



Malaysian Institute Of Taxation

# TAX NASIONAL

Official Journal of The Malaysian Institute of Taxation

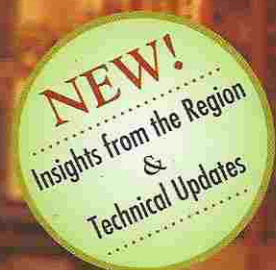
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## Goods and Services Tax in Malaysia

Towards Electronic Tax Filing System:  
Technology Readiness and Responses  
of Malaysian Tax Practitioners



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# How to become a member of the Malaysian Institute of Taxation



## BENEFITS AND PRIVILEGES MEMBERSHIP

The Principal benefits to be derived from membership are:

- Members enjoy full membership status and may elect representatives to the Council of the Institute.
- The status attaching to membership of a professional body dealing solely with the subject of taxation.
- Obtain of technical articles, current tax notes and news from the Institute.
- Obtain of the Annual Tax Review together with the Finance Act.
- Opportunity to take part in the technical and social activities organised by the Institute.

## CLASSES OF MEMBERSHIP

There are two classes of members, Associate Members and Fellows. The class to which a member belongs is herein referred to as his status. Any Member of the Institute so long as he remains a Member may use after his name in the case of a Fellow the letters Fellow of Taxation Institute, Incorporated (F.T.I.I.), and in the case of an Associate the letters Associate of Taxation Institute, Incorporated (A.T.I.I.).

## Qualification required for Associate Membership

1. Any Registered Student who has passed the examinations prescribed (unless the Council shall have granted exemptions from such examinations or parts thereof) and who has had not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
2. Any person whether in practice or in employment who is an advocate or solicitor of the High Court of Malaya, Sabah and Sarawak and who has had not less than three (3) years practical experience in practice or employment relating to taxation matters approved by the Council.
3. Any person who has passed the Advanced Course examination conducted by the Department of Inland Revenue and who has not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
4. Any person who is registered with MIA as a Chartered Accountant and who holds a Practising Certificate and an audit licence issued pursuant to the Section 8 of the Companies Act, 1965.
5. Any person who is registered with MIA as a Chartered Accountant with Practising Certificate only and has had not less than two (2) years practical experience in practice or employment relating to taxation matters approved by the Council.

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8. Any person who is an approved Tax Agent under Section 153 of the Income Tax Act, 1967.

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A Fellow may be elected by the Council provided the applicant has been an Associate Member for not less than five (5) years and in the opinion of the Council he is a fit and proper person to be admitted as a Fellow.

## APPLICATION FOR MEMBERSHIP

Every applicant shall apply in a prescribed form and pay prescribed fees. The completed application form should be returned accompanied by:

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  - (a) Identity Card
  - (b) All educational and professional certificates in support of the application
2. Two identity card-size photographs.
3. Fees:

|                         |                  |
|-------------------------|------------------|
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| (b) Annual Subscription | RM200            |
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The Council may at its discretion and without being required to assign any reason reject any application for admission to membership of the Institute or for a change in the status of a Member.

Admission fees shall be payable together with the application to admission as members. Such fees will be refunded if the application is not approved by the Council.

Annual subscription shall be payable in advance on admission and thereafter annually before January 31 of each year.



## The President's Note



With the first quarter of the year 2005 coming to an end, I am sure many of our members are busy getting their clients tax returns completed for timely submission. I would like to advise members to observe and comply with the deadline for the submission of the Forms BE and B which falls on 30 April and 30 June respectively.

In the past, the Institute has been focused in offering training programmes to its members and tax practitioners. However, this year as part of our efforts in reaching out to the public and assisting them in understanding the self-assessment system, we have organised training programmes specifically designed for the education of the general public. These programmes have been made possible with the co-operation of the major media houses in Malaysia.

For example, the introduction of Forms B and BE by the Lembaga Hasil Dalam Negeri this year has led to a lot of enquiries from the public. In view of this, the Institute has embarked on a series of workshops to train members of the public on how to complete the income tax return forms.

Nationwide workshops on how to complete the Form BE will be organised by the Institute and The New Straits Times Press at major cities in the country. The first workshop is scheduled to start in Kuala Lumpur on March 26 and will be followed by similar workshops in Georgetown, Johor Bahru, Kuantan, Kota Kinabalu and Kuching. The Lembaga Hasil Dalam Negeri officers will be assisting in providing the training.

I am sure members of the Institute would have taken note that the number of training programmes offered in the first quarter of the year has increased significantly. This is in line with our efforts in ensuring that our members are well-versed with the latest developments in taxation.

All this and many more branch activities will mean a busy year ahead for the Institute. The Institute hopes to receive the continuous support from members as well as non-members who have been very supportive of our events in the past.

Also, the 13th Annual General Meeting (AGM) is fast approaching. I wish to inform that the AGM will be held sometime in May and the AGM is a good opportunity for members to network and exchange views and thoughts. I would like to urge all members to attend the AGM as I believe that the voice of every member counts.

**Ahmad Mustapha Ghazali**  
President

# The Editor's Note

Welcome to the first issue of Tax Nasional for the year 2005. It has been a long journey for the journal since the idea of having the Institute's own journal was first mooted. Over the years we have continuously improved the journal. To further equip members with valuable information, I am delighted to introduce two new segments commencing from this issue. From this issue onwards, we will include a segment known as the Technical Updates which contains brief quarterly reports on developments in tax legislations and compliance matters. Also, look out for the segment entitled "Insights from the region" by Karen Tan which provides an update on the recent tax developments taking place in the Asia-Pacific region.



For coverage on past events, please read about them in Institute News.

Other articles of interest in this issue include:

## Tax Considerations in Share Valuation

Kenneth Yong provides us with an overview of the effect taxation has in influencing the methods of valuing company shares.

## Towards Electronic Tax Filing System: Technology Readiness and Responses of Malaysian Tax Practitioners

An article by Lai Ming-Ling, Dr. Siti-Normala Sheikh Obid and Dr. Ahamed-Kameer Meera on the study of tax practitioners' technology readiness and their attitude, perceptions and usage intentions towards electronic tax filing.

## Goods and Services Tax in Malaysia

The impending implementation of the Goods and Services Tax (GST) in January 2007 has prompted Dr. Jeyapalan Kasipillai and Dr. Jonathan Baldry to examine some of the important aspects of replacing the current sales and services taxes. The article, amongst others also summarises the features and advantages of GST and a discussion on the weaknesses of the current indirect tax regime in Malaysia.

## Customs Requirements for Passengers

In this article, Thomas Selva Doss addresses some of the questions and issues about customs requirements that frequently cross the minds of passengers arriving in Malaysia.

## Learning Curve

In this issue, Siva Nair leads us into the discussion of establishing whether a particular receipt is capital or revenue in nature.

Harpal S. Dhillon  
Editor of Tax Nasional



Malaysian Institute Of Taxation

The Malaysian Institute of Taxation ("the Institute") is a company limited by guarantee incorporated on October 1, 1991 under Section 16(4) of the Companies Act 1965. The Institute's mission is to enhance the prestige and status of the tax profession in Malaysia and to be the consultative authority on taxation as well as to provide leadership and direction, to enable its members to contribute meaningfully to the community and development of the nation.

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# Tax Nasional

Official Journal of the Malaysian Institute of Taxation

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



# TAX AUDITS AND INVESTIGATIONS

With audits and investigations thrust into the limelight, the Malaysian Institute of Taxation (MIT) organised a seminar on "Tax Audits & Investigations - The Way Forward" on the 28 February 2005. The seminar aimed at highlighting the crucial period during and after a tax audit and investigation as well as measures that can be taken.

Speakers, comprising of Mr Christopher Low, Mr Anand Raj, Mr Krishnan Kanan and Mr Wan Heng Choon, presented papers covering various

issues ranging from an overview of legal issues in tax audits and investigations to customs audits and investigations.

A special highlight at the seminar was the presence of Mr Quah Sin Hor, Director of Investigations Department of the Inland Revenue Board (IRB), who served as one of the panelist. With Mr Quah, participants were given an insight on the measures and procedures outlined by IRB on matters pertaining to tax audits and investigations.

## Workshop on Self Assessment System for Individuals & Form B Training

With the self assessment system for individual taxpayers just around the corner, there is a need to have a proper understanding about our role and responsibilities. This is more evident with the introduction of the Form B and BE by the IRB this year.

The Malaysian Institute of Taxation organised a one day workshop on Self Assessment System for Individuals combined with Form B training. Mr Ravi Chandran from the Bahagian Khidmat Korporat of IRB provided training on the methods of filling the new Form B for YA 2004. The workshop also addressed issues on tax management strategies under Self Assessment System and the impact of self assessment for individuals, which was presented by Mr Ong Gim Yan.



LHDN officers from left: Mr Ravi Chandran, Cik Mahhani A Manan and Cik Norhaslinda bt Bukhari



Mr Ong Gim Yan presenting a paper at the workshop



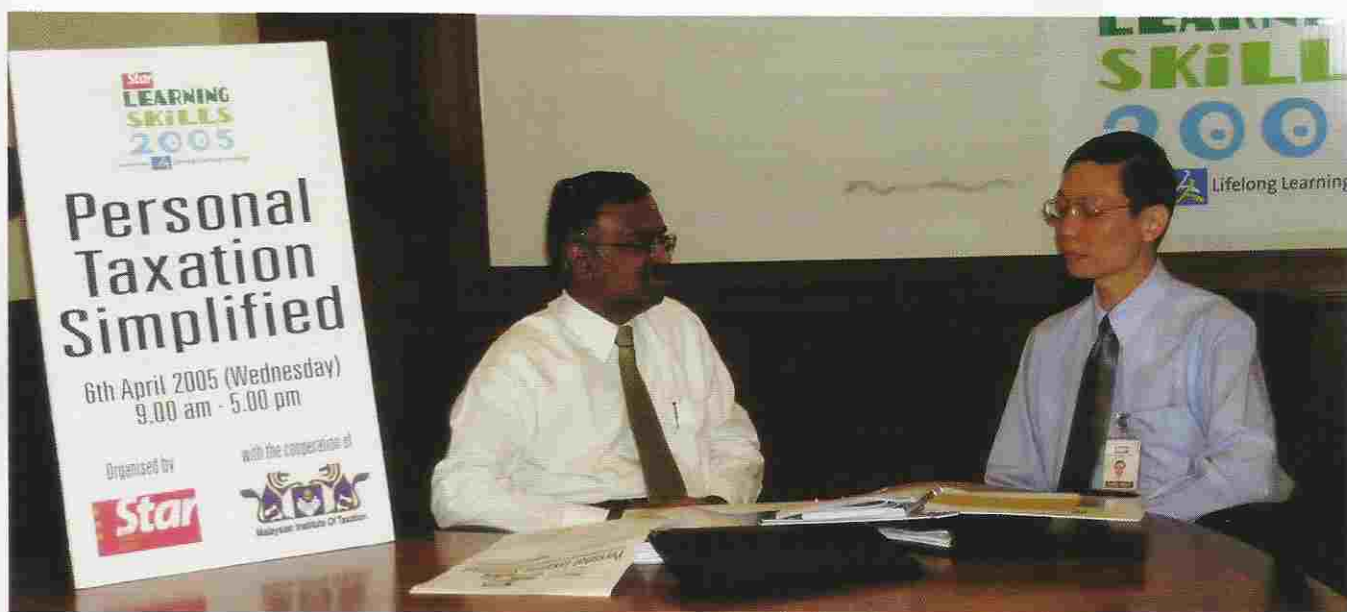
# Workshop on Tax Incentives

Mr Harvindar Singh, a Senior Manager from Ernst & Young Tax Consultants, recently conducted a workshop on Tax Incentives, organised by the Malaysian Institute of Taxation.

A regular speaker at seminars on Malaysian taxation at tax and financial conferences, Harvindar gave an insight into tax incentives such as pioneer status and investment tax allowance, reinvestment allowance, such as promotion of exports as well as some highlights of the 2005 Budget proposals.

He will be conducting another workshop on "My Client is being Audited" on 4 April 2005.

## PERSONAL TAXATION SIMPLIFIED WORKSHOP



Mr SM Thanneermalai, Vice President of MIT with Mr Tan Chon Meng, Accountant of STAR at the press conference

The STAR will be organising a Personal Taxation Simplified Workshop in cooperation with the Malaysian Institute of Taxation (MIT) on 6 April at Eastin Hotel, Petaling Jaya.

