdn Bhd

In its examination of the phrase "condition of sale", our High Court in *L Sdn Bhd* applied the common law meaning and ruled in favour the taxpayer. The taxpayer advanced the following arguments to persuade the Court:

(a) the words "condition of sale" were unambiguous and as such, must be given its ordinary meaning;
(b) where clear and unambiguous statutory provisions can be applied directly to the facts, it is not necessary to resort to an analysis of the economic realities of a transaction;
(c) if Parliament had intended that royalty wherever, whenever and however paid in relation to exportation of goods must be regarded as an adjustment item for the purposes of calculating customs value, there will be no need to provide for the legal formula "*as a condition of the sale of goods for export to…*"; and
(d) the legal effect of the interlocking agreements between the parties does not render the payment of royalty as a pre–condition of export.

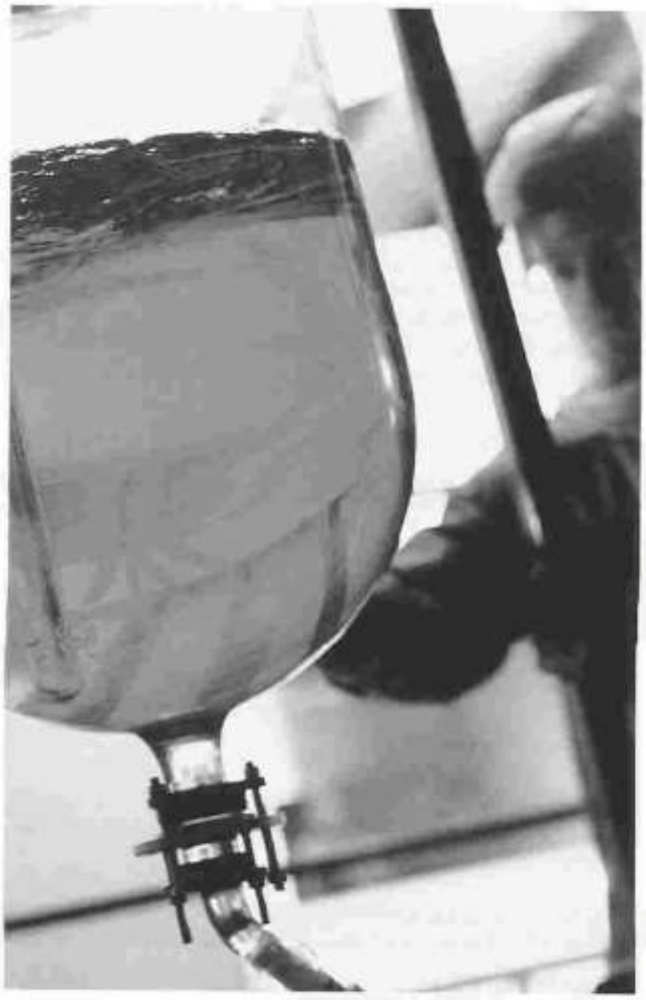
The Customs' submission based on the economic realities test, i.e. the taxpayer must be taken to purchase the tangible goods with the intangible rights, as without the latter, the goods have no value, was rejected by the Court. The authors acknowledge that from a business perspective, there may be some merit to contend that an importer's right to import products at some point may be linked to royalty payment. This is especially where the imported products have no real market potential and value without intangibles like trademark and trade name. However, when a phrase like "condition of sale" has a settled legal meaning, it is always preferable to apply that rather than create a complex meaning or series of tests to determine such phrase.

The Court in *Nike Sales* and *L Sdn Bhd* rightly rejected the economic reality test advanced by the Customs as the phrase "condition of sale" as they appear in Regulation 5(1)(a)(iv) are clear and unambiguous. The Court had repeatedly held that where clear and unambiguous statutory provisions could be applied directly to the facts, it was not necessary to resort to an analysis of economic realities of a transaction. In fact, the accepted principles of statutory interpretation do not allow reference to be made to the economic reality test without taking into account, first and foremost, the words used in the statutory provision.

This approach is consistent with the Federal Court in *Palm Oil Research and Development Board Malaysia & Anor v Premium Vegetable Oils Sdn Bhd* [2004] 2 CLJ 265 which outlined the correct approach when interpreting a taxing statute:

(a) First, the words are to be given their ordinary meaning.
(b) Secondly, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption so to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.
(c) Thirdly, the object of the construction of a statute being to ascertain the will of the legislature, it may be presumed that neither injustice nor absurdity was intended. If therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted.
(d) Fourthly, the history of an enactment and the reasons which led to its being passed may be used as an aid to its construction.

Further, the authors are of the view that the economic reality test will also render devoid of any meaning to the phrase condition of sale and will subject virtually all royalty payments as part of the value of goods. Had Parliament intended for all royalty payments to be dutiable, it would not have stated it is only those that are paid "*directly or indirectly, as a condition of the sale of the goods for export to Malaysia*". The Court of Appeal in *Ketua Pengarah Hasil Dalam Negeri v Daya Leasing Sdn Bhd* [2005] 2 CLJ 449 held that one of the salutary canons of statutory construction is that Parliament does not act in vain and the courts strongly lean against a construction which reduces a statute to a futility. Moreover, it requires no feat of imagination in a draftsman to see that cases may arise where royalty payment is not a condition of sale and if it were intended to subject such payment to be dutiable under Regulation 5(1)(a)(iv), one would expect that to be made clear (see the House of Lord decision of *Saxone Lilley & Skinner (Holdings) Ltd v Commissioner of Inland Revenue* [1967] 44 TC 122).



In fact, following *Premium Vegetable Oils*, if the words "*directly or indirectly, as a condition of the sale of the goods for export to Malaysia*" are ignored, one would not be promoting the purpose or object of Parliament but be defeating it.

Conclusion

The authors welcome the decision in *L Sdn Bhd* as it amplifies the position adopted in *Nike* and *Mattel* that where a phrase has a settled legal meaning, that meaning is to be applied rather than to resort to a new complex meaning. In this regard, the phrase "condition of sale" in Regulation 5(1)(a)(iv) must be given its ordinary common law meaning. *L Sdn Bhd* highlights that the mere fact royalty was paid does not *ipso facto* mean it was a "condition of sale" and that the customs valuation must be adjusted to include the royalty paid. TG

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TECHNICAL UPDATES

These technical updates are summarised from selected Government Gazettes published between 30 August and 7 December 2010 as well as Public Rulings and guidelines issued by the Inland Revenue Board (IRB) during the same period.

INCOME TAX

Income Tax (Determination of Knowledge Worker, Qualified Activity & Specified Region) Rules 2010
It was announced in Budget 2010, that knowledge workers residing and working in the Iskandar Development Region (IDR) will enjoy a preferential tax rate of 15% on their employment income. The Rules provide clarification as to who would qualify as a "knowledge worker", the activities that qualify for this incentive and the designated areas for carrying out these activities.

The Rules also provide the manner of determining the chargeable income that will be subject to the preferential rate of tax.

The Rules shall have effect from the year of assessment 2010.

STAMP DUTY

Stamp (Amendment) Act 2010
The Stamp (Amendment) Act 2010 which amendments the Stamp Act 2010 came into operation on 1 November 2010. The amendments are as follows:

The definition of "duly stamped" in s 2 was amended to include the term "amount of advance duty paid". The change in definition is as a consequence of the introduction of advance duty in s 36AA.

A new s 36AA was inserted. This section seeks to introduce a new mechanism to pay duty for an instrument of transfer of an immovable property where the duty payer may apply to the Collector to pay duty in advance based on the formula as provided in the new section.

Section 36B was amended to empower the Collector to make an additional assessment where the proper amount of duty is higher than the advance duty paid.

A new s 36C was inserted. Under the new section, where the proper amount of duty is equal or lower than the advance duty paid, the Collector shall notify the duty payer on the proper amount of duty and refund any advance duty paid in excess.

Section 37 was amended. The amendment to s 37 requires the Collector to make an endorsement of any advance duty paid on any instrument which would enable the instrument to be deemed to have been duly stamped for the purposes of the Stamp Act 1949.

Section 38 was amended to provide that nothing in s 36AA, 36B and 36C will extend to any instrument chargeable with ad valorem duty and made as a security for money or stock without limit.

New s 74A and 74B which were inserted into the Stamp Act 1949 empower the Collector to issue a certificate to prevent a person from leaving Malaysia without paying any duties, penalties or sums required to be paid under the Stamp Act 1949 and provide for the consequence of leaving Malaysia without paying such duties, penalties or sums required.