The objective of the workshop is to educate the public on how to complete their tax returns and to provide participants with the essential knowledge in taxation.

In relation to this, STAR organised a press conference recently with Mr SM Thanneermalai, Vice President of MIT, who is also

the Senior Executive Director of PricewaterhouseCoopers. At the press conference, Mr Thanneermalai explained that this workshop is aimed at assisting the public to understand their roles and responsibilities under the Self Assessment System.

He urged the public to participate at the workshop as they will be assisted on how to calculate taxes, what type of documents the taxpayers should keep for deduction purposes and what is taxable and deductible under the new concept.



# Technical Updates

(JAN 05 – MAR 05)

BY MIT TECHNICAL DEPARTMENT

## Public Ruling

*Public Ruling 5/2004* entitled “*Double Deduction Incentive on Research Expenditure*” was released on 6 January 2005. The Ruling details the incentive as provided for under section 34A of the *Income Tax Act 1967* and is effective from Year of Assessment 2005 onwards. It discusses the definition of “Research” and “Research on IT and Software” and what expenditure would qualify for the double deduction. It also sets out the new application procedure as well as the relevant application forms to be completed. The Public Ruling is available in [www.mit.org.my](http://www.mit.org.my) under the Technical Section - Guidelines/Rulings.



## Forms

A new Return of Remuneration by an Employer for Year 2004 was issued by the Inland Revenue Board in January 2005. The said Return is available in [www.mit.org.my](http://www.mit.org.my) under the Technical Section - Practice Statements.

## Legislation

### Parliamentary Acts

The Finance Act 2004 (Act 639) was gazetted on 30 December 2004. A copy of the Act is available in [www.mit.org.my](http://www.mit.org.my) under the Technical Section - Published Reports.

### Gazette Orders

The following Orders and Rules have been gazetted:-

- *Income Tax (Accelerated Capital Allowance) (Power Quality Equipment) Rules 2005* [P.U. (A) 87]
- *Income Tax (Accelerated Capital Allowance) (Renewable Energy) Rules 2005* [P.U. (A) 88]
- *Double Taxation Relief (The Government of the Republic of Chile) Order 2005* [P.U.(A) 84]
- *Income Tax (Exemption) (No.12) Order 2005* [P.U.(A) 77]
- *Income Tax (Deduction for Investment in a Venture Company) Rules 2005* (revokes *Income Tax (Deduction for Investment in a Venture Company) Rules 2001*) [P.U.(A) 76]
- *Income Tax (Exemption) (No.11) Order 2005* (revokes *Income Tax (Exemption)(No.3) Order 2001*) [P.U. (A) 75]

## Dialogues

An Operations Dialogue was held by the Inland Revenue Board with the professional bodies on 16 February 2005.

## Guidelines

### Securities Commission

The Securities Commission (SC) released its *Guidelines on Real Estate Investment Trusts* (Guidelines). The Guidelines will be effective from 3 January 2005. The Guidelines supercedes the earlier *Guidelines on Property Trust Funds* that were issued on 13 November 2002. The Guidelines are available at the SC's website at [www.sc.com.my](http://www.sc.com.my).

The key features of the Guidelines include liberalisation of the borrowings limits for a REIT, relaxation on acquisitions of leasehold properties and flexibility accorded to acquisitions of real estates that are encumbered by financial charges.

The level of disclosure and reporting required of a REIT has been enhanced with a view to facilitate more comprehensive and timely disclosure of information to investors. Additionally, submission requirements and procedures have also been revised to promote faster decision turnaround time, which would ultimately improve efficiency in fund raising exercises for a REIT.

## Miscellaneous

### HRD Levy

With effect from 1 January 2005, 10 new industries from the services sector will be required to pay the training levy to the Human Resources Development Bhd (HRDB). These will include sectors (with 10 employees or more) from the following:-

- direct selling;
- port services;
- engineering support and maintenance;
- research & development;
- warehousing services;
- accounting and auditing;
- engineering;
- security services;
- private hospital services;
- hypermarkets, supermarket, departmental store services (50 employees or more).

Employers from these sectors are required to pay an amount equivalent to 1% of the employees' salaries (i.e. basic salary plus fixed allowance).

Employers who fail to register may be liable to a penalty of RM10,000 or 1 year imprisonment or both. Employers who fail to pay the levy may be liable to a penalty of RM20,000 or 2 years imprisonment or both. Late payment of the levy (which is due before the last day of the following month) may be liable to interest charge of 10% per annum.

Members who wish to enquire further may contact HRDB at 03-2098 4800 or visit [www.hrdnet.com.my](http://www.hrdnet.com.my) for more information.

## RETURN SUBMISSION DEADLINES

| Type of Forms                            | On or Before                    |
|--|---------------------------------|
| <b>Forms C&amp;R/C1/TA/TC</b>            | (7 months after financial year) |
| - financial year ended 30 June 2004      | 31 January 2005                 |
| - financial year ended 31 July 2004      | 28 February 2005                |
| - financial year ended 31 August 2004    | 31 March 2005                   |
| - financial year ended 30 September 2004 | 30 April 2005                   |
| - financial year ended 31 October 2004   | 31 May 2005                     |
| - financial year ended 30 November 2004  | 30 June 2005                    |
| <b>Form E</b>                            | 31 March 2005                   |
| <b>Non Business Source</b>               |                                 |
| - Form BE                                |                                 |
| - Form M                                 |                                 |
| - Form TP                                |                                 |
| - Form TF                                |                                 |
| - Form TJ                                | 30 April 2005                   |
| <b>Business Source</b>                   |                                 |
| - Form B                                 |                                 |
| - Form M                                 |                                 |
| - Form P                                 |                                 |
| - Form TP                                |                                 |
| - Form TF                                |                                 |
| - Form TJ                                | 30 June 2005                    |



# Insights from the Region

BY KAREN TAN



This newly created column tracks some of the tax happenings and recent tax developments in the Asia-Pacific region, with a specific focus on Malaysia and Singapore.

In this maiden issue, the indirect tax developments in Malaysia and India are briefly discussed. This article also takes a close look at some of the recent changes in Singapore namely the tax implications of limited liability partnerships (LLPs) and the tax treatment of business trusts and trust companies. It ends with a short discussion on the proposed introduction of the current year basis of taxation in Singapore, similar to that adopted in Malaysia in 1999.

## India & Malaysia - VAT / GST developments

Value-added tax (VAT) or Goods and Services Tax (GST) has been sparking interest in the region. After several false starts, India finally pushed ahead with the introduction of VAT announced in 2004 by its new Prime Minister. It had set 1 April 2005 as the deadline to implement the new regime. With approximately 27 states being VAT-ready and the remaining states working towards being VAT-compliant, it remains uncertain whether this deadline could be successfully achieved this time.

Apart from India, Malaysia also announced, in its 2005 Budget, that it will be introducing GST in 2007. India and Malaysia will be joining approximately 120 countries around the world in implementing this trendy consumption tax. This new regime will replace the Malaysian consumption tax regimes consisting of sales tax and service tax and is likely to move from the existing multiple tax rate structure to a single tax rate (with possible exemptions). It is envisaged that this multi-staged tax will enhance tax compliance and improve transparency in the indirect tax regime.

## Singapore - Taxation of Limited Liability Partnerships

In Singapore, two additional business structures, namely the limited partnerships (LPs) and Limited Liability Partnerships (LLPs) were introduced recently to provide greater flexibility and choice for doing business in Singapore. The tax treatment of the LLPs is set out in the *Income Tax (Amendment) Act 2004*, which came into force on 23 November 2004.

### *Advantages of the LLP structure*

Unlike a general partnership, the LLP is treated as a separate legal entity. As such, the LLP can own property in its own name. Another unique feature of the LLP is that the partners are accorded limited liability protection. As such, the liability of an LLP partner is limited to the amount of capital contributed to the LLP. Apart from retaining the benefits of a general partnership and the ability to preserve the privacy of its financial accounts, the LLP is also relatively cheaper to maintain from a compliance perspective.

### *Income tax implications*

The responsibility for filing the annual income tax returns for the LLP and the statement of the respective partners' contributed capital rests with the precedent partner of the LLP. For income tax purposes, an LLP will be treated as a partnership notwithstanding that it is a separate legal entity from its partners. As such, the partners will be taxed individually in respect of their proportionate interests in the LLP profits. If the partners are individuals, they will be subject to the graduated scale of 0% to 22% whereas a company is subject to flat 20% corporate tax rate on every dollar after the first \$100,000 of chargeable income – which is not imputed back to the shareholders. From a tax perspective, using an LLP appears to be an attractive option to achieve greater tax efficiency when compared with that of a company.

The capital allowances and trade losses of the LLP are allocated to the respective partners to be offset against their personal incomes from all other sources but the quantum is capped at the partner's contributed capital in a particular Year of Assessment.

### *Transferring into an LLP*

For businesses presently operating under a different vehicle but wish to transfer its existing business to a newly established LLP, the tax treatment of capital allowances and losses must be considered. Generally, the unabsorbed capital allowances, losses and donations can be carried forward and utilised against future taxable income of the individual partner (individual or company) of the LLP. However, where the individual partner or transferor company does not become a partner in the transferee LLP, the unabsorbed capital allowances cannot be carried forward against future taxable income and will be permanently lost. Other similar tax concerns when transferring an existing business between entities are applicable here and they include the valuation of trading stock, transfer of debts and transfer of depreciable assets.

### *Summary*

The LLP's separate entity status and the limited liability protection accorded to the LLP partners are two significant



advantages of this business structure. Coupled with its ability to have a more flexible internal arrangement of the partnership structure and the benefit of perpetual succession through an LLP, the LLP appears to be an attractive business structure. It possesses the combined benefits from companies and partnerships and reflects a business entity that would be viable for any type of business venture.

It is noteworthy that although the Companies Commission of Malaysia had conducted a public consultation in January 2004 to consider introducing the LLP as an additional business structure in Malaysia, no further developments have taken place since.

### Singapore - Tax treatment of a Business Trust and a Trust Company

Below is a brief comparison of a business trust and a trust company. Although they both contain the term "trust" in them, they are, in fact, used for different purposes.

#### Business trust

By way of background, a business trust (BT) is not a separate legal entity. It is essentially a business that is structured as a trust and is constituted by a trust deed under which the trustee has legal ownership of the assets of the BT. Typically, the trustee also manages the business for the benefits of the beneficiaries under the BT. Pursuant to the enactment of the *Business Trusts Act* on 1 September 2004, BTs can be used to undertake business operations in Singapore.

#### Tax treatment

Any trust registered as a business trust will not be taxed as a normal trust. Instead, it will be treated like a company. It will adopt the one-tier system and income of a registered BT will continue to be taxable at the trustee level. The unit holders of the registered BT will not be taxed on their share of the statutory income of the trustee to which they are entitled to. No credits will be allowed to the unitholders for the tax paid by the trustee of the registered BT.

#### Trust company

In contrast, a trust company is one which engages in the business of acting as a trustee or administering trusts. Trust companies are commonly utilised by high net-worth individuals to act as trustees or to administer a trust for the beneficiaries. They will be regulated under the *Trust Companies Bill 2005* which has had its second reading by the Monetary Authority of Singapore.

#### Tax treatment

The trustee of a trust will be chargeable to income tax on the income derived from trust properties. A beneficiary of the trust is taxed on the share of the statutory income of the trustee for any year of assessment which corresponds to the share of the trust income to which the beneficiary is entitled for the year

preceding that year of assessment. However, he will be allowed to claim a credit for tax paid by the trustee on his share of the trustee's income to which he is entitled.

### Singapore - Switching to Current Year Taxation

At present, income is taxable in Singapore on a preceding year basis, ie income tax payable this year is based on income earned in the previous year. However, the Singapore Government is considering the merits of replacing the preceding year basis of assessment with a current year basis of assessment for the taxation of income.

Under the proposed current year basis of assessment, tax is paid on current income rather than income earned in the previous year. For salaried individuals, the tax payable amount may be withheld by the employers on a monthly basis from their salaries and then paid over to the tax authorities. For companies, tax may be paid in instalments in the current year. This Pay-As-You-Earn (PAYE) system is adopted in many countries including Australia and Malaysia.

Under the proposed current year taxation, it is likely that there will be better matching between income and tax expenditure. There will also be improvements in cash flows particularly for companies. Where companies make lower profits or even losses during a downturn year, they need not be paying tax based on previous year's profits.

Notwithstanding the potential advantages from a cash flow perspective, the shift from the preceding basis of assessment to the current basis is likely to increase compliance costs for taxpayers. This issue must, however, be weighed against the benefits which could be derived under the proposed current year basis of assessment.

In addition, transitional measures must also be undertaken to ensure a smooth change in the basis of assessment. The possibility of double taxation can be prevented by giving a waiver from tax in respect of the income (subject to some exceptions) for the particular basis year. For example, Malaysia had granted companies and individuals a tax waiver for the transitional year (ie 1999) when it adopted the current year taxation. After careful deliberation, the Ministry of Finance decided not to implement current year taxation at this stage. The announcement was made in the Budget 2005 speech presented by Prime Minister Lee Hsien Loong on 18 February 2005.

#### The Author

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Industry

☐ Accounting Services

☐ Legal Services

☐ Associations

☐ Manufacturing/ Printing

☐ Construction

☐ Property/ Conveyancing

☐ Education

☐ Retail Trading

☐ Finance

☐ Telecommunications

☐ Government

☐ Tourism

☐ Health Services

☐ Transport

☐ HR Consulting

☐ Utilities

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# Tax Considerations in Share Valuation

BY KENNETH YONG

KLSE STREET JOURNAL

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Edited and

## What's New

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ELER SAID it will omit its 1995 dividend, a widely expected move, firmed that it will post a net \$3.54 billion as the result of a restructuring program.

(Article on page 3.)

ministers endorsed a plan to le mad-cow disease, but Britain the council's support for a cotton on U.K. beef exports.

(Article on page 7.)

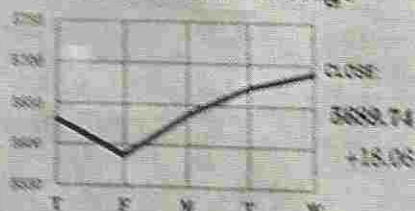
ce unveiled plans to introduce tion in its long-protected

A PLANE CRASHING the U.S. secretary of commerce crashed in Croatia.

Local authorities searching for the wreckage of a plane carrying Ron Brown said they had found four bodies and the military plane's tail. The plane, a T-43, the military version of a Boeing 737, was en route from the northeastern Brazilian town of Tula, the base of U.S. troops with the NATO-led peace force. As it approached Cluj airport from the northwest, it apparently crashed into a hill on its final approach just north of the airport, 20 kilometers southeast of Dubrovnik. Diplomatic and security sources said the plane crashed in stormy weather. As many as eight of the dozen U.S. executives scheduled to have been with the

## Markets Summary

### KLSE Industrial Average



LONDON  
FT-SE 100 3725.1 -3.4

FRANKFURT  
Dax 2494.4 -6.82

| DOLLAR   |        | POUND    |         |
|----------|--------|----------|---------|
| DM1.4810 | -0.002 | \$1.5263 | +0.0028 |

Current values represent 2 p.m. New York trading.

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## Introduction

With a large number of variables to consider, and a variety of ways to calculate them, share valuation is undeniably a complicated exercise. One such variable that goes into valuing shares is *tax*. While common sense would tell us that tax effects are generally adverse, the precise manner in which taxes affect the share pricing mechanism is somewhat less clear-cut.

This article provides an overview of the effect taxation has in influencing three common methods of valuing company shares, namely the earnings multiple method, the dividend discount model, and the net tangible asset approach. Because different assumptions underlie different methods of share valuation, the tax effects can vary significantly.

## Taxes and value measurement

It is an undisputed fact that profits enhance a company's value. The darlings of the share market are all highly profitable companies that declare a generous stream of dividends.

Under financial reporting, the book value of a company is encapsulated in the "shareholders equity" figure, or its numerical equivalent - the "net assets" figure (total assets less total liabilities). Profit, a constituent of shareholders equity, adds to the book value of the company and thus, enhances share value.

By most accounts, taxes represent a significant "expense" that slashes away a sizeable portion of a company's annual profits. The higher the tax, the lower the profit, and thus the lesser the book value. In short, taxes reduce book value.

## Micro-economic effect of tax

Undeniably, reduction of profits due to taxes is an unpleasant realisation that crosses the minds of every director, shareholder and businessman. Taxes require cash to be paid to the Inland Revenue Board, and also reduce the amount of retained earnings that a company accumulates over the years, thus depriving a company of precious resources that could have been ploughed-back for business expansion. Economists call this plough-back the *multiplier effect*.

To observe a live example of exploiting the multiplier effect, we need search no further than Budget 2004 which conferred a preferential 20% tax rate (instead of the usual 28%) to the first RM500,000 of chargeable income of small and medium scale companies (SMCs). The effect of this lower tax rate is to ensure that SMCs pay less tax and have more funds to reinvest for business growth, thus putting the multiplier effect into action on a national scale.

## Effective tax rate

Ignoring the preferential tax rate on SMCs, the prevailing corporate tax rate in Malaysia is 28%. However, few companies are taxed on accounting profit at exactly 28%. The effective tax rate, which is the "tax expense divided by the accounting profit" (MASB 25/FRS 112, para 85) can differ from the statutory rate of 28% for several reasons, including:

- different rates and timing of depreciation and capital allowances.
- differences in tax and accounting rules relating to timing of income/expense recognition.
- RM50,000 and RM100,000 restrictions in capital allowance claim on non-commercial vehicles.
- tax rules require source-by-source matching of income and expenses.
- capital gains not subject to tax.
- expenses not allowed for deduction.
- tax incentives that reduce taxable income.

Items (a) and (b) are usually temporary differences that are effectively smoothened out through deferred tax provisions. However, the other items are permanent factors that can cause a lower or higher effective tax rate.

A low effective tax rate is desirable because it increases profits, and more importantly, enhances the return-on-equity that spurs the multiplier effect. Companies that consistently achieve a low effective tax rate compared to their peers (eg by enjoying pioneer status, investment tax allowance and other tax incentives) will gain a financial advantage, and command more favourable earnings-based share valuation.

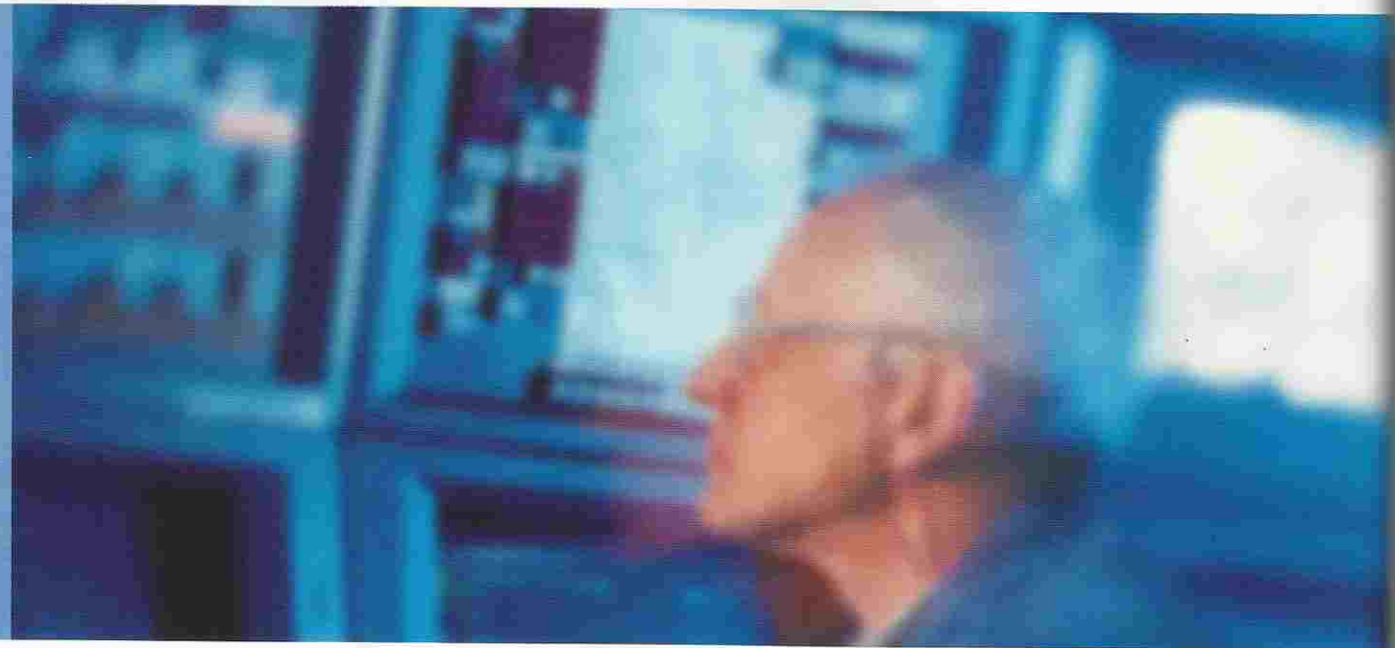
## Valuation methods

There are three widely used methods of share valuation: the earnings multiple method (which is an earnings-based approach), the dividend discount model (which is a dividend-driven approach), and the net tangible asset approach (which is a balance sheet valuation approach). It must be noted that these three methods take very different perspectives in valuing company shares, and quite often, all three methods are adopted to obtain a range of possible values for the share under examination. Because the mechanics of each method are different, some methods are directly affected by changes in tax rates, some are quite insensitive to corporate tax rates, and others may even show unexpected positive outcomes to adverse movements in tax rates.

## Earnings multiple

The Earnings multiple approach is also known as the Price Earnings ratio approach. It is a two-step process that involves (1) determining the Price Earnings or PE ratio and (2) multiplying the PE with the expected future earnings per share or EPS, to estimate the share price in future.





The earnings multiple approach is directly influenced by prospective earnings of a company. It has already been explained that low effective tax rates can enhance company earnings. Thus, all things being equal, if future tax rates are expected to reduce, companies will be able to post a higher EPS. Multiplying the higher EPS with the historical PE will surely roll out higher expected share values. Therefore, tax reductions that lead to lower effective tax rates will cause the earnings multiple approach to yield more favourable share values.

### Dividend discount model

The way the Dividend Discount Model (DDM) works is written in its name: all future dividends are discounted to present value to arrive at the share price. There are many versions of the dividend discount model (eg Gordon growth model, No-growth model, 2-stage DDM, H-model, 3-stage DDM, Growth Duration model, etc). Mostly, the major difference lies in the pattern of dividends (eg dividends can be constant, declining, increasing or multi-staged and the model is modified to accommodate the pattern assumed).

The cash inflow from dividend income is the net dividend after tax. Section 108 of the *Malaysian Income Tax Act* stipulates that tax of 28% be deducted from gross taxable dividends. However, dividends are taxed in the hands of the shareholders (tax resident individuals) at their respective tax rates (which can range from 0% to 28%) and **not** at the corporate tax rate. The excess of 28% (tax deducted from dividends) and the shareholder's tax rate represents a refund (a cash inflow), which the shareholder will receive from the Inland Revenue Board. It follows that a complete dividend discount model should also take into account such tax refund as a cash inflow. This has several major implications.

Firstly, because shareholders are taxed at their individual scale rates, the corporate tax rate of 28% (tax deducted from dividends)

is rendered irrelevant to the DDM share valuation process. This would hold true even when the corporate tax rate is reduced because the cash value of a net dividend received would be adjusted upward following lesser tax deducted from dividends.

Secondly, because different shareholders are taxed at different rates (depending on their chargeable income), the share price - predicted from a dividend discount model incorporating tax refunds - will be different for each shareholder. There would not be a single predicted price. The higher the **shareholder's** tax rate (as opposed to the **corporate** tax rate), the lower the predicted share price.

Thirdly, different investors' tax exposures may cause some polarisation among investors, as low tax-rate investors may prefer to hold shares that pay dividends while high tax-rate investors seek out shares with capital gain potential (not taxable in Malaysia). Arguably, if all investors factored such considerations into share valuation, the demand and desirability of dividend paying and non-dividend paying shares could be affected (the tax clientele hypothesis).

However, if the dividend income were tax exempt, then the tax effects above would not arise as the dividend discount model becomes indifferent to investors' tax exposure.