Stamp Duty (Remission) Order 2010
The Stamp Duty (Remission) Order 2010 provides for the remission of stamp duty in respect of any instrument executed between a customer and a financier pursuant to the change of the finance scheme of an existing loan from conventional to Shariah.

CUSTOMS AND EXCISE

Sales Tax (Exemption) (Amendment) (No 5) Order 2010 [P.U.(A) 354/2010]
The Order seeks to amend Schedule A of the Sales Tax (Exemption) Order 2008. The amendment brings into effect the exemption of sales tax on mobile phones. The sales tax exemption took effect on 15 October 2010.

Sales Tax (Exemption) (Amendment) (No 4) Order 2010 [P.U.(A) 299/2010]
The Order seeks to amend Schedule B of the Sales Tax (Exemption) Order 2008. The amendment brings into effect the exemption of sales tax on empty containers (including bottles, drums, cylinders and other reusable packaging materials) exported (containing the goods) and subsequently re-imported (without the goods) into Malaysia. The sales tax exemption took effect on 1 September 2010.

Case Commentaries

By Foong Pui Chi & Irene Yong

In this part of the article, Foong Pui Chi examines the scope of s 4 (f) of the Income Tax Act 1967 (ITA) in light of the recent public ruling[1] on withholding tax on income under s 4(f)[2] (s 4(f) public ruling).

Tax Law: Withholding Tax on s 4(f) Income

Introduction

Under the ITA, certain payments made to non-residents are subject to withholding tax, including payments of royalty, interest, amounts paid in consideration of technical advice, assistance or services and rent or other payments made for the use of any moveable property.

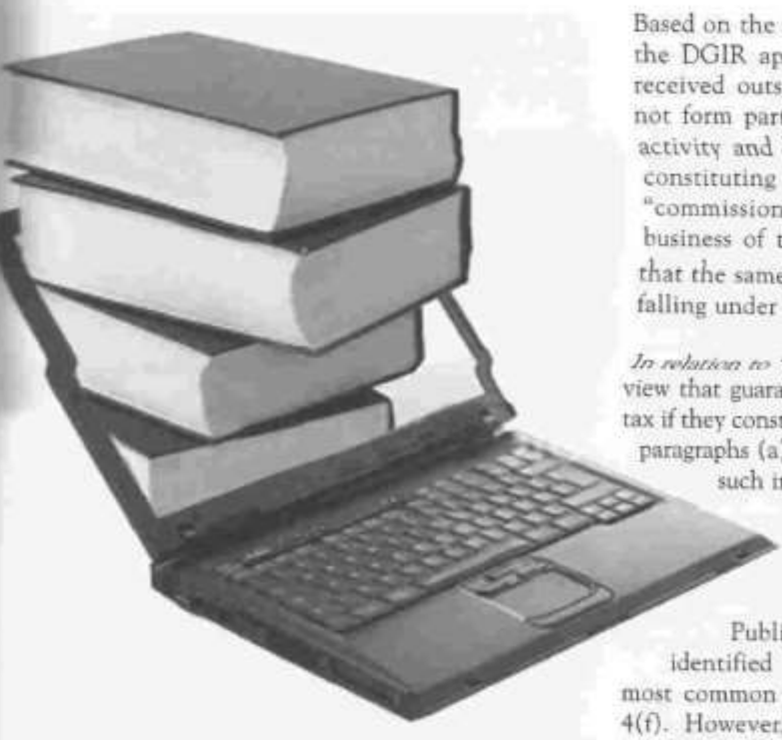
With effect from 1 January 2009, Parliament sought to enlarge the scope of withholding tax by enacting s 109F[3] which was introduced in the Finance Act 2009. Section 109F reads as follows:

> "**109F. *Deduction of tax from gains or profits in certain cases derived from Malaysia***
>
> *(1) Where any person (in this section referred to as "the payer") is liable to make payments to a non-resident in relation to <u>any gains or profits falling under para 4(f)</u> which is derived from Malaysia, he shall upon paying or crediting such payments deduct therefrom tax at the rate applicable to such payments, and (whether or not that tax is so deducted) shall within one month after paying or crediting such payments render an account and pay the amount of that tax to the Director General...*" (Emphasis added).

Section 4 of the ITA reads as follows:

> "**4.** ***Classes of income on which tax is chargeable.***
>
> *Subject to this Act, the income upon which tax is chargeable under this Act is income in respect of –*
>
> *(a) gains or profits from a business, for whatever period of time carried on;*
> *(b) gains or profits from an employment;*
> *(c) dividends, interest or discounts;*
> *(d) rents, royalties or premiums;*
> *(e) pensions, annuities or other periodical payments not falling under any of the foregoing paragraphs; and*
> *(f) <u>gains or profits not falling under any of the foregoing paragraphs</u>.*" (Emphasis added).

1 A Public Ruling is issued for the purpose of providing guidance to the public and officers of the Inland Revenue Board of Malaysia, setting out the interpretation of the DGIR as to how any existing provision of the ITA applies or would apply to any person or class of persons, or any type of arrangement. See s 138A of the Income Tax Act 1967.
2 Public Ruling No. 1 of 2010 – this Public Ruling was issued on 19 April 2010 but is deemed to be effective from 1 January 2009.
3 Section 109F of the ITA was inserted by s 37 of the Finance Act 2009.



Accordingly, s 109F would subject to withholding tax "gains or profits not falling under any of the foregoing paragraphs", that is, income not otherwise covered under paragraphs 4(a) to (e) (s 4(f) income).

The question is what constitutes s 4(f) income?
In order to determine whether a particular payment falls within s 4(f), one is first required to ascertain whether that payment is caught by paragraphs (a), (b), (c), (d) or (e) in s 4.

Budget Speech and Public Ruling
When introducing the new amendment in the 2009 Budget[4], it was indicated that s 4(f) income includes commissions, guarantee fees and introducer's fees. The Director General of Inland Revenue (DGIR) through the issuance of the s 4(f) Public Ruling also appears to take that position, without any explanation or basis as to why these particular types of receipts have been singled out.

In para 4.3 of the s 4(f) Public Ruling, the DGIR has also set out certain factors to be considered in relation to s 4(f) income:

- the payment is revenue and not capital in nature;
- the payment is not income that falls under sections 4(a) to 4(e) and s 4A of the ITA;
- the payment received by a non-resident is in the nature of a miscellaneous income. Such income is often casual in nature and casual income means an occasional income, which is received outside the ordinary course of trade or vocation;
- the payment is for an isolated transaction; and
- there is an absence of repetition of transactions to indicate the commercial nature of the transaction.

Based on the examples given in the s 4(f) Public Ruling, the DGIR appears to take the view that "commission" received outside the ordinary course of business would not form part of the non-resident's business or trading activity and hence, such income should be regarded as constituting s 4(f) income. On the other hand, if the "commission" is received in the ordinary course of business of the non-resident, the DGIR is of the view that the same would be classified as business income, not falling under s 4(f).

In relation to "guarantee fee", the DGIR appears to take the view that guarantee fees would be subjected to withholding tax if they constitute casual income which does not fall under paragraphs (a) to (e) of s 4 or s 4A of the ITA and where such income is received outside the ordinary course of business of the non-resident.

Substance over Form
From the examples set out in the s 4(f) Public Ruling, it appears that the DGIR has identified "commission" and "guarantee fee" as the most common types of payment to be associated with s 4(f). However, this should not mean that every item labelled as "commission" or "guarantee fee" must inevitably be caught by s 4(f) of the ITA as this would be tantamount to giving precedence to form over substance. Many business deals and commercial transactions nowadays are far more complex than the examples provided in the s 4(f) Public Ruling. The nature and purpose of payments made to non-residents should be carefully determined as labels are not always conclusive or descriptively accurate.

Income from Isolated Transactions
It also appears from the s 4(f) Public Ruling that the DGIR has taken the view that if a payment arises from a single isolated transaction, it would be caught under s 4(f). Such a view, however, may be somewhat superficial as case law has demonstrated that even income from an isolated transaction may be considered as business income falling under s 4(a) on the basis that it is an adventure in the nature of trade.

Conclusion
The s 4(f) Public Ruling merely sets out the interpretation of the DGIR and the scope of s 4(f) is not as clear cut as the s 4(f) Public Ruling seeks to portray and it remains open for taxpayers to take a contrary view depending on the facts and circumstances of the transaction.