### Net tangible asset

The net tangible asset or NTA approach attempts to capture the value of the balance sheet into a single figure: the "share holders equity". This figure would be the carrying value of the company and serves as an approximation to the liquidation value of the company. In a variation of the NTA approach, adjustments can be put through to write off non-collectable debts, and additional impairment made to reflect fair values of investments and stocks, prior to valuation.



But for the most part, NTA reflects the book value of the company based on financial elements captured on the balance sheet. Changes in tax rates do not directly affect the NTA approach, as taxes tend to influence earnings more readily than asset values.

### MASB 25/FRS 112-recognising effects of utilised tax losses

Prior to MASB 25/FRS 112, one aspect of taxation was generally excluded from the NTA approach: unutilised tax losses. This happened because the financial accounting system at the time did not subject tax losses to recognition on the balance sheet. Under the *Malaysian Income Tax Act 1967*, tax losses do not expire, and are available to set off against all future taxable income arising from business sources.

MASB 25/FRS 112 that became effective from 1 July 2002 recognised the effects of tax losses as valuable assets on the balance sheet, thus officially bringing the effect of tax losses into the realm of share valuation. Under MASB 25/FRS 112 para 37, "a deferred tax asset should be recognised for the carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised".

The additional deferred tax asset recognised increases the "net asset" value and the "shareholders' equity" value of the company, thus enhancing its NTA and share price derived therefrom.

MASB 25/FRS 112 requires a deferred tax asset to be recognised based on the future tax rates when the tax savings are expected to arise. Ironically, and contrary to common sense, expected **decreases in future tax rates** could result in the NTA approach indicating a **lower share value** for a company with a tax loss carried forward.

### True value of tax losses

The value of an asset for valuation purposes is the present value of the discounted future cash flows produced by the asset. Similarly, the value of a deferred tax asset is the discounted present value of the mean future tax savings. The longer it takes a company to utilise the tax losses, the less valuable is the tax saving.

Unfortunately, MASB 25/FRS 112 - which recognises the effects of tax losses at gross book values - does not adjust for time-value discounting. As such, the book value of a deferred tax asset usually overstates its true value for share valuation purposes and thus, needs to be scaled down by a correction factor.

### Message in tax losses

Tax losses can be a double-edged sword. On one hand, it enhances balance sheet valuations by recognising future tax savings as deferred tax assets.

However, a history of tax losses can also be a premonition of continued future losses. If the circumstances leading to the loss persisted, it could wipe out future earnings and eliminate the prospect of future dividends, thus rendering the earnings multiple and dividend discount model inoperable. Therefore, correct interpretation of tax losses is a risky bet. At the very least, there is a greater likelihood of higher perceived earnings volatility, which may have a negative effect on expected earnings.

### CONCLUSION

In virtually every aspect of business and finance, the effects of tax are both considerable and important. Share valuation is no exception. However, despite common sense, the accounting and financial technicalities of each valuation method suggest that tax effects are not homogeneous but can produce surprising and unexpected results. A thorough appreciation of tax complexities will surely fine-tune the valuation process.

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# Towards electronic tax filing system:

## Technology readiness and Responses of Malaysian Tax Practitioners

BY LAI MING-LING, DR SITI-NORMALA SHEIKH OBI,  
DR AHMAD-KAMEEL MEERA



## ABSTRACT

This paper examines tax practitioners' technology readiness and subsequently their attitude, perceptions and usage intentions towards the electronic tax filing (e-filing) system. A questionnaire survey was administered on 192 tax practitioners and the Technology Readiness Index (TRI) of Parasuraman and Colby (2001) was adapted. Findings showed that the respondents were positive towards the new technologies; nonetheless, they were concerned about the security of the e-filing system. Based on TRI, the respondents were segmented into explorers (14.6%), pioneers (35.9%), sceptics (20.8%), paranoids (25.5%) and technology laggards (3.1%). The results also suggested that there were significant differences in attitude, perceptions and usage intentions towards the e-filing system across the technology readiness segments.

## 1.0 INTRODUCTION

Globally, the tax environment is changing rapidly. Not only the social, economic and political conditions are evolving quicker than ever before, but also the revolution of Information and Communication Technology (ICT) is challenging the operation of tax systems and its administration (Hicks and Rubenstein, 1996; Tanzi, 2001). Specifically, in the tax compliance settings, the development of Internet technology has opened up new opportunities for tax agencies, taxpayers and their representatives to communicate electronically. Worldwide, several tax agencies; in particular those in the Asia-Pacific region and European Union have opted to adopt the electronic filing (e-filing) system progressively. Basically, the e-filing system encompasses the use of Internet technology and the Worldwide Web for a wide range of tax administration and compliance purposes; it integrates tax preparation, tax filing and tax payment. Most recently, the Inland Revenue Board of Malaysia (the IRB) is also reforming the tax administrative policies to embrace an e-filing system (SGATAR, 2001). Chong (2004) reported that on 17 May 2004, the IRB had launched the e-filing system to corporate taxpayers.

Empirical evidence shows that tax compliance could only work effectively with the assistance and cooperation of tax practitioners (Erard, 1993; Klepper and Nagin, 1989). Klepper and Nagin (1989, p.191) opine that, "Tax preparers represent both a mean of increasing compliance and also potentially a threat to compliance". For instance, in the United States and Australia, the tax authority is counting on tax practitioners to promote the e-filing system (James and Wallschutzky, 1993; Kaham, 1999). In a similar vein, the IRB is also counting on local tax practitioners to promote the e-filing system. However, to-date, there have been no published empirical studies on the readiness and reactions of the Malaysian tax practitioners towards the e-filing system. Therefore, this study aimed (i) to examine the technology beliefs of Malaysian tax practitioners; (ii) to segment tax practitioners based on their beliefs; (iii) to ascertain tax practitioners' attitude, perceptions and usage intentions of the e-filing system; and (iv) to examine the relationship between attitude, perceptions and usage intentions of the e-filing system across technology readiness segments.

## 2.0. LITERATURE REVIEW

An earlier study by Dabholkar (1994) found that individuals can simultaneously harbour positive (favourable) and negative (unfavourable) beliefs about new technologies, and information technology/information system (IT/IS) consumers differ in terms of their beliefs/feelings about the various options of new technologies, and these beliefs/feelings positively correlated with intentions to use.

Findings from a handful of studies relating to consumer's technology interactions also offer empirical support; for example, Mick and Fournier (1998) identified eight "paradoxes" of technology with which IT/IS consumers have to cope, namely control/chaos, freedom/enslavement, competence/incompetence, efficiency/disengagement, assimilation/isolation, engagement/disengagement, new/obsolete and fulfilment/creation of needs. Parasuraman (2000) asserted that all these paradoxes implied that technology might trigger both positive and negative beliefs/feelings. For instance, with the advent of Internet technologies, some individual appreciate the personal, societal and commercial benefits of the Internet, whilst some are paranoid of its usefulness and concerns over the ill effects of the Internet. Extant studies (Chang and Kannan 2002; Parasuraman and Wuhler 2002) found that a person can be a technology "innovator", dare to experiment, but still be sceptical about the benefits of technology, or can believe strongly in technology but also wary of its security.

Parasuraman and Rockbridge Associates jointly developed the Technology Readiness Index (TRI) to measure technology readiness. Parasuraman (2000, p.317) highlighted that the TRI is "a multiple-item scale with sound psychometric properties that can be used to gain an in-depth understanding of the readiness of a technology customer (both internal and external) to embrace and interact with technology, especially computer/internet-based technology."

Parasuraman and Colby (2001) analyse the various technology beliefs into four distinct technology readiness dimensions, namely, (1) optimism, (2) innovativeness, (3) discomfort and (4) insecurity. Parasuraman and Colby (2001) define the four technology readiness dimensions as follows:

**Optimism:** The optimism facet is defined as a positive view of technology, beliefs in the benefits of technology in increasing job efficiency, and enhancing individual lives at work and at home. It is a general dimension that captures specific feelings, which suggests that 'technology is a good thing'. The following two views from the technology readiness scale are examples of statements relating to optimism:

- I find new technologies to be mentally stimulating.
- I like computer programs that allow me to tailor things to fit my own needs.

**Innovativeness:** The innovativeness dimension refers to the extent to which a person believes that he or she is a thought leader. It measures the extent to which a person believes that he



or she is at the forefront of trying out new technology-based products/services. The following statements illustrate the types of beliefs contributing to innovativeness:

- I can usually figure out new high-tech products and services without much help from others.
- I am among the first in my circle of friends to acquire new computer technology when it appears.
- Other individuals come to me for advice on new technology.

**Discomfort:** Discomfort refers to a perceived lack of control over technology and a feeling of lack of confidence in using the new technologies properly. The following statements illustrate the types of beliefs contributing to discomfort:

- It is embarrassing when I have trouble with a high-tech gadget while other individuals are watching.
- When I get technical support from a provider of high-tech products or services, I sometimes feel as if I am being taken advantage of by someone who knows more than I do.

**Insecurity:** Insecurity is defined as distrust of technology-based transactions and scepticism about its ability to work properly. The following three perspectives from the technology readiness scale illustrate insecurity perceptions:

- I do not consider it safe to do any kind of financial business online.
- If I provide information over the Internet, I can never be sure if it really gets to the right place.
- I worry that other individual will see the information I send over the Internet.

The first two technology readiness dimensions, ie optimism and innovativeness are the 'contributors' that may motivate individual to adopt new technology; while the other two dimensions, discomfort and insecurity are 'inhibitors' that may delay or prevent technology adoption. Collectively, the combination of scores on the four dimensions represents a person's overall technology readiness. Hence, technology readiness is defined as individual's propensity to embrace and use new technologies at home and at the workplace; and technology readiness is an overall state of mind and not a measure of competency (Parasuraman, 2000; Parasuraman and Colby, 2001). In a nutshell, the different types of technology beliefs blend to produce one's overall technology readiness. The positive beliefs propel individual towards new technologies, while negative beliefs may hold them back; individuals with more positive beliefs are more ready to use the various new technologies (Dabholkar, 1994; Parasuraman and Colby, 2001).

To sum up, Parasuraman and Colby (2001) stated that there are three important components of technology readiness: Firstly, technology readiness varies from one individual to another; anyone can be a consumer of a technology, but some may seek technology actively, whilst others may need special help or coaxing. Secondly, technology readiness is multifaceted.

Thirdly, technology readiness can be used to predict and explain consumers' response towards new IT/IS. Technology readiness is a key factor in the adoption of online methods of conducting commerce, and that technology readiness correlates with actual use and intention to use the technology based products and services in varying degrees. They also found that technology readiness is correlated with attitudes toward an IT/IS.

Based on TRI, technology customers can be classified into five groups, namely, the highly optimistic and innovative "Explorer", the innovative yet cautious "Pioneers", the uncertain "Sceptics" who need the benefits of technology proved, the insecure "Paranoid", and the resistant "Laggards". Consistent to finding of Roger (1995), Parasuraman and Colby (2001) found that the explorers and pioneers are thought leaders and more technology savvy than the rest of the group.

On the other hand, empirical studies found that individual differences influence an individual's beliefs about new technology and his/her usage intentions (Agrawal and Prasad, 1999). Individual differences are defined as any dissimilarity across individual, including differences in cognitive style, personality, and demographic variables (Zmud, 1979). Usage intention is defined as a measure of the strength of one's intention to perform a specific behaviour (Fishbein and Ajzen, 1975). It is hypothesized that user's acceptance of IT/IS can be predicted by a measure of their usage intentions (Davis, 1989; Chau and Hu, 2001). Davis (1989) found that the usage intentions of IT/IS can be measured from the user's attitudes and beliefs of the IT/IS; and a prospective user's overall attitude towards using an IT/IS is hypothesized to be major determinant of whether or not a person actually uses it.

Several past studies supported that individual's computer use and acceptance can be predicted reasonably well from their usage intentions (Jackson et al., 1997; Chau and Hu, 2001). Attitude towards using the IT/IS is jointly determined by two beliefs, ie perceived usefulness and perceived ease of use (Davis, 1989). Perceived usefulness and perceived ease of use are significant constructs that influence computer acceptance behaviour (Davis, et al., 1989; Jackson et al., 1997). Davis et al. (1989, p.320) defined perceived usefulness and perceived ease of use as "the degree to which a person believes that using a particular system would enhance his or her job performance" and "the degree to which a person believes that using a particular system would be free of effort", respectively.

### 3.0 RESEARCH METHODOLOGY

A survey method was used in this study. The questionnaire was subjected to two pre-tests. We pre-tested the questionnaire with eight professionals, and the pilot test was carried out on 35 tax practitioners. Systematic sampling method was used and the sample was limited to those tax practitioners who were public accountants authorised by or under written law to be an auditor or person in authority such as the tax partners, tax directors or tax managers who were working in the audit firms registered with Malaysian Institute of Accountants (MIA) as at 31 July 2002. The survey questionnaire was posted to



practitioners throughout Malaysia. 192 completed questionnaires were received; hence the response rate was about 33.6% (192/572).

A summated scale was used to compute the mean score for each technology readiness dimension. The combination of scores on the four dimensions represents a person's overall technology readiness, and a condensed version of the TRI scale is adapted with written permission. Additionally, multiple item questions were used to measure the usage intentions, attitude and perceptions of the e-filing system (see Appendix I). The composite scale was used to compute the mean score for each construct.

#### 4.0. DATA ANALYSIS<sup>1</sup>

##### The Respondents' Profile

The respondents represented a wide coverage across Malaysia. Of the 192 questionnaires that were analysed, the respondents comprised 154 proprietors/tax partners (80.2%), 10 tax directors (5.2%), and 28 tax managers (14.6%). The respondents comprised of Chinese (86.5%), Indian (6.2%), Malay (5.2%) and other races (2.1%). About 86% of the respondents were male and 14% were female. Approximately 22% of the respondents were aged below 35 and the remaining was above 35 years (78%). More than 91% of the respondents indicated that they were members of professional accounting bodies, and 48% were member of Malaysian Institute of Taxation.

##### Technology Readiness (TR) Dimensions

Table 1 presents the statistical analysis for each TR dimensions. The results showed that the respondents were highly positive or optimistic towards new technologies with a mean score of 4.29 on the 5-point scale (significant at  $p < 0.001$ ). However, they have a low level of innovativeness, with a mean score of 2.86 on the 5-point scale (significant at  $p < 0.05$ ). Table 1 also reported that the respondents experienced moderate degree of discomfort with new technologies (means=2.93). By and large, the respondents were wary of the security of the Internet technology with a mean value of 3.59 on the 5-point scale (significant at  $p < 0.001$ ).

Overall, the survey findings indicated that the respondents were highly optimistic about the benefits of the new technology, they believe new technology is mentally stimulating, give them control and freedom of mobility. Nonetheless, they were less receptive and experienced moderate level of discomfort with new technology, and were wary of the security of the Internet technology. Therefore suggesting that the tax authorities need to ensure that the new tax filing technology is very user-friendly and easy to use, as well as to provide courteous technical support, hands-on training as well as reassurance to overcome technology resistance.

**Table 1**

TR Dimension, Mean and One Sample t-test

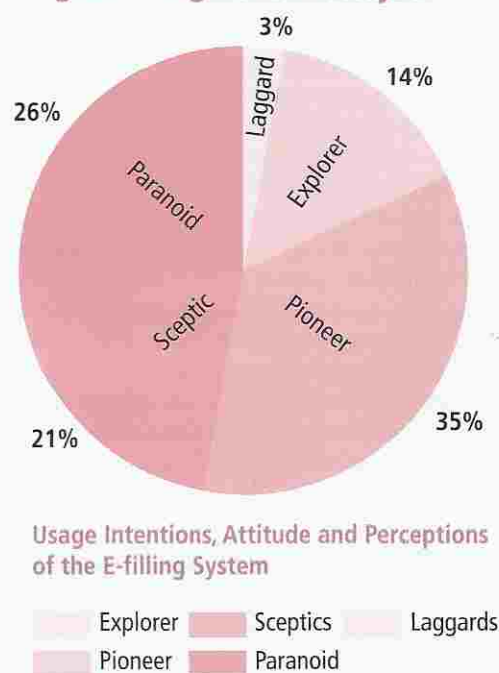
| TR Dimension   | Item mean | Std deviation | t-score (p-value)    |
|----------------|-----------|---------------|----------------------|
| Optimism       | 4.289     | 0.571         | 31.3 ( $p < 0.001$ ) |
| Innovativeness | 2.857     | 0.886         | 2.2 ( $p < 0.05$ )   |
| Discomfort     | 2.932     | 0.932         | 0.9 ( $p = 0.319$ )  |
| Insecurity     | 3.590     | 0.925         | 8.8 ( $p < 0.001$ )  |

All items were measured based on scale of 1 (strongly disagree) to 5 (strongly agree).

##### Segmental Analysis

As mentioned earlier, the combination of scores on the four dimensions represents a person's overall technology readiness. Based on the respondent's technology readiness score, the segmental analysis as presented in Figure 1 showed that 14.6% of the respondents were explorers, 35.9% were pioneers, 20.8% were sceptics, 25.5% were paranoids, and 3.1% were technology laggards.

**Figure 1 Segmental Analysis**



Usage Intentions, Attitude and Perceptions of the E-filing System

##### Usage Intentions, Attitude and Perceptions of the E-filing System

In turn, the respondents were asked to indicate their usage intentions, attitude and perceptions towards using the e-filing system. The reliability test, showed a Cronbach's (standardised) alpha range from 0.79 to 0.97, for usage intentions, attitude, perceived usefulness, perceived ease of use and perceived insecurity constructs, a level generally considered satisfactory for multi-item scales (Nunnally 1978). As presented in Table 2, the mean score observed for usage intentions variable was 5.65 on a 7-point scale ( $t = 21.41$ ,  $p < 0.001$ ).

<sup>1</sup> The data used in Lai et al. (2004) is again used here.



Table 2

## Scale Statistics

| Variable              | Mean* | Standard Deviation | Reliability (Cronbach alpha) | % Indicated slightly agree, agree and strongly agree |
|-----------------------|-------|--------------------|------------------------------|--|
| Usage Intentions      | 5.65  | 1.07               | 0.90                         | 82.8%  |
| Attitude              | 5.63  | 1.20               | 0.92                         | 79.7%  |
| Perceived Usefulness  | 5.19  | 1.07               | 0.89                         | 70.8%  |
| Perceived Ease of Use | 5.02  | 1.23               | 0.97                         | 62.0%  |
| Perceived Insecurity  | 4.56  | 1.35               | 0.79                         | 40.6%  |

\* All variables were measured based on scale of 1 (strongly disagree) to 7 (strongly agree), and were significant at 1% level

Furthermore, Table 2 shows that in total, a substantial majority (82.8%) of the respondents indicated that they intend to use the e-filing system, whilst, 79.7% of the respondents have positive attitudes towards using the e-filing system; 70.8% of them perceived that the e-filing system is useful in enhancing his/her job performance, about 62% of the respondents perceived that e-filing system is easy to use. Overall, 40.6% of the respondents were wary of the perceived insecurity of the e-filing system.

#### A Test of Relationship between Usage intentions, Attitudes and Perceptions of E-filing System Across Technology Readiness Segments

The chi-square test result as shown in Table 3 indicates that all the respondents who were classified as explorers (100%) were more inclined to use the e-filing system as compared to those who were classified as sceptics (95%), paranoids (73.5%) and laggards (33.3%), at 1% significant level ( $\chi^2=48.83$ ,  $p<0.001$ ). In turn, the results as presented in Table 4 also indicated that there were significant differences in attitudes towards using the e-filing system, perceived usefulness and perceived ease of use across the five technology readiness segments, at 1% significant level, based on the chi-square test.

Table 3

#### Segmental Analysis and A Test between Technology Readiness Segment and Usage Intention as well as Attitudes Towards the e-filing System

| Technology readiness segment                        | Segmental classification Quantity (Percentage %) | Intend to use the e-filing: Quantity (%) within segments) | Have positive attitude Quantity (%) within segments) |
|---|--|---|--|
| Explorer  | 28 (14.6%)                                       | 28 (100%)   | 27 (96.4%)   |
| Pioneer   | 69 (35.9%)                                       | 55 (79.7%)  | 58 (84.1%)   |
| Sceptic   | 40 (20.8%)                                       | 38 (95.0%)  | 31 (77.5%)   |
| paranoid  | 49 (25.5%)                                       | 36 (73.5%)  | 36 (73.5%)   |
| Laggard   | 6 (3.1%)   | 2 (33.3%)   | 1 (16.7%)  |
| Total=192   | 192 (100%)                                       | 159 (82.8%)   | 153 (79.7%)  |
| Chi-square, <i>p</i> -value, degree of freedom (df) |  | $\chi^2=48.83$ , $p<0.001$ , $df=8$                       | $\chi^2=50.69$ , $p<0.001$ , $df=8$                  |

Table 4

#### A Test of Relationship between Technology Readiness Segment and Perceptions of Electronic Filing System

| Technology readiness segment (Quantity)             | Perceived e-filing is useful Quantity (% within segments) | Perceived e-filing is easy to use Quantity (% within segments) | Perceived e-filing is insecure Quantity (% within segments) |
|---|---|--|---|
| Explorer (28)                                       | 25 (89.3%)  | 26 (92.9%)   | 6 (21.4%)   |
| Pioneer (69)  | 54 (78.3%)  | 43 (62.3%)   | 24 (34.8%)  |
| Sceptic (40)  | 27 (67.5%)  | 24 (60.0%)   | 11 (27.5%)  |
| Paranoid (49)                                       | 29 (59.2%)  | 24 (49%)   | 33 (67.3%)  |
| Laggard (6)   | 1 (16.7%)   | 2 (33.3%)  | 4 (66.7%)   |
| Total=192   | 136 (70.8%)   | 119 (62.0%)  | 78 (40.6%)  |
| Chi-square, <i>p</i> -value, degree of freedom (df) | $\chi^2=34.13$ , $p<0.001$ , $df=8$                       | $\chi^2=35.15$ , $p<0.001$ , $df=8$                            | $\chi^2=44.14$ , $p<0.001$ , $df=8$                         |

As a whole, the results showed that those who have a high level of technology readiness, namely, the explorers and pioneers are more likely to use the e-filing system than the rest of the groups. These findings are consistent with the contentions of Rogers (1995) that explorers and pioneers are thought leaders, and it also lends support to the findings of Parasuraman and Colby (2001).

## 5.0 DISCUSSION

In this study, the TRI scale serves as one of our tools for studying the real world phenomena. TRI is used to study the tax practitioners' technology readiness towards using the new tax filing technology in the foreseeable future pertaining to Malaysian tax compliance setting. Overall, the results indicated that Malaysian tax practitioners have positive beliefs or are optimistic about new technologies. Nevertheless, they are also wary of the security of Internet technology, as tax practitioners are concerned about the security of tax data sent online. It is worth noting that the UK tax professionals have the similar concerns (AccountingWeb, 2002; 2004).

The survey results provide an insight that the tax authorities need to ensure that the e-filing system is useful and easy to use in order to encourage the tax practitioners to file tax returns electronically. In addition, it is imperative for the tax authorities to address the fundamental risks associated with e-filing system before implementing the system nationwide, as perceived insecurity of the system would be the 'inhibitor'.

Collectively, the survey results provide important insight that paying explicit attention to intended tax users' technology readiness may assist the tax authorities in formulating their business and marketing strategy to accelerate the adoption of e-filing system. Hence, the tax authorities ought to devise strategies to capture the explorers and pioneers (or the early adopters) among the tax practitioners group and use them as a channel to advocate and promote the e-filing system. Different marketing strategies are needed to introduce e-filing technology





to the five different technology readiness segments. Parasuraman and Colby (2001) suggest that the key to introducing technology to the 'pioneer' is to offer technical support and reassurance to overcome technology resistance; and the key to introducing technology to the 'sceptics' is to prove to them that e-filing has tangible business benefits (such as cost and time saving).

With the implementation of self-assessment system, more taxpayers are expected to turn to the tax practitioners for tax assistance. Hence, in view of the vital role of tax practitioners in the tax compliance setting, early adopters should be identified, rewarded and their names published on the IRB's websites, in the mass media and in the professional magazines. Kahan (1999) asserted that the US revenue authority considers tax professionals to be value-added resellers who help to distribute e-filing products and services. In a similar vein, the Malaysian tax authorities should recognise, manage and motivate tax practitioners as e-filing service distributors and advocates to accelerate the diffusion of the e-filing system.