Conversely, the examples provided in the s 4(f) Public Ruling are in no way exhaustive as there may be other types of payment which may well be caught by the withholding tax net vide s 109F of the ITA as s 4(f), being a residual/miscellaneous category of income, is not meant to be restrictive. It remains to be seen what other types of payment would come within this category.

4 Tabled in Parliament on 29 August 2008.

In this section of the article, Irene Yong examines the recent High Court decision in Kerajaan Malaysia V Ekran Berhad in relation to when a stay of proceedings should be granted for recovery of tax assessed.

Case Note: *Kerajaan Malaysia v Ekran Berhad*[5]

Facts

The Inland Revenue Board had raised an assessment for the year of assessment 1997 (disputed assessment) seeking to tax Ekran Berhad (EB) in the amount of RM25,036,323.98 (tax amount). As EB did not pay the tax amount, the Government of Malaysia (GOM) instituted a civil suit for the recovery of the tax amount.

Although EB opposed the suit on the grounds that the disputed assessment was erroneous, summary judgment was granted to the GOM to recover the tax amount.

EB then counterclaimed for a declaration that gains on capital account were not subject to income tax and also lodged an appeal (tax appeal) to the Special Commissioners of Income Tax (SCIT) on the grounds that the disputed assessment was erroneous.

The tax appeal was allowed by the SCIT. However, upon appeal to the High Court by the GOM, the decision of the SCIT was overturned and judgment was given by the High Court in favour of the GOM. Dissatisfied with the High Court's decision, EB further appealed to the Court of Appeal against the High Court's decision.

As the taxpayer had succeeded in the first instance before the SCIT, the GOM applied for and was granted a stay of proceedings pending disposal of its appeal by the High Court.

After the High Court's decision was delivered in favour of the GOM, it was the taxpayer who then sought a stay of the proceedings pending disposal of its further appeal to the Court of Appeal.

Issue

The issue for the High Court's determination was whether the stay of proceedings sought by the taxpayer should be granted in the instant case.

The Law

The relevant legislative provisions of the Income Tax Act 1967 (ITA) at the material time provided as follows:

"Section 103. Payment of tax.

(1) Subject to this section, tax payable under an assessment or a composite assessment shall on the service of the notice of assessment or composite assessment on the person assessed, other than a company to which s 103A applies, be due and payable at the place specified in the notice whether or not that person appeals against the assessment.

Section 106. Recovery by suit.

(1) Tax due and payable may be recovered by the Government by civil proceedings as a debt due to the Government. ...

(3) In any proceedings under this section the court shall not entertain any plea that the amount of tax sought to be recovered is excessive, incorrectly assessed, under appeal or incorrectly increased ... "

Decision

The High Court held that it was trite law that <u>special circumstances</u> must be shown in order for an application for a stay of proceedings to succeed, in the same way that it applies to an application for a stay of execution. Accordingly, the High Court applied the same test as was applied by the High Court to grant a stay in the following cases.

In **Kerajaan Malaysia v Jasanusa Sdn Bhd**[6] and **The Government of Malaysia v Datuk Haji Kadir Mohamad Mastan and another case**[7], the Supreme Court and the High Court respectively granted the stay of execution sought by the respective taxpayers.

The Courts further held that sections 103(1) and 106(3) of the ITA do not bar a Court, in appropriate circumstances, from exercising its inherent powers in granting a stay, even in a tax case, as the ITA does not have any provision curtailing or restricting the inherent jurisdiction of the Court to stay an execution.

5 Suit No. 22-84-2003 III(II). Unreported decision of the High Court.
6 [1995] 2 MLJ 105
7 [1993] 4 CLJ 98

In the light of the legislative provisions set out above, in particular s 106(3), a taxpayer cannot rely on grounds that the amount of tax sought to be recovered by way of the disputed assessment was excessive, incorrectly assessed, under appeal and the like to defend against tax recovery suits instituted by the GOM.

Notwithstanding the foregoing, the High Court held that it was not precluded from granting a stay of proceedings under its inherent jurisdiction and power to grant a stay.

The High Court held that the facts of the instant case constituted special circumstances for the grant of a stay as, amongst other things:

(a) the GOM itself had applied and succeeded in obtaining a stay of proceedings; and
(b) it would be unfair and unjust for the taxpayer to pay the substantial amount of taxes as they had succeeded before the SCIT in the tax appeal.

The High Court also took cognizance of the fact that the findings of, and the inferences drawn by, the SCIT were binding on appellate courts and not subject to review by the appellate courts, as was held by the Court of Appeal in [illegible] **Lubricants (M) Sdn Bhd v Ketua Pengarah Hasil [illegible] Negeri**[8].

Conclusion

EB confirms that the strict provisions of sections 103 and 106 are not cast in stone. The power lies in the High Court by way of its inherent jurisdiction to achieve a fair and just outcome. The following passage from **Jasanusa** neatly summarises the object and purpose of sections 103 and 106 of the ITA, at page 112 of the report:

> "*Matters of this nature involve, inter alia, balancing the need of the Government to realise taxes and the need of the taxpayer to be protected against arbitrary or incorrect assessments. The Court should be ever vigilant against taxpayers who may use the procedure of the Court, like applying for a stay of execution, to defer or postpone payment of his just dues or to abscond by migration or to dissipate the assets to defeat the judgment. The Court should also bear in mind the possibility of arbitrary or incorrect assessments, brought about by fallible officers who have to fulfil the collection of a certain publicly declared targeted amount of taxes and whose assessments, as a result, may be influenced by the target to be achieved rather than the correctness of the assessment.*" [Emphasis added] TG

[illegible] [2007] 6 MLJ 65

International News

By Rachel Saw

The column only covers selected developments from countries identified by the CTIM and relates to the period 11 August 2010 to 10 November 2010.

China (People's Rep.)

Equity investment losses of enterprises: income tax treatment – Notice of relevant issues released

The State Administration of Taxation (SAT) published a Notice on Issues of Income Tax Treatment in Enterprises' Equity Investment Losses on 28 July 2010 (Announcement No. 6, 2010 of SAT). The Notice has retrospective effect from 1 January 2010.

Under Art 8 of the Enterprise Income Tax Law (EITL), reasonable expenses actually incurred in relation to the business operations of an enterprise, including losses, are allowed as a tax deduction in calculating taxable income. There is no limit on the deduction for equity investment losses.

The Notice stipulates that a one-time deduction from an enterprise's taxable income for losses from its equity investment is allowed in the year the confirmed losses are incurred. Losses incurred before the publication of the Rules (ie 28 July 2010) are allowed as a one-time tax deduction in 2010.

Previously, the tax law allowed a deduction for equity investment losses from the withdrawal, transfer or disposal of equity investment, provided the deduction in each tax year did not exceed the income from equity investment and transfer in that year. Excess losses could be carried over to the following five tax years for tax deduction, and any remaining amounts allowed as a one-time deduction in the sixth year from the equity investment transfer.

Offshore services outsourcing in a demonstration city: business tax exemption – Notice of relevant issues released

The Ministry of Finance (MoF), SAT and Ministry of Commerce jointly issued a Notice of Business Tax Exemption for Offshore Services Outsourcing in a Demonstration City on 28 July 2010 (Caishui [2010] No.64).

It is stipulated in the Notice that enterprises registered in 21 Chinese "demonstration cities" for offshore services outsourcing and deriving income from offshore services outsourcing from 1 July 2010 to 31 December 2013, are exempted from business tax. The cities are Beijing, Tianjin, Dalian, Harbin, Daqing, Shanghai, Nanjing, Suzhou, Wuxi, Hangzhou, Hefei, Nanchang, Xiamen, Jinan, Wuhan, Changsha, Guangzhou, Shenzhen, Chongqing, Chengdu and Xi'an.

"Income derived from offshore services outsourcing" refers to income received from overseas companies for the provision of services by the enterprises under a commission contract with those overseas companies, or by their direct subcontracting enterprises. The services are:

- Information Technology Outsourcing (ITO), which includes outsourcing of software development, information technology development services as well as information systems operation and maintenance;
- Technical Business Process Outsourcing (BPO), which includes business process design services, inner management services, operations services as well as supply chain management services; and
- Technical Knowledge Process Outsourcing (KPO), ie intellectual property research, pharmaceutical and biotechnology R&D and tests, product research and development, industrial design, analytics and data mining, design and development of animation and online games, education courseware development, engineering design, etc.