## 6.0 LIMITATION OF THE STUDY

Apart from the normal limitations associated with survey research, this study has some additional caveats. At the time of study, actual behaviour in using the e-filing system could not be measured directly; for both practical and theoretical reasons, usage intentions were used as proxies for actual usage. Related to this, the survey finding reports that the respondents had a strong usage intentions towards using the e-filing system; however, it is a self-reported measure. Consequently, the result may not be a precise measure and could be over reported. At best, self-report usage intentions should serve as relative indicators (Legris et al., 2003).

This paper provides only a snapshot of the evidence collected from one major segment of tax user groups, ie the tax practitioners. Hence, future research could be conducted on other intended tax user groups (such as tax employees and taxpayers) to gain further insights.

## 7.0 CONCLUSION

The survey findings provide an insight that measuring intended users' technology readiness is a key component of the e-filing system implementation process. It is also important for the tax authorities to study the customers (taxpayers and tax agents) and tax employees' technology beliefs, in order to find out their level of technology readiness, and to examine what factors that are driving or hindering the potential tax users' ability to embrace e-filing system voluntarily. Specifically, tax practitioners' technology readiness may be used as a good predictor of their ultimate acceptance of the e-filing system.

A clearer understanding of tax users technology readiness may help answer a variety of questions germane to the effective management of the e-filing system. For instance, what are tax users state of readiness to interact effectively with technology-based products and services? Do they have any distinguishing demographics and characteristics? Answers to these and related questions may provide useful insights pertaining to the types of systems that are likely to be most appropriate, the pace at which the systems should be implemented and the types of support needed to assist intended tax users in voluntary compliance. Essentially, there is a practical need for the e-filing system to be made acceptable to the tax practitioners, tax employees and taxpayers; systems that are not accepted by their intended users will not result in any sought-after benefits, as any new technology that is not used is of little value.





## ACKNOWLEDGEMENT

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## APPENDIX I: Extract of Questionnaire Items

### Usage Intentions (Source: Adapted from Davis, 1989)

Assuming I have access to the electronic filing system, I intend to use it.  
Assuming I have access to the electronic filing system, I predict I would use it.

### Attitude Towards the E-filing System (Source: Adapted from Chau and Hu, 2001)

Using the e-filing system is a wise idea.  
Using the e-filing system is beneficial.  
Using the e-filing system is an innovative approach.  
Using the e-filing system is a bad idea (reverse score).

### Perceived Usefulness of the E-Filing System (Source: Adapted from Davis, 1989)

Using the e-filing system will improve my job performance.  
Using the e-filing system will increase my job productivity.  
Using the e-filing system will enable me to do my job more quickly.  
Using the e-filing system will provide information that is useful to me.

### Perceived Ease of Use of the E-Filing System (Source: Adapted from Davis, 1989)

I believe the e-filing system will be easy to learn.  
I believe the e-filing system will be easy to operate.  
I believe the e-filing system will be easy to master.  
I believe the e-filing system will be easy to use.

### Perceived Insecurity of the E-Filing System (Source: Adapted from Parasuraman, 2000)

I do not consider it safe to do tax filing online.  
I do not consider it safe to do tax enquiry online.  
I do not consider it safe to give out bank account numbers over a computer.  
I do not consider it safe to do tax transactions electronically without confirmation by respective tax officers later.

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# **GOODS AND SERVICES TAX IN MALAYSIA**

**BY DR JEYAPALAN KASIPILLAI AND DR JONATHAN BALDRY**



## 1. INTRODUCTION

The Malaysian Government first announced, in 1989, its intention to introduce a VAT system. A commitment, to introduce a Goods and Services Tax (GST) system with effect from 1 January 2007, has now been made pursuant to the 2005 Malaysian Budget, which was presented in September 2004. The GST system will essentially replace the existing sales and services tax regime.

GST, popularly known as Value Added Tax (VAT), is the most common form of broad-based indirect tax used in the world today. Of 201 countries and semi-sovereign territories listed in the 2004 Deloitte Touche Tohmatsu summary of indirect taxes, 121 (ie 60%) have VAT in place as their main indirect tax instrument, while another 12 are reported as in the process of introducing or "considering" the introduction of VAT. Among the 30 member states of the Organisation for Economic Co-operation and Development (OECD), Japan and the United States of America (USA) are the only two that do not have VAT. Japan, instead, has a 5% consumption tax. China, one of the two non-OECD powerhouse economies, has implemented VAT, whilst India will be introducing VAT. Currently the states in India continue to use their existing sales tax.

These statistics make it clear that GST (or VAT) is the dominant indirect tax in use in the world's economies today, though Japan and the USA are major exceptions. Perhaps more important for Malaysia is the fact that GST has also become dominant among its close trading and regional partners in the Association of South East Asian Nations (ASEAN). Of the nine other members of ASEAN, five already have GST (or VAT) in place, ie Indonesia (10%), Philippines (10%), Singapore (5%), Thailand (7%) and Vietnam (5% and 10%).

This article examines the important aspects of replacing the current Malaysian sales and service tax with a broad-based GST, and will summarise the most important features and advantages of GST, followed by a discussion on the weaknesses of the current indirect tax regime, how GST can minimise evasion and avoidance, the case for replacing the current indirect tax regime with a broad-based GST, and finally, some concluding comments.

## 2. THE GOODS AND SERVICES TAX

### 2.1 Characteristics of the GST

The term "Goods and Services Tax" covers a set of broad-based ad valorem taxes that share three common features. Firstly, the tax is levied at every stage of the production process. Secondly, the amount collected at each stage is based on the value added at that stage. Thirdly, most varieties of GST also use a method of assessment known as the "input tax credit method"; whereby the tax assessed on a business is, the difference between what is effectively a turnover tax

assessed on sales (at the standard GST rate) and tax credits given in respect of GST already paid on its consumable inputs, such as raw materials, fuel and power, and semi-finished components.<sup>1</sup>

In principle, the overall base of a GST can be all or any part(s) of final expenditure in the economy. In practice, most GST used in the world today is of the consumption type, where the tax base is private domestic consumption. The term "GST" will be taken to mean "VAT of the consumption type" in the remainder of this article.

In its effect, a pure GST, with no exemptions and no zero-ratings except for exports, is no different from a tax on retail sales, ie it taxes all domestic private consumption expenditure. However, while the GST seems at first sight to be more complex than a retail sales tax as a way of taxing domestic consumption, and consequently more costly in terms of both compliance and administration, it has significant advantages over a retail sales tax in practice. This is because either form of consumption tax would necessarily require exemptions for small businesses (however defined) in order to avoid the cost-inefficiency of collecting small amounts of tax from a large number of businesses, as well as exemptions for particular sorts of commodities with special and unusual characteristics (these are considered in 2.2).

When any such exemptions are made, the GST is to be seen as both more cost efficient and economically viable than a retail sales tax. It also has some compliance advantages.

A GST taxes the value added by each business in the economy, except for the value added by businesses in the supply chain of exported goods and services. Consider a simple example of a non-exported commodity's supply and production chain. A farmer grows wheat using no inputs other than labour and land. He sells the wheat to a flour miller for \$100. The flour miller uses labour and equipment (but no other consumable inputs) to turn the wheat into flour, which is sold to a baker for \$150. The baker in turn uses labour and equipment to turn the flour into bread, which is sold to a retail bread shop for \$260. The bread shop finally sells the bread to consumers for \$300.

The value added at each stage is the value of sales less the cost of consumable inputs. Hence the farmer's value added is \$100, the miller's is \$50 (ie \$150 - \$100), the baker's is \$110 (ie \$260 - \$150) and the retailer's is \$40 (ie \$300 - \$260). Note that the sum of value added in this supply chain is RM300, equal to the market value of the bread bought from the retailer.

<sup>1</sup> According to Sanford (1989), the actual value added by each business is never computed, rather, the difference between the VAT on purchases and the VAT on sales is remitted to the revenue authority in each of the accounting period.



A GST at 10% will tax value added at each stage, generating total revenue of \$30 (ie  $\$10 + \$5 + \$11 + \$4$ ), which is the same as would be generated under a retail sales tax of 10% (on the retail price of \$300).

### 2.2 Input Tax Credits

The method invariably used for assessing and collecting GST is the input tax credit method. This method first assesses the gross GST liability of each business as the tax rate applied to sales, then it allows the business a credit against GST incorporated in the business's input costs. The net tax liability is computed simply by subtracting the total of input tax credits from the gross tax liability.

From one viewpoint, the input tax credit method can be viewed simply as a useful procedure for measuring value added and computing the tax due on it. An alternative method of measuring GST is to sum up the various factor payments, ie wages, rent, profits and depreciation, at each stage. However, it does have some specific advantages. Firstly, if any goods or services are to be zero-rated (effectively GST-free), the input tax credit method allows a very simple procedure for implementing zero-rating (see 2.4). Secondly, the method has some advantages in terms of compliance, because (i) the information given by the taxable businesses on their tax returns generates a paper trail that can be useful for tracing tax defaulters, and (ii) the availability of input tax credits generates incentives for businesses, both to register for GST and to provide truthful information on their returns.

Specifically, since the tax returns require the purchasing business in any transaction to properly account for input purchases in order to claim the relevant tax credits, these can be used to cross-check the sales details provided by the supplying business. Under the self-assessed tax regime, such cross-checking would only take place as part of the audit and investigation process. Moreover, there is no incentive for the purchasing business to understate their purchases, so the information provided by the purchaser that is available for cross-checking sales information (by the supplier) can be generally regarded as having a high degree of reliability.

### 2.3 Exemptions

Under GST, the term "exemption" applied to businesses means that businesses with certain characteristics, such as a turnover below a specified threshold level, are not required to register for GST (see 2.5). The businesses are therefore not required to charge GST on their sales, and they are not eligible to claim input tax credits on their purchases. Exemptions applied to particular commodities mean that GST is not charged on sales of such commodities,

consequently the input tax credits cannot be claimed on inputs used in the production of these commodities.<sup>2</sup>

The effect of exemptions is that exempt commodities bear less than the full rate of GST, the amount of GST being borne depending on the ratio of the value added in the selling business to total value added. For example, suppose a business is exempt and the GST rate is 10%. The business purchases inputs costing \$110 from registered suppliers, these costs include GST of \$10 (1/11 of \$110) paid on these inputs both by the supplier and further back in the supply chain. The business then makes GST-exempt sales of \$160. The value added by the business is \$50. If its sales were taxed, they would bear another \$5 of tax, making the market price equal to \$165, of which \$15 was GST. In fact, with the exemption, the market price is only \$160, of which \$10 is tax, giving an effective tax rate of only 6.7% ( $\$10/\$150$ ) because tax on the value added at the last point in the supply chain is not collected. The general rule is that the proportional reduction in the effective tax rate equals the share of the exempt business in total value added for the relevant commodity. This rule applies wherever the exempt business is located in the supply chain, and is also applicable to exempt commodities.

The arguments in favour of exemptions are largely pragmatic. The main argument for exempting particular businesses is that a comprehensive GST will include many small businesses that will be "insignificant" taxpayers.

As the costs of administration and enforcement of a tax will be positively related to the number of taxpayers (other things being equal), any reduction in numbers will generate large cost savings. Exemption of small businesses will also considerably decrease the total compliance costs of the tax. The disadvantage is that exemption of small businesses means sacrifice of revenue and also, by reducing the effective tax rate on the sales of these businesses, it will violate the efficiency criterion. Fortunately, neither impact will be significant. While the extent of revenue loss and tax rate distortion will depend on where the exemption limit is set, in general the effect will be modest because the only tax losses will be in respect of the value added by the exempt businesses, since they are small, the value added (hence the tax revenue lost) will be correspondingly modest.

Exemptions or special arrangements for goods and services can be justified where the characteristics or peculiarities of these commodities or of particular types of transactions pose special difficulties for the

<sup>2</sup> The terminology used in Australia for zero-rated sales is "GST-free supply", and for exempt sales "input-taxed supply". The zero-rated commodities bear no tax while the GST-supply bears less tax than the full rate of tax.



administration of GST. All systems allow for these cases. These similar difficulties apply in many cases, such as the sale of financial services (as compared with financial advice, which is easily taxable), gambling transactions, second-hand goods and sales of collectables through auctions.<sup>3</sup> Every GST system has to make special arrangements for these sorts of goods and services. These special arrangements may involve exemption from the tax or, in some cases, special valuation rules. As a result of these arrangements, the administration or compliance costs of the tax are effectively lower without having a major impact on economic efficiency.

## 2.4 Zero-rating

The effect of zero-rating applied to particular commodities is that these commodities become totally free of GST. Zero rating is applied by allowing a business to claim all input tax credits related to the supply of the commodity, while taxing sales at a nil rate. Effectively, the business has a zero gross GST liability on sales, making its net liability negative (ie it receives a refund) after subtracting credits from the gross liability. The result is that all GST on inputs is refunded, and so the commodity does not bear any of the tax.

Ignoring cost-effective considerations, the most efficient GST is one that applies to all goods and services (except for exports) with has no exemptions, either for particular commodities or for particular businesses, and is levied at a single rate.<sup>4</sup> This comprehensive GST scores highly in terms of Adam Smith's three canons of taxation, it is a simple tax with clear liability and economically efficient. A comprehensive GST of this sort maximises economic efficiency and maximises compliance costs (Freebairn, 1997 and Pope, 1999).

Simplicity leads to minimal administrative costs and minimal compliance costs for taxpaying businesses. The comprehensive GST is simple and certain, because it is based on a general rule, all businesses are required to register for GST, to collect and remit VAT on all inter-business and retail transactions, and a single tax rate applies to all sales and input tax credits except for exports. This means that no business needs to have any doubt about their liability to GST or about which tax rate applies to the transactions, noting that it is comparatively easy to define and

understand what an export is. Equally important, no business has any incentive to spend resources on arguing that the commodities it sells should be subject to a lower or zero rate of tax, neither does it have any incentive to spend resources on lobbying for its products to be put into the lower tax or zero-rated brackets.

A comprehensive GST is economically efficient because, by taxing all domestic consumption at a single rate and zero-rating exports, it does not distort relative domestic prices of consumer goods. If exports were not zero-rated, producers would obtain a lower net price for exports than for domestic sales, because the tax cannot be passed on in the export market as it can in the domestic market. This will distort production by reducing the supply of exportable commodities and diverting resources to the production of import substitutes.

With the exception of exports, there is no justifiable case for zero-rating any commodities and by extension, there is no justifiable case for multiple rates of GST. A reasonable response to these arguments is that while equity is a respectable aim of economic policy, abandoning many of the benefits of a comprehensive GST in order to protect the poor is unnecessary. Alternatives are available, such as changes in income tax rates or in social security provisions that compensate the poor for the impact of a GST. Certainly these possibilities are limited in Malaysia and other developing countries with a small population of income taxpayers and limited social security, but there are reasons for thinking that the equity implications are in practice, insignificant (see 5).

## 2.5 Threshold Level

The threshold issue is not to be taken lightly given that a low initial threshold in numerous countries that introduced GST has been cited as one of GST's main drawbacks. For example, Uganda's GST (known as VAT) faced problems when it was introduced in 1996 (at \$20,000, later raised to \$50,000) (Ebrill et al., 2002). An important observation is when there are no administrative or compliance costs, the most preferred registration threshold is zero. This however is not the case. An ideal guide is to fix the threshold at the level where the compliance costs saved are balanced with the revenue foregone. If one can establish by application of empirical tools that the value-added base is largely concentrated among few enterprises, then, a high threshold is of course the most pragmatic approach. A case in mind is the prevalence of several supermarkets, as well as hypermarkets, that make-up the bulk of the transactions of goods and services. Why then not concentrate on the large players and relieve the small timers who under normal circumstances struggle to compete due to low economies of scale?

3 From 1 January 2005, business-to-business supplies of financial services in New Zealand, previously exempt from GST, will be zero-rated for tax purposes and the new reverse charge will tax certain imports of services. Registered recipients of supplies of imported services such as legal, accountancy and managing services, as well as new software institutions will have to add GST to the price of imported services if the same services would have attracted GST if supplied in New Zealand (Scott, 2004).

4 Several countries have used multiple tax rates rather than the use of a single rate recommended by the International Monetary Fund. For example, Vietnam has two basic rates (10% and 5%).



One other point that needs to be mentioned if not emphasised due to its significance is the crucial advantage accruing to a business entity registered for GST purposes. Many businesses that are not required to register have to do so, because they sell to other registered businesses and many of these refuse to deal with non-GST suppliers due to the extra administrative burden involved.<sup>5</sup>

### 3. MALAYSIA'S INDIRECT TAX REGIME

In 2003, 46.4% of the total Federal tax revenue was from direct taxes, the remainder comprised of indirect taxes 23.6% and non-tax revenues 30% (see Table 1). Examples of non-tax revenues include royalties from the petroleum sector, collections from licenses, permits, road tax and registration fees.

Table 1: Federal Tax Revenue (2003)

|                      | Revenue (RM Million) | Percentage |
|----------------------|----------------------|------------|
| Direct Taxes         | 43,016               | 46.4       |
| Indirect Taxes       | 21,875               | 23.6       |
| Non Tax Revenue      | 27,913               | 30.0       |
| <b>Total Revenue</b> | <b>92,804</b>        | <b>100</b> |

Source: Bank Negara Malaysia- Annual Report 2003

<sup>5</sup> In Australia, registration for GST provides the business with an Australian Business Number (ABN), though businesses that are not required to register for GST may obtain an ABN if they wish ([www.ato.gov.au](http://www.ato.gov.au)).

### 3.1 The Indirect Tax Structure

Alongside export and import duties, stamp duties, and excise duties on tobacco, alcohol and a few other products, the most broadly based indirect taxes in Malaysia are the sales tax and the services tax (Kasipillai, 2004). Both are administered by the Royal Customs Department, which also administers customs duty and excise duty. A separate department, the Inland Revenue Board, administers income tax and certain other taxes such as real property gains tax, stamp duty and petroleum income tax.

Although, customs duty is the oldest form of indirect taxes but for the years 2001 and 2002, sales tax was the largest contributor of indirect taxes followed by excise duty (see Table 2). In 2003, sales tax generated approximately 12.3% of Federal indirect tax revenue and the service tax slightly over 3%. This compares with the total 7.8% generated by customs duty (Economic Report, 2003/04).

Available data reported in Table 2 suggests a decreasing trend in revenue collection from indirect taxes as a percentage of the Federal tax revenue and if this trend is not monitored, it could affect its share of contribution to Government revenue in future years. Since GST is a broad-based tax that covers the whole production-distribution chain, its implementation may assist jumpstart the development of an efficient tax administration.

Table 2: Indirect Taxes as a Percentage of Federal Tax Revenue (1990-2003)

| Year | Total Tax Revenue % | Total Indirect Taxes % | Customs Duty % | Excise Duty % | Sales Tax % | Service Tax % | Other Indirect Taxes % |
|------|---------------------|------------------------|----------------|---------------|-------------|---------------|------------------------|
| 1990 | 100                 | 51.04                  | 25.37          | 10.67         | 11.50       | 0.57          | 2.93                   |
| 1991 | 100                 | 48.70                  | 23.75          | 11.03         | 10.70       | 0.52          | 2.70                   |
| 1992 | 100                 | 46.47                  | 21.11          | 10.64         | 10.71       | 1.12          | 2.89                   |
| 1993 | 100                 | 46.49                  | 18.90          | 11.64         | 10.87       | 1.92          | 3.16                   |
| 1994 | 100                 | 46.22                  | 18.07          | 11.46         | 11.01       | 2.20          | 3.48                   |
| 1995 | 100                 | 45.53                  | 15.54          | 12.67         | 11.68       | 2.44          | 3.20                   |
| 1996 | 100                 | 45.32                  | 15.17          | 12.25         | 11.58       | 2.60          | 3.72                   |
| 1997 | 100                 | 43.25                  | 14.13          | 11.29         | 11.50       | 2.75          | 3.58                   |
| 1998 | 100                 | 33.79                  | 9.90           | 7.91          | 8.48        | 3.19          | 4.31                   |
| 1999 | 100                 | 39.91                  | 11.89          | 10.41         | 9.90        | 3.22          | 4.49                   |
| 2000 | 100                 | 38.18                  | 9.81           | 8.06          | 12.65       | 3.60          | 4.06                   |
| 2001 | 100                 | 31.53                  | 6.60           | 6.71          | 11.96       | 3.13          | 3.13                   |
| 2002 | 100                 | 33.67                  | 6.69           | 7.10          | 13.82       | 3.31          | 2.75                   |
| 2003 | 100                 | 33.71                  | 7.82           | 7.75          | 12.27       | 3.14          | 2.72                   |

Source: Economics Reports (various year)



### 3.2 Sales Tax

Sales tax was introduced in Malaysia under the *Sales Tax Act 1972*. It is an *ad valorem* tax applying to all goods manufactured in Malaysia (excluding a number of special designated areas) or imported by any person or company, unless the relevant entity is exempt from sales tax licensing or the commodity in question is exempt. There are currently four rates of sales tax, (i) 5% applying to fruits, certain food and building materials, (ii) 20% applying to liquor and alcoholic drinks, (iii) 25% applying to cigarettes and tobacco products, and (iv) 10% which is the default rate applying to all other products. In principle, the sales tax is a broad-based indirect tax. In practice, the wide range and sheer number of exemptions make it a very selective tax.

All manufacturers, other than those specially exempt, are required to be licensed for sales tax purposes. All manufacturers with annual sales of taxable goods less than RM100,000 are exempt from sales tax. Products listed in Schedule A of the *Sales Tax (Exemption) Order 1980* and those manufactured using any of the manufacturing processes listed in Schedule B of the *Sales Tax (Exemption from Licensing) Order 1997* are exempt products. In addition, all sales of exported products by licensed manufacturers are exempt. Finally, all manufacturers producing solely exempt products or using solely the manufacturing activities listed in these schedules are themselves exempt from licensing and their sales exempt from the tax.

The effect of the exemptions is that a wide range of products and manufacturers are untaxed. Products that are free from sales tax range from ready-mixed concrete to restaurant meals and bespoke clothing. An additional class of exemptions is allowed to limit the extent of "cascading" of the sales tax. As the tax is imposed on sales of taxable goods by licensed manufacturers at any stage in the supply chain, the tax is liable to cascading. Where a licensed business sells a taxable product to another, who uses this as an input into another manufacturing process that produces another taxable product, the sales tax paid by the first manufacturer is included in the input price of the second manufacturer, and sales tax chargeable at this second stage is partly charged on the tax component of the inputs.

Three methods are available for exempting such inter-business transactions from sales tax and so to limit the extent of cascading. The "ring system" allows one licensed manufacturer to purchase certain inputs from another free of sales tax. It is available by prior application, subject to a number of conditions and approval. The "refund system" allows the licensed manufacturer making a sale to another to claim a refund on sales tax paid in respect of the products sold.

Finally, the "credit system" allows a licensed manufacturer a credit for sales tax paid on its inputs, to be set-off against the tax liability it incurs on its own future sales.

It should be noted that these special arrangements would not be effective in preventing all cascading. Firstly, credits for inter-business sales are not automatically available to licensed manufacturers. Secondly, they are not available to unlicensed manufacturers, including those at early stages in the supply chain. This can mean that while one cascading link is avoided, cascading can nevertheless be carried through to later stages of the chain. In other words, unlicensed manufacturer B can purchase inputs inclusive of sales tax from a licensed manufacturer A and then make tax exempt sales to another licensed manufacturer C. Manufacturer C pays the sales tax incorporated in its inputs as a result of the tax paid by A, and then charges sales tax on its sales, with no refund or exemption available for the sales tax component of its inputs.

### 3.3 Service Tax

Service tax was introduced under the *Service Tax Act 1975*. Like the sales tax, it applies to all "taxable services" supplied by "taxable persons" in Malaysia, excluding the designated exempt areas. It is applied at a single rate of 5% on the turnover.

Unlike the sales tax, which in principle is a broad-based tax applicable to all "manufactured products" unless they or the manufacturers are exempt, the services tax applies only to a set of defined activities classified as "taxable services", and to businesses supplying these services that are not otherwise exempt. Liability to be licensed for services tax is based on a combination of business characteristics and the types of services it offers. It should be noted that the services tax, like the sales tax, is open to cascading, because many of the services listed in the schedule are supplied to businesses as well as to consumers. This cascading can also occur through interaction with the sales tax, for example, where a taxable service (such as parking) is sold to a licensed manufacturer who subsequently incorporates the services tax on inputs in the sales tax on what it sells. There are no provisions under the services tax for exempting such inter-business sales of services.