It is also stated in the Notice that the amount of business tax that is exempted from 1 July 2010 to the release date of the Notice can be deducted from business tax payable for 2010, and any amount which is not deducted in 2010 will be refunded.

Enterprise reorganisation: EIT treatment – Administrative rules released

Following the Notice of Certain Issues Regarding the Enterprise Income Tax Treatment of Enterprise Reorganisation (Caishui [2009] No.59) on 30 April 2009, the SAT issued the Administrative Rules Regarding the Enterprise Income Tax Treatment of Enterprise Reorganisation (Announcement No. 4, 2010 of SAT) on 26 July 2010 pursuant to the Enterprise Income Tax Law of the People's Republic of China and its Implementation Rules, the Tax Collection and Administration Law of the People's Republic of China and its Implementation Rules as well as Notice No.59. The Rules apply retroactively from 1 January 2010.

The Rules further clarify the relevant definitions in Notice No.59, such as parties in various restructuring transactions, the date of reorganisation, common control etc. They also set out the documents that must be submitted to the tax authorities when an enterprise is converted from a legal person into an unincorporated organisation, as well as for the application of special tax treatment.

A reorganisation must have a reasonable commercial purpose to qualify for special tax treatment, and the enterprise is required by the Rules to provide the following information in that respect:

- Method, background and time of transaction, business operations before and after the transaction as well as relevant business practices;
- The transactional form and substance (legal consequences, actual or commercial outcome of the transaction);
- Possible change of tax status for all parties due to the restructuring;
- The change in financial situation for all parties due to the restructuring;
- Whether the restructuring activities will bring any abnormal economic interest or potential responsibility that would not occur under normal market conditions; and
- The involvement of non-resident enterprises in the restructuring.

Substantiating documents must be submitted to the competent tax authorities by all parties when filing the annual return of enterprise income tax for the following year after restructuring is completed, certifying that there is no change in the conditions qualifying them for special tax treatment in the 12 consecutive months after restructuring. If any change occurs in one of the parties, resulting in the restructuring activities not qualifying for special tax treatment, all the other parties must be informed in writing within 30 days from the change. The "main party" must inform the competent tax authorities within 30 days after receiving the notice, and all the parties must make adjustments in the tax treatment for the restructuring within 60 days after the change.

The Rules also clarifies the tax treatment of "step transactions".

Tax reforms planned

It has been reported that a new round of tax reforms is planned, which will concern:

- *VAT and business tax*
  - Most services, which are currently subject to business tax, will instead be included within the scope of VAT.
  - VAT revenue–sharing between the central and local governments will be reviewed and amended, with the local governments receiving a larger share of the revenues.
- *Real property tax*
  - The Ministry of Residential Homes has been ordered to collect the data of the registration of residential homes and of home owners in cities, to enhance the administration and collection of the real property tax, which is expected to be the third largest tax revenue generator after VAT and business tax.
- *Individual income tax*
  - Relieving the tax burden of the low–income earners.
  - Improving the collection of tax from the high–income taxpayers.

Resource tax and environmental tax

- The scope of the resource tax and environmental tax will be extended, and its administration will be enhanced.

- *Social security tax*
  - A study has been conducted to determine whether the social security premiums can be imposed in the form of a tax.

Cross–Taiwan Straits air transportation income: Exemptions clarified

The MoF and the SAT jointly issued a Notice on 6 September 2010 (Cai Shui [2010] No. 63 regarding the tax exemptions for income derived from cross–Taiwan Straits air transportation (cross–straits air transportation income).

According to the Notice, cross–straits air transportation income is exempt from business tax and enterprise income tax retroactively from 25 June 2009.

Business tax paid can be offset against the business tax due (from other non-exempt business) in 2010, and any excess will be refunded. Any enterprise income tax paid the cross-straits air transportation income will be refunded.

Qualifying Taiwanese airlines:

- must be registered in Taiwan; and
- must possess a permit issued by the Chinese aviation authority, or by a recognised authority as listed in the "Supplementary Agreement of the Cross Straits Air Transportation".

Tax treatment of sale and lease-back in financial lease transactions clarified

The SAT issued a Notice on 8 September 2010 (SAT [2010] No. 13) clarifying the tax treatment of sale and lease-back in a financial lease transaction. The Notice applies as from 1 October 2010.

According to the Notice, the sale by the lessee in a sale/lease-back transaction of a financial lease is not subject to value added tax (VAT), business tax and enterprise income tax.

For the purposes of enterprise income tax, no gains on the sale in the form of the sale/lease-back will be recognised, and the depreciation of the leased assets of such transaction may be claimed on the basis of the original value brought forward by the lessee before the sale. During the period of the lease, the part of the payment that is categorised as interest is a deductible expense for the lessee.

Deed tax and individual income tax on residential properties adjusted

The MoF, the SAT and the Ministry of Housing and Urbanisation jointly issued a Notice on 29 September 2010 (Cai Shui [2010] No.94) adjusting the Deed Tax and Individual Income Tax on residential property transactions. The content of the Notice is summarised below:

- *Deed tax*

From 1 October 2010, the deed tax is reduced by 50% with regard to purchase of a residential property which is the sole residential home for the family. The term "family" includes the buyer, spouse of the buyer and their young children. Where the area of the residential property purchased by an individual is up to and including 90m2, the deed tax charges is reduced to 1% (the normal rate is 3%). The residential properties which do not meet the requirements are not eligible for the reductions of the deed tax.

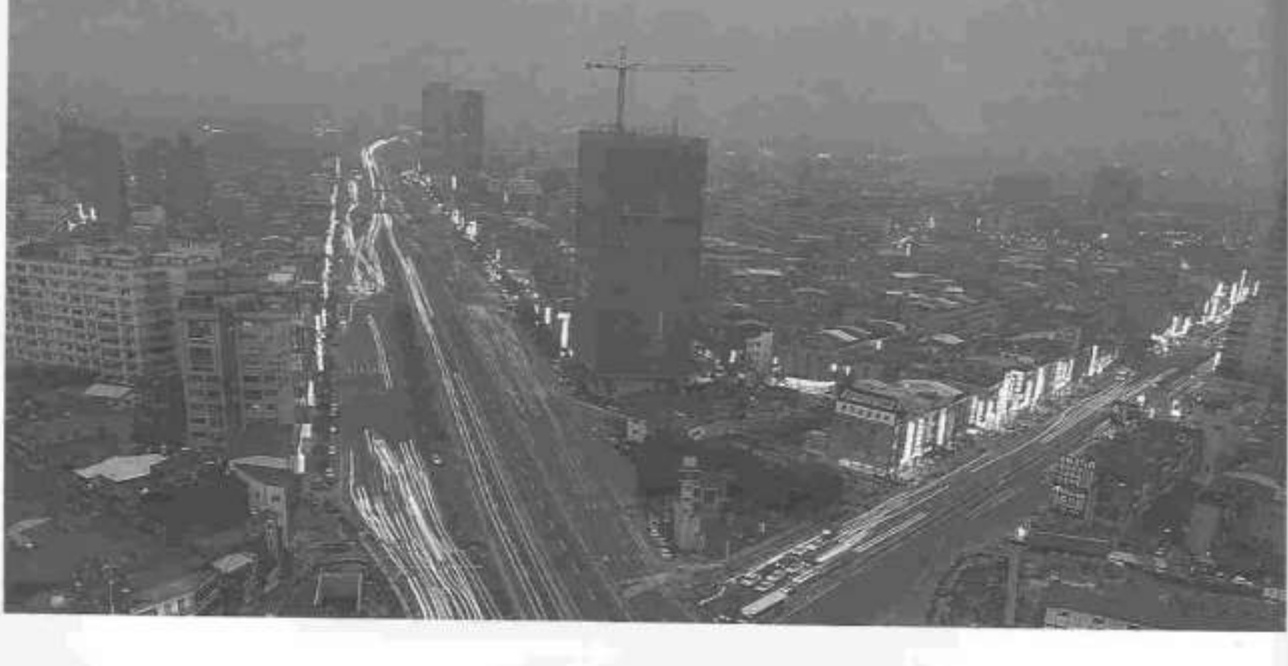
- *Individual income tax*

From 1 October 2010, the individual income tax exemption for the gains on disposal of a residential property by an individual, who buys another new residential property within one year of the sale, ceased to apply. Further, the Notice abolished Art 1 of the Notice (Cai Shui Zi [1999] No.210), Art 1 of the notice (Cai Shui [2010] No.137) and Art 3 of the notice (Cai Shui Zi [1999] No.278).

Urban maintenance and construction tax and education surcharge for foreign invested enterprises, foreign enterprises and foreign individuals

The SAT issued a Notice on 18 October 2010 (Guo Fa [2010] No. 35) announcing that foreign invested enterprises, foreign enterprises and foreign individuals are subject to the urban maintenance/construction tax of 1985 and education surcharge of 1986 as from 1 December 2010. From the same date, all the applicable regulations and rules on this tax and charge also apply to foreign invested enterprises, foreign enterprises and foreign individuals that were previously exempt from such a tax and charge.

The tax and charge are based on the amounts paid on VAT, business tax and consumption tax. Depending on where the taxpayer is located, the rate of the urban maintenance and construction tax could be 7% (in a city), 5% (in a county or town) or 1% (in the other remaining areas). The education charge is 3% throughout the country.



[O]ffsetting losses against adjusted taxable income following [a] tax investigation
[Th]e SAT issued an announcement on 27 October 2010 [(G]ong Gao [2010] No. 20) concerning the offsetting of [lo]sses against adjusted taxable income as a result of a tax [in]vestigation. The announcement applies from 1 [D]ecember 2010. The content of the announcement is [su]mmarised below.

[Th]e losses incurred in the previous tax years can be offset [ag]ainst the taxable income arising from tax adjustments [as] a result of a tax audit if such losses are allowable under [th]e Enterprise Income Tax Law. The remaining taxable [in]come after offsetting should be taxed according to the [ta]x laws and regulations. Depending on the [ci]rcumstance, the adjustments made by the tax authority [wi]ll be settled or penalized on the basis of the "Tax [C]ollection Law".

[U]nsettled tax issues regarding the previous years (including [th]e years before 2008) must be settled pursuant to this [an]nouncement.

India

Direct Tax Code Bill, 2009 – approved by Cabinet
The Cabinet approved the Direct Tax Code Bill, 2009 (DTC) [o]n 26 August 2010. The DTC is placed before the parliament [fo]r approval on 30 August 2010. If approved, the DTC will [re]place the existing Income Tax Act, 1961 and will be [e]ffective from 1 April 2012.

Indonesia

[W]ithholding tax refund to non–residents
The Tax Office issued Regulation No. PER–40/PJ/2010 on 9 [A]ugust 2010, which sets out the procedures for non–residents [wi]th no permanent establishment in Indonesia to apply for [re]funds of overpaid withholding tax.

The Regulation also lists certain situations, in which the [re]fund will not be approved, ie where:

- the recipient is an Indonesian tax resident;
- the withholding tax has not been remitted by the withholding agent;
- the tax has been claimed as a tax credit or tax deduction overseas or has been borne by the withholding agent;
- the claim is not in accordance with the applicable tax treaty;
- there is evidence of treaty abuse; or
- the withholding tax collected is in line with the provisions of the applicable tax treaty.

Re–characterisation of income received by expatriate reallocated as payment to employer's related foreign company
The Ministry of Finance issued Regulation No. 139/PMK.03/2010 on 11 August 2010, which gives the Directorate General of Tax (DGT) the authority to re–characterise income received by certain expatriate employees in Indonesia.

Pursuant to the Regulation, where an expatriate employee receives income from a local employer, and the local employer reallocates part or all of the expatriate's income in the form of a payment (eg management fee, technical fee or other service fees) to a related foreign company (of which the expatriate is also an employee), the DGT may re–characterise the offshore payment as being the expatriate's Indonesian employment income. The maximum amount of such income that can be deemed received by the expatriate is limited to the amount paid out by the Indonesian employer to its related foreign company.

The regulation is effective for payments made on or after 11 August 2010.

Introduction of transfer pricing regulations
The Director General of Taxation (DGT) has introduced transfer pricing (TP) regulations for Indonesian taxpayers, via Regulation No. PER–43/PJ/2010 which took effect on 6 September 2010. The Regulation is based significantly on the OECD's TP Guidelines, and its main contents are summarised below.

• *Scope*
The Regulation applies to transactions between related parties which have an impact on the reporting of income or expenses for corporate tax purposes, including:

- the sale, transfer, purchase or acquisition of tangible goods and/or intangible goods;
- payments of rental fees, royalties, or other payments for the provision of or use of both tangible and intangible property;
- income received or costs incurred for the provision of or utilisation of services;
- cost allocations; and
- the transfer or acquisition of property in the form of a financial instrument, as well as income or costs from the transfer or acquisition of the financial instrument.

• *Arm's–length principle*
Taxpayers who earn income or incur expenses of IDR 10 million and above must implement the ALP according to the following steps:

- perform a comparability analysis;
- determine the most appropriate TP method;
- apply the ALP to the tested transaction based on the result of the comparability analysis and the selected TP method; and
- document each step of the process in determining the ALP or profit in consideration of the prevailing tax regulations.

The comparability analysis to be undertaken is consistent with that outlined in the OECD's guidelines and internal comparables are preferred over external comparables.

The Regulation also endorses the five OECD TP methods, and specifically states that the hierarchy is as follows:

- comparable uncontrolled price (CUP) method;
- resale price method (RPM);
- cost plus method (CPM);
- profit split method (PSM); and
- transactional net margin method (TNMM).

• *Special transactions*

(a) Services. In order for services transactions to be in compliance with the ALP, it is necessary to confirm that the service is actually rendered, that it provides the recipient with a commercial or economic benefit, and that the value of the service fee is in line with comparable arm's–length service fees or with the costs that would have been incurred by the recipient had it performed the activities itself. No service fee should arise where a parent company performs an activity in its capacity as shareholder of the group.

(b) Royalties. In the case of royalties, it is necessary to confirm that the transaction actually takes place, that the intellectual property provides a commercial/economic benefit to the licensee, and that the royalty paid is consistent with comparable arm's–length royalties. A comparability analysis for royalty transactions should consider:

- the geographical coverage;
- exclusive or non–exclusive character of any rights granted; and
- whether the licensee has the right to participate in further developments of the property by the licensor.

• *Documentation*

A taxpayer's TP documentation must at least include:

- an overview of the company such as group structure, organisation chart, shareholding structure, business operations, list of competitors and a description of its business environment;
- price policy and/or cost allocation policy;
- comparability analysis;
- list of selected comparables; and
- application of the selected TP method.

• *Other*

The Regulation states that the DGT is empowered to make primary and secondary TP adjustments and those mutual agreement procedures and advance pricing arrangements are available to taxpayers.

Singapore

Stamp duty on sale of residential properties – additional details

The Inland Revenue Authority of Singapore (IRAS) has issued further details on the applicability of the seller's stamp duty (SSD) on the sale of certain residential properties.

The SSD applies on residential properties which are acquired on or after 20 February 2010 and disposed of within one year from the date of acquisition.

In addition, the SSD is also imposed on residential properties bought on or after 30 August 2010 which are sold within three years of acquisition. For these properties, the SSD would be tiered according to the duration of the holding period. As such, the seller pays:

- the full duty rates for "the conveyance, assignment or transfer of property" if the residential property is sold within one year or purchase;
- two–thirds of the amount if sold in the second year; and
- one–third of the amount if sold in the third year.

Thailand

15% withholding tax: Thai bonds

The Finance Minister announced on 12 October 2010 that a 15% withholding tax is imposed, reportedly with immediate effect, on interest and capital gains earned by foreign investors on Thai bonds.

Vietnam

Decrees and Circulars on VAT – Input VAT credit on house rental for foreign experts

The General Department of Taxation issued OL 2696/TCT–CS on 22 July 2010, clarifying the treatment of input VAT incurred on housing leased for foreign experts. Pursuant to the OL, where the foreign experts hold management positions in Vietnam, and receive a salary from Vietnam based on labour contracts signed with Vietnamese business entities, the house rental fee paid by these entities would be taxable as Personal Income Tax (PIT) in the hands of the foreign experts. Additionally, the VAT on the house rental paid shall not be creditable.

Conversely, where the foreign experts remain employees of foreign entities but are assigned to work in Vietnam, and the salary is paid by the foreign entities but the accommodation costs are borne by the Vietnamese entities (pursuant to a contractual agreement), the input VAT on the house rental paid is creditable and the rental itself is deductible for Enterprise Income Tax (EIT) purposes.

Decrees and Circulars on VAT – Finance consultancy services

The General Department of Taxation issued OL 2061/TCT–CS on 14 June 2010, clarifying that finance consultancy services (such as IPO consultancy, securities listing, etc) are subject to VAT at the rate of 10%. These services have been distinguished from securities businesses (such as securities brokering, securities trading, consulting on securities investment) which are not subject to VAT (Circular 129/2008/TT–BTC) dated 26 December 2008.

Decrees and Circulars on PIT – Social insurance contributions

The General Department of Taxation issued OL 2124/TCT–TNCN dated 17 June 2010, clarifying that voluntary contribution to social insurance schemes made by individuals with business income shall not be deductible for PIT purposes.

Under Circular 02/2010/TT–BTC dated 22 January 2010, issued by the Ministry of Finance, only compulsory social insurance contributions are deductible for PIT purposes. The same applies for compulsory foreign social insurance contributions made either by foreign individuals resident in Vietnam or Vietnamese individuals working abroad. As long as these compulsory foreign social insurances are similar to the Vietnamese social insurances (ie social insurance, health insurance, unemployment insurance, etc), these contributions should be deductible for PIT purposes if supported by proper documentation.

Decrees and Circulars on PIT – *Per diems*

The Ministry of Finance issued Circular 97/2010/TT–BTC on 6 July 2010 setting the *per diem* level at VND 150,000 per day (previously, VND 70,000). Pursuant to Circular 130/2008/TT–BTC dated 26 December 2008, per diems paid to employees are deductible up to double the per diem level as set by the MoF. Thus, per diems paid up to VND 300,000 per day are deductible. In addition to the non–deductibility of the per diem in excess of VND 300,000, the excess would also be subject to PIT.

Decrees and Circulars on EIT – Non–deductible bonus

The GDT issued OL 2138/TCT–CS (OL 2138) on 17 June 2010, clarifying the meaning of bonuses of a "non–salary nature" as referred to in Circular 130/2008/TT–BT. Circular 130 states that bonuses of a non–salary nature are not deductible for EIT purposes. Pursuant to OL 2138, a bonus of a "non–salary nature" is a non–contractual bonus, ie the payment and its requirements for payment are not stipulated in the labour contract. As such, business entities should have a bonus policy in place, with the bonus and its requirements for payment clearly stated in their employees' labour contracts in order to ensure the deductibility of bonuses paid.

Decrees and Circulars on EIT – Loss carry–forward

The General Department of Taxation (GDT) issued OL 1534/TCT–CS on 7 May 2010 confirming that business entities are permitted to carry forward the losses of any fiscal year up to a maximum of five years. However, the carry–forward is to be done after the year–end EIT finalisation and not during the quarterly tax return submissions.

Malaysia – treaty developments

- **The following amending protocols to existing tax treaties were signed**
  - Bahrain and Malaysia on 14 October 2010
  - The Government of the United Kingdom of Great Britain and Northern Ireland and Malaysia on 27 September 2010
  - The Government of the State of Kuwait and Malaysia on 30 August 2010
  - The Government of the Republic of Seychelles and Malaysia on 30 August 2010
- **The following amending protocols to existing tax treaties entered into force**
  - Turkey and Malaysia on 15 July 2010. The protocol generally applies from 1 September 2010.
  - Japan and Malaysia will enter into force on 1 December 2010. The protocol generally applies from 1 January 2011.
- **The following amending protocols to existing tax treaties were ratified**
  - On 12 October 2010, France ratified the amending protocol between France and Malaysia.
  - On 5 November 2010, Germany ratified the income tax treaty and protocol between Germany and Malaysia.
  - On 8 September 2010, The Government of the Republic of San Marino ratified the income tax treaty and protocol between the Republic of San Marino and Malaysia. TG

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What Kind of Leader are You?

By Taranjeet Singh

The time of the year has come around again – where salary increases and bonuses are about to be paid out. Company performance has been good, employees have performed well. Theoretically, your employees should be happy. But beneath the calm surface lies an undercurrent, which if not effectively managed, may well have negative consequences to your firm. The reality is how many of your employees are reflecting on current situations and are contemplating employment opportunities elsewhere.

The saying "people join companies but leave their bosses" will come home to roost early next year. This will be a good time for us, as managers and business leaders, to look deep within ourselves to see if we are indeed the cause of staff retention, or worse, attrition!

Through many years of rigorous research, Hay Group has identified six leadership styles that can be consistently applied to all managers, irrespective of geography; ie authoritative, affinitive, coaching, coercive, democratic and pacesetting.

While there is clearly no one best style of leadership – each one brings its strengths and limitations and is appropriate for certain situations. For instance, the coercive approach is useful in getting an organisation through business turnaround, but will stifle initiative and innovation in the good times. The affinitive style is most suitable when garnering support and driving motivation within the team but may not be the ideal style to drive a high performance work culture. For the latter, the pace setting style is most suitable.

Effective leaders are adept at all six leadership styles and can seamlessly switch from one to another, depending on the prevailing circumstances at hand. But, typically, managers will default to the style they are most comfortable with, especially in times of crisis and stress. Hence, the Jekyll-Hyde syndrome of our own managers which we have all borne witness to at some point in our career.

And herein lies the proverbial rub – a preferred leadership style which has worked well during a time of recession might fail miserably during an economic upturn. Essentially, the "horses of courses" terminology is most apt in such an instance. Let us now consider each leadership style in detail and the situations to which they are best suited.

Who is your boss?

(a) The Visionary Manager

This is the classic "rock-star" CEO. Virgin's charismatic Richard Branson springs to mind. You paint the big picture and see it as your role as moving the team towards a shared vision. Because you believe that selling your long-term vision is the key to success, you will take time to explain the 'whys'.

What irritates you is when your subordinates try to provide you with their version of the vision and how it is to be achieved. Visionary leaders like you see scoping and conveying the big picture as your job, and you certainly don't want, or expect, your employees to do likewise.

Thus, communicate with your team by asking for them to reflect upon the vision that you have provided so as to confirm that they have understood it and show what they will do to realise the same. Your weak point is that you don't pay adequate attention to the details, so let your team know that it's their job to see to the "woods from the trees".

(b) The Affinitive Manager

This leader is concerned about creating harmony and promoting friendly relations. You tend to avoid performance-related confrontations. Highly collaborative in nature, you are most likely to ask "how are you?" and mean it.

Leaders like you generate a lot of goodwill simply because you don't mind rolling up your sleeves and pitching in on the shop floor.

However your inherent need for constant harmony among your team members may get in the way of making the tough but crucial decisions. So if there is bad news to be broken, you must not take it personally, after all it is for the collective good that you are working towards. To this end, try to use external sources of information, such as customer satisfaction or employee engagement surveys and the like to help support your case.

(c) The Coaching Leader

Such a leader focuses on the long-term professional development of employees. You enjoy helping your subordinates identify their strengths and weaknesses, encouraging them to establish long-term goals, and you even provide guidance and feedback to them.

For those employees who are looking for a boss to help boost their career, you are the dream manager to work for.

But for employees who are working for the pay cheque and are just looking for someone to tell them what to do, you will probably be a bane of their life. So, bear in mind that while you are constantly looking out for the on-going development of your team members and motivating them to do even better, your team members must be willing to be coached. Failure of this happening could possibly result in frustration by both parties.

(d) The Directive Team Leader

This type of leader needs no introductions – we've all met someone like this before. Intent on getting others to "just-do-it-exactly-the-way-I-tell-you", you issue directives, rely on negative, corrective feedback and 'motivate' by stating the negative consequences of non-compliance. While this style is useful for getting projects and organisations out of a crisis situation or driving high performance, its continued use will in turn have disastrous repercussions to the organisation. Those self-driven, highly motivated, high-performers will walk out the door when the opportunity presents itself.

And because you don't trust others to get it right, delegation is not something which you are comfortable with. After all, no one is able to do it as well as you can. Hence, when you do manage to successfully delegate some of your responsibilities, inform your team to keep you in the loop throughout the process and in turn double-check to see that they are delivering in the form and fashion that you want, how you want it and when you want it. Be mindful that this style is not one that is sustainable for the long-term.

(e) A Participative Leader

A participative leader is one who focuses on building commitment and generating new ideas. You invite employees to develop directions for themselves and the organisation at large. To this end, many meetings are conducted to gather and discuss employees' views. This is done to ensure that every ones views are taken into account when crafting future plans or actions.

If you are managing a team of self-starting, achievement-oriented employees, eg a sales team, management consultants, and the like, working with you will be an intensely frustrating experience for them. All they really want is to be left alone to get things done and not participate in endless meetings.

To this end, so long as you ensure that the meetings are kept short and succinct and there is clarity of focus arising from them as to next steps, you will be able to effectively harness the power of the collective whole. And it is this that will make the difference to the organisation's future sustainability.

(f) The Pacesetting Leader

Pacesetting leaders set high standards of excellence, are apprehensive about delegating and have little sympathy for poor performance. Usually leading by example, you will take away jobs if high performance is not forthcoming. However, what happens more often is that complex jobs are not delegated at all, as you often assume that the best way to get them done quickly and to your satisfaction is to do it yourself. Margaret Thatcher and Steve Jobs are prime examples of pacesetting leaders.

To work successfully with you, your team must earn your trust quickly by turning in excellent work in a consistent fashion. But do be aware that working for a pacesetting leader can wreck havoc on work-life balance and lead to exhaustion and burn-out in the long run, so don't be surprised if few people in your team seem to have your stamina levels.

Right situation, right style

Needless to say, your leadership style has the biggest impact on the working climate and your employees' effectiveness. The recent economic downturn has witnessed more directive and pacesetting styles of leadership as companies fight for their very survival. However with the recovery, it's timely to reflect on whether we have the right leadership styles for the right situations.

Or look at it another way. While you as the CEO make promises about what your organisation can deliver to customers, shareholders and other stakeholders, it is your employees who keep these promises on your behalf. Do we really want to put detached or ineffective employees in front of our clients and investors?

The good news is that you can learn to widen your inventory of leadership styles as to be a more effective manager. Managers with the right leadership skill sets will be able to consciously draw upon their 'bag of tricks' to pull out the style that works best for that situation that they find themselves in.

What is the bottom-line impact? Hay Group's Insight research shows that companies that engage and enable their employees outperformed their industry peers on revenue growth by approximately 4.5 times. In terms of profitability, such companies exceeded industry averages in terms of five-year Return on Assets, Return on Investment and Return on Equity by 40% to 60%. This level of performance is not to be sneered at, in any sort of economic climate. With the economic recovery within Asia well on the way, the future is definitely looking bright, the question is, does your management team have the right kind of leadership skills to see it through? TG

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Repairs & Renewals

By Siva Subramaniam Nair

Readers would remember that we are still looking at deductions under s 33(1) of the Income Tax Act 1967 (ITA) (as amended) and that we concluded the last article with the discussion on the deductibility of rental expense under sub-section (b).

In this article, I shall deal with explaining the scope of repair and renewals with the aid of case law precedents, discuss the principle of replacing an entirety as opposed to a subsidiary part of an asset and the explore the concept of improvement.

The deductibility of repairs and renewals is covered under sub-section (c) which reads:

expenses incurred during that period for the repair of premises, plant, machinery or fixtures employed in the production of gross income from that source or for the renewal, repair or alteration of any implement, utensil or article so employed, other than implements, utensils, articles (the expenditure on which would be qualifying plant expenditure for the purposes of Sch 3) or any means of conveyance, excluding the cost of reconstructing or rebuilding—

(i)	*any premises, buildings, structures or works of a permanent nature;*
(ii)	*any plant or machinery; or*
(iii)	*any fixtures;*

The first thing that is obvious from reading the above provision is that capital expenditure is not allowed as a deduction. Actually, the sub-section expressly prevents a double deduction for the capital allowances and industrial building allowances already given, by providing that no deduction will be given for the "*qualifying plant expenditure for the purposes of Sch 3*" Secondly, whilst capital allowances are usually only permitted for a business source, this provision applies to all sources of income and thirdly, this sub-section does not prohibit a deduction for the repair of assets *qualifying plant expenditure for the purposes of Sch 3*, but only a renewal of such assets.

So what constitutes a Repair?

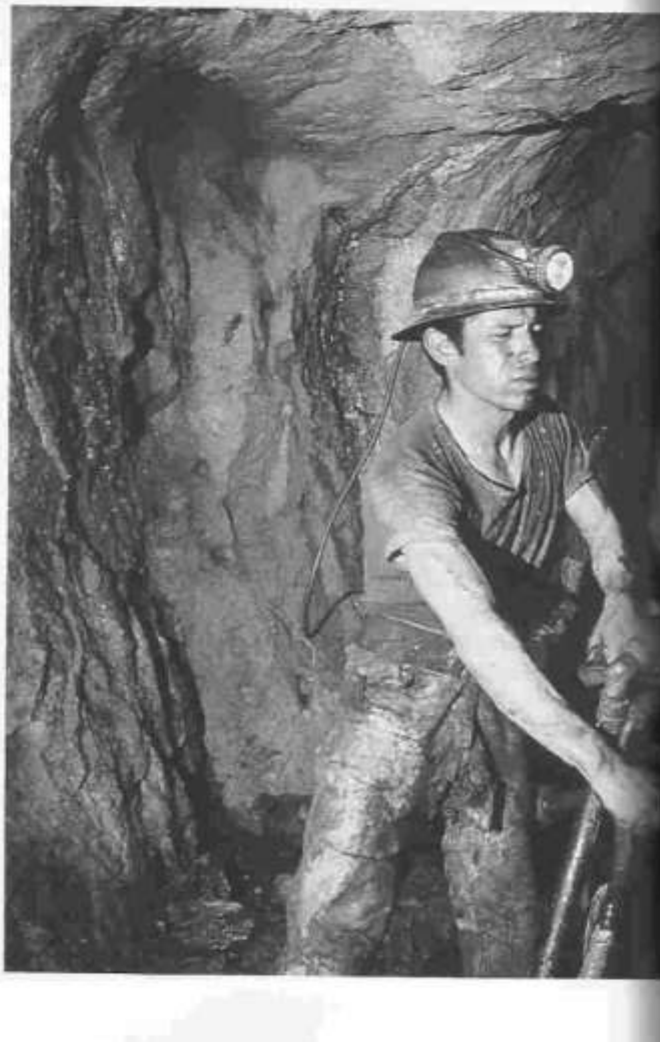
Generally, repair involves the replacement of a subsidiary part of the whole asset whereby an income-producing asset, through maintenance, is kept in its current state and preserved so as not to allow it to deteriorate. However, it does not materially add to the value nor prolong the life of the asset but instead merely keeps it in a good and efficient operating condition. A clear example would be the cost of servicing air-conditioners or changing the spark plugs or black oil in a car. It is necessary to keep it in good working condition. In contrast replacing the whole engine of the car with a new one would definitely lengthen its economic life and therefore be regarded as capital.

In terms of case law, *Queensworth v Vickers Ltd. 6 TC 671* illustrated the fact that when a channel requires dredging to keep it clear, such expenses would be revenue in nature, but the cost of building a new wharf to make the dredging unnecessary was not allowed. However, the cost of clearing of wrecks sunk during the war to make the harbour safe were granted a deduction in *Whelan v Dover Harbour Board [1934] 18 TC 555*.

A Renewal?

Renewal involves the replacement of a substantial part of the whole asset. However, if the whole asset or entirety is replaced then it is of a capital nature and in consequence does not rank for a deduction.

Buckley, L.J. in *Lurcott v Wakeleyand Wheeler [1911] 1 KB 905* explains:



'Repair and 'renew' are not words expressive of clear contrast. Repair always involves renewal; renewal of a part; a subsidiary part... Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject matter under discussion

The provision also (amongst other items) excludes "*the cost of reconstructing or rebuilding*". Unfortunately if interpreted literally would rule out most repairs for there are a few repairs that do not involve an element of reconstruction. The principle of "entirety" has arisen to reconcile this apparent contradiction.

Principle of Entirety

Based on this principle, where the subject matter forms only a small part of a large system, it is a repair, but where the subject matter is the entirety, its replacement or reconstruction represents a capital expenditure.

The following cases provide a clear illustration of the above juxtaposition.

O'Grady v Bullcroft Main Collieries Ltd. (17 TC 93)

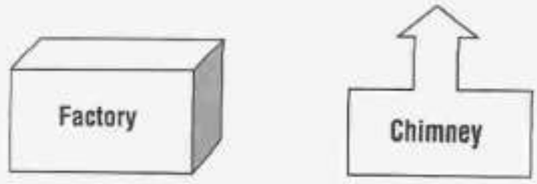
Facts of the Case

The company, which carried on the business of coal mining, replaced an unsafe chimney with another on an adjacent site.

Decision of the Court

The whole cost of the chimney was capital expenditure on the ground that the new chimney was on its own an entirety.

The chimney was a stand–alone structure **NOT** part of the factory building as illustrated below:



BUT:

The situation differs in the case of **Samuel Jones & Co. (Devondale) Ltd. v CIR (32 TC 513).**

Facts of the Case

A company carrying on the business of processing paper had to replace a chimney because of its dangerous condition. It therefore removed the old chimney and replaced it with a new one and claimed a deduction for the whole cost.

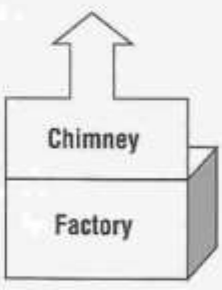
Decision of the Court

The whole cost would qualify for a deduction.

The judge in the latter case held that "the chimney with which we are concerned is physically, commercially and functionally an inseparable part of the 'entirety', which is the factory. It is doubtless an indispensable part of the factory, doubtless an integral part; but none the less, subsidiary part, and one of many subsidiary parts, of a single industrial profit making undertaking..."

Further he was "unable to see why the expense incurred in relation to this transaction should not be treated as an admissible revenue expenditure on repairs.... [and admits that]...I am in part influenced in reaching that conclusion by the fact that the factory as a whole is insured for something in the region of \$165,000 whereas the expense in taking down the old chimney and building the substitute is only a matter of \$4,300 or about 2%."

In this case the chimney formed part of the factory building as diagrammatically shown below:



The Samuel Jones decision was followed in *CIT v "X" Rubber Co., Ltd.*

Facts of the Case

A special drainage system in a rubber estate owned by the taxpayer had ten watergates of which one sprang a leak and had to be replaced as illustrated above:

Decision of the Court

The water drainage system as a whole was the entirety and therefore the replacement of one gate was repair of part of the entirety and in consequence deductible.

BUT:

In *Phillips v Whieldon Sanitary Potteries Ltd [33 TC 213]*, the cost of replacing a barrier to stop water from seeping into a factory from a canal was held to be capital expenditure as the barrier was the "entirety".

Another such example whereby expenditure incurred on an almost identical subject matter was treated as capital in one instance and revenue in another involves the replacement of railway tracks. Replacement of worn railway tracks and sleepers was held to be repair of a part and therefore deductible *(Rhodesia Railway Ltd. v Collector of Income Tax, Bechuanaland Protectorate ITC [1933] AC 368)* whereas the relaying of a railway track with a different type of rails was held to be an improvement of the whole and therefore not deductible *(Highland Railway Co. v I.R.C. [1889] 2 TC 485)*.

The above cases serve to reinforce the fundamental principle that the facts of each case have to be considered and that superficial similarities like the subject matter alone are never decisive. Now let's look at improvements.

Improvement

Where the repair or renewal involves an improvement so that the new structure or building differs materially from the old, the whole of the expenditure incurred is regarded as capital in nature. Examples of these would be the replacement of a zinc roof with one using tiles or replacing simple cement flooring with marble.

In *William P Lawrie v CIR [34 TC 21,]* instead of repairing a leaking roof, the whole building was lengthened and heightened and the roof was replaced with a new one by the taxpayer. The whole expenditure was held to be capital and no deduction was allowed.

Improvement also encompasses the use of improved materials and construction techniques. However this does not mean that to qualify as a repair or renewal, the material used must be identical with the materials replaced. The guiding principle is that if the work done amounts to no more than a restoration of the asset to its original condition, a revenue deduction can be enjoyed.

Although normally extensive improvements would be capital in nature but in *Conn v Robins Brothers [43 TC 266]* the appellate court concurred with the Commissioners that the amount spent by the taxpayer was "all on essential works, on repairs, not on improvements'.

Buckley J commented:

> *"In the light of that circumstances it seems to me that this was expenditure incurred by the Company with a view to enabling it to continue to earn profits from its business, not by acquiring some asset for that purpose but by putting the Company's existing asset into a state of repair which would enable it to continue to use that asset. No doubt in the course of carrying out these works certain structural alterations were made, as one would expect with any extensive repair of a building over 400 years old, were being carried out at a time where building techniques have completely altered. But the fact that there were alterations in the structural details of the building does not seem to me to be good ground for proceeding upon the basis that the work produced something new. On the contrary I think ... that the result of this work was not to produce something new but to repair something which had previously existed."*

In the next article we shall look at other aspect governing the deductibility of repairs and renewals. TG

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Notice Board

Introduction of e-Ledger

The Inland Revenue Board (IRB) has introduced the e-Ledger facilities in November 2010 to enable taxpayers to check on the accuracy of their personal particulars such as address and bank account number and whether their records of tax transactions with the IRB, namely, assessments, payments and repayments, have been updated. For more information, please refer to the Frequently Asked Questions on e-Ledger at CTIM's website or at the IRB's website.

Malaysian Goods and Services Tax Portal

The Ministry of Finance, together with the Royal Malaysian Customs (RMC), launched the new Malaysian Goods and Services Tax (GST) Portal. The portal is designed to provide information as well as free online services to consumers, industry players and the general public on the proposed GST.

Guidelines on Procedures issued by the Royal Malaysian Customs

The Royal Malaysian Customs (RMC) has issued guidelines on procedures pertaining to the following:

- Windfall profits levy
- Excise duty
- Service tax
- Sales tax
- Sales tax on petroleum

The above guidelines cover, among others, the procedures for applying for licences, payments of levy / duty / tax, and conditions for taxability and claiming of exemptions.

Double Taxation Reliefs

- Double Taxation Relief (The Government of the Republic of Seychelles) (Amendment) Order 2010 [P.U.(A) 286/2010]

- Double Taxation Relief (The Government of the State of Kuwait) (Amendment) Order 2010 [P.U.(A) 287/2010]

(The above protocols amending the Double Taxation Agreement (DTA) between Malaysia and the Republic of Seychelles, and between Malaysia and Kuwait have been gazetted on 26 August 2010. The amendments in Acticle 26 are related to Exchange of Information.)

- Double Taxation Relief (The Government of His Majesty the Sultan and Yang Di-Pertuan of Brunei Darussalam) Order 2010 [P.U.(A) 78/2010]

(The above agreement signed between Malaysia and Brunei on 5 August 2009 was ratified on 17 June 2010. This DTA is effective for the years of assessment beginning on or after 1 January 2011 for income tax and withholding tax, whilst for petroleum income tax, it is effective for the years of assessment beginning on or after 1 January 2012.)

Income Tax (Special Treatment on Interest on Housing Loan) (Amendment) Regulations 2010 [P.U.(A) 288/2010]

The Order amends Regulation 5 of the *Income Tax (Special Treatment on Interest on Housing Loan) Regulations 2009 [P.U.(A) 109/2009]* and is retrospective from year of assessment 2009 and subsequent years of assessment.

Special Fixed Deposit Rate of 3.2% p.a to CTIM members

Hong Leong Bank Berhad is offering special fixed deposit rate of 3.2% p.a to CTIM members for tenure of one to three months. The minimum amount to be placed is RM5,000.00 and the maximum amount is RM100,000.00. The promotion ends on 31 January 2011.

Chartered Tax Institute Tax Institute of Malaysia (CTIM) is Recruiting an Assistant Manager/Technical Manager

CTIM is inviting suitably qualified candidates to apply for the abovementioned position in the premier body for tax professionals. Interested applicants can refer to the Institute's website for more information.

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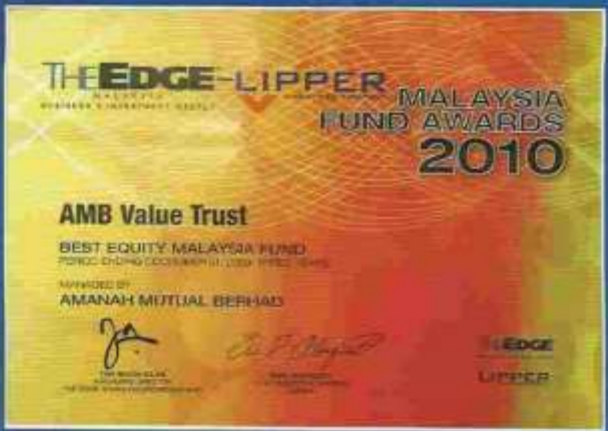

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