## 4. MINIMISING EVASION OR AVOIDANCE UNDER GST

A strong argument for the introduction of GST rather than another form of general consumption tax is the general belief that it would reduce evasion and avoidance. According to Minh Le (2003), GST (or VAT) is broadly



described as "self-enforcing". The description arises due to the very nature of the invoice-based credit GST, i.e. a taxable business can claim for the refund of the input GST only when a claim is evidenced by purchase invoices. This mechanism of course requires businesses to maintain invoices of their transactions and is an efficient means for tax officials to carry out audits, verify records and enforce compliance.

A major theme of tax policy discussion during the last two decades in countries such as Malaysia and Australia is the view that income tax was being evaded and avoided in large proportions.<sup>6 & 7</sup> The complying taxpayers, however, tend to be those who have no option, i.e. the middle-income employees, subject to Pay-As-You-Earn (PAYE) tax deductions. High-income employees have access to a variety of tax minimisation options that can lean towards tax avoidance, while the self-employed as well as small and medium businesses have numerous ways of converting income into tax-free expenses or simply evading taxes.

Consequently, policy makers advocate for a shift of the revenue base away from direct taxes and towards a general consumption tax of GST for two main reasons. Firstly, increasing the share of indirect taxes in total revenue will reduce the total amount of direct taxes that are available to be avoided or evaded, and so lower the actual amount of direct tax losses due to these activities. Secondly, it is believed that if the indirect tax selected as a replacement revenue tool were GST, there would not be a commensurate increase in indirect tax evasion or avoidance (i.e. an increase in indirect tax losses that would offset the reduction in direct tax losses). Overall, a reduction in direct tax rates offset by the introduction of GST (so that the total effect under full compliance will be revenue neutral) is expected to generate a net revenue gain, because there will be minimal evasion or avoidance of GST.

It is probably true that GST cannot be easily avoided. Tax avoidance is generally characterised as arranging one's financial affairs so that tax liabilities are minimised. GST does not allow for much discretion in this regard, i.e. an

enterprise's GST liability depends on the revenue it receives and the input costs it incurs. It is difficult to reclassify inputs and outputs in a purely financial way to reduce tax liabilities, hence difficult to avoid GST, though avoidance does become a possibility when there is zero-rating of some commodities (so the business may change the form in which a good or service is offered so that it becomes zero-rated). Other than this, the only ways of reducing VAT liabilities are to (i) under-state revenues, or (ii) overstate GST-liable input costs.

Additionally, where there are different rates or exempt products, it may be possible to falsely classify some or all outputs as exempt or inputs as GST-liable. Each of these activities will constitute GST evasion. However, the argument is that with GST, such evasion is very difficult because it requires collusion between businesses. In order to under-state revenues, the business selling a product must induce the purchaser to accept an invoice for less than the actual amount charged for a commodity. If the purchasers were consumers, they would presumably be willing to do so only if there was a financial payoff, and this required the seller to accept a lower price than they would otherwise receive. For example, if the seller offers a commodity for \$100 but wants to reduce the revenue reported to \$50 on this transaction, he must offer the buyer a discount to execute the deal, say receiving an actual price of \$90. This sort of transaction is possible but the requirement that the seller must bribe the purchaser by offering a discount for their collusion reduces the incentive to evade.

## 5. A GST FOR MALAYSIA

History shows quite clearly that the sort of far-reaching tax reform which will see GST introduced in the country does not develop as a result of overwhelming political pressure in a democracy. Rather, it develops primarily as a result of a Government's conviction that it is needed for the national good, though it invariably has the support of big businesses that see the clear economic benefits of having a broad-based indirect tax. The case





for choosing GST as the preferred method of taxing consumption is strong and indeed timely. Administrative feasibility is not an issue, as can be seen with Thailand, Vietnam, Indonesia and Singapore (*inter alia*) that already have VAT; there is no doubt that it is administratively feasible to introduce this tax in Malaysia, a country with a higher level of income and at a more advanced stage of development than many of these other countries.

### 5.1 Designing the Best Template for GST

Since a decision has been made to introduce GST in Malaysia, what form would it take? As mentioned earlier, the ideal GST is one with no exemptions and no zero-rating, except for exports. In practice, pragmatic considerations require exemptions at least for small businesses, and exemptions or special arrangements for sales that involve special considerations. This ideal sort of GST is not common, but the example of New Zealand shows that it is possible, and the New Zealand tax can provide a good template for Malaysia. A good example of the New Zealand experience with the GST can be found in Stephens (1993). When the tax was introduced in 1987, the elected New Zealand Government had a large majority in the parliament, and with no upper house to pacify, it made minimal compromises in the coverage of the tax. By contrast with GST introduced in most other countries, including Australia, and Thailand, New Zealand does not apply zero-rating to any products other than exports, and all exemptions are made on clear pragmatic grounds. This makes it a relatively simple and can be easily implemented. Like the New Zealand Government in 1988, the current Malaysian Government is strong and secure enough to preside over the introduction of a simple and effective GST that will be a massive improvement, rather than just a modest improvement, over the current regime (Kasipillai and Baldry, 2004).

### 5.2 Objections to GST

There is concern that the GST adversely affects the distribution of real income. In the past, the main objection to a broad-based GST in Malaysia was undoubtedly based on equity concerns: the tax will raise the relative prices of foodstuff, clothing, transport, fuel and power and other basic commodities, which have a disproportionate impact on the real income of the poor. A sophisticated econometric analysis is required to establish the extent of relative price changes with introduction of GST, and whether this will have a significant impact on real income of the poor. However, a number of considerations suggest that the impact may be quite moderate. Firstly, there is a sales tax (and to a lesser extent, services tax) component already hidden in the price of all commodities. Secondly, insofar as the poor are more likely to buy basic foodstuff from what will be a largely exempt sector of retailing (markets and small stores), while most of the supply chains for these foodstuff will also be exempt, and only a small GST component will be included in the retail prices.

Manufactured items purchased from small stores will normally contain a bigger GST component, but exemption of these small businesses will guarantee that the effective tax rate is lower than the nominal rate. Where other "necessities", such as public transport, medical care and fuel are concerned, there is already sufficient Government intervention in the relevant sectors to ensure appropriate and well-targeted protection of the poor. For example, increased subsidies to fuel cost will largely shield the poor from increased transport prices, while providing few benefits to higher income people. In the event that there is a predicted significant impact on the poor, alternative avenues for effecting compensation should be explored. What should not be done is to apply zero-rating to "necessities"; this compromises the effectiveness of GST and increases its cost, it can have an unintended equity impact and is a virtually unmoveable set of concessions once it is in place.





## 6. CONCLUDING REMARKS

The introduction of a GST in Malaysia is indeed timely. The current indirect tax system is cumbersome and inefficient, and does not provide the country with the tax revenue buoyancy that the growing economy needs. GST is the best choice for replacing the sales and services taxes. A broad-based GST on the New Zealand model with minimal exemptions and no zero rating other than for exports is an ideal option for Malaysia, and equity concerns can be largely taken care of by other policies.

Planning for a change as major as a new tax such as the GST takes time and the two-year preparatory period is indeed necessary; rates and exemptions need to be determined, transitional arrangements organised, education (both for administrators and taxpayers) arranged and carried out, and the requisite information and forms printed and posted on the Website. The planning process is crucial if Malaysia is to have a modern and effective indirect tax structure by 2007. The implementation of GST can enable substantial improvements in overall tax administration, more importantly, the establishment of an integrated tax administration and the development of modern procedures based on voluntary compliance.

Broadly speaking, a shift towards more indirect taxation in the economy will allow for a general reduction in income tax rates. The extent of the reduction will depend on the sensitive GST rate. To obtain a shift in the revenue mix will require a higher rate of GST or a reduction in the number of zero-rated commodities, neither of which are popular among the masses.

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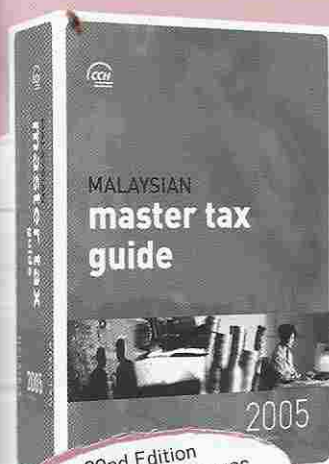
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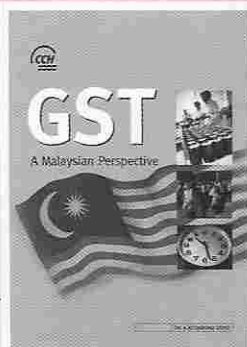
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# RECEIPTS – REVENUE OR CAPITAL?

BY SIVA NAIR

*Revenue or Capital*





In the last issue we grappled with whether a new business started by a person already conducting a business, would constitute a separate business or an extension of the existing business. Now we shall discuss whether a particular receipt or compensation received is capital or revenue.

Section 3 of the *Income Tax Act 1967* (ITA, as amended) (referred to hereafter as "the Act") that deals with the scope of charge. It reads:

*"Subject to and in accordance with this Act, a tax to be known as income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia."*

Only receipts which constitute income are subject to income tax in Malaysia. Capital receipts or gains are **NOT TAXABLE** (for income tax purposes). Therefore, it is advantageous for a taxpayer to structure his transaction as a capital item (if he can) so that it is not chargeable to tax.

The Act does not provide a definition of what constitutes income. Where the Act is silent or ambiguous, reference can be made to precedents established in tax cases either in Malaysia or other countries where the tax provisions are similar (if not synonymous).

### MIT TAX II DEC 2002 Q3(a)

The ITA does not explain the meaning of "income". Explain, by reference to relevant case law, what do you understand by the definition of "income".

The answer provided includes the following points:

- Income tax is a tax on income.
- However since the *Income Tax Act 1967* does not explain the meaning of income and there is no generally accepted definition of income, the Courts have formulated tests for the determining what is income.
- From the case of *CIT v Shaw Wallace* (61 TC 178), the following tests can be used as a guide to determine whether a receipt is considered to be income:
  - i) **Regularity of income** - this is an indication (though not conclusive) that a particular receipt is income in nature.
  - ii) **Definite source of income** - there is a source where the income is derived, eg salary from employment, rental income from the letting of property, etc.
  - iii) **Not a windfall** - gain from lottery winnings for instance is not considered to be income in nature.
  - iv) **Not capital gains** - income from the disposal of assets is not to be treated as capital gains and therefore not subject to income tax.

This case is discussed further below.

Lord Wright in *Kamakshya Narain Singh v CIT* [11 ITR 513] remarks:

*Income, it is true, is a word difficult and perhaps impossible*

*to define in any precise general formula. It is a word of the broadest connotation.*

In *Heather v P-E Consulting Group Ltd* [48 TC 239], Lord Denning in commenting on the difference between capital and revenue expenditure states:

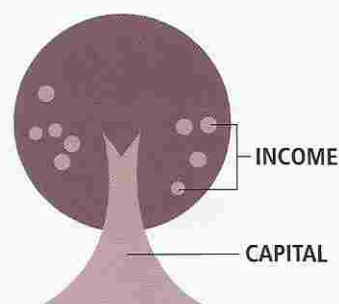
*Some cases lie on the border between the two and this border is not a line clearly marked out, it is a blurred and undefined area in which anyone can get lost. It is like the border between day and night, or between red and orange. Everyone can tell the difference, except in the marginal cases and then everyone is in doubt. When these marginal cases arise, then the practitioners, be they accountants or lawyers, must of necessity put them into one category or the other; and then, by custom or by law, by practice or by precedent, the border is staked out with more certainty.*

### CAUTION:

Students should note that statute law takes precedence over case law, i.e. where there is an expressed provision in the Act subjecting a receipt to tax, it will be taxable, notwithstanding the fact that case law has proven such receipt to be a capital.

For example, students will recall in the article on employment income, there were tax cases where the courts had confirmed that compensation for loss of employment or restrictive covenant payments received were capital in nature. However, since sec 13(1)(e) specifically includes these items as part of gross income from employment, they are held to be taxable in Malaysia.

In the article on "Basis and Scope of Charge" [Tax Nasional 2nd Quarter 2001], we discussed, amongst others, two of the approaches adopted by the courts in determining whether a receipt is capital or revenue. These are illustrated below.



### FRUIT & TREE ANALOGY

Sankey, J. in *Pool v Guardian Investment Trust Co Ltd* (1921) 8 TC 167 points out Justice Pitney's judgment in *Eisner v Macomber* (1919) 252 US 189, whereby it is held that the fundamental relation of capital to income has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream to be measured by its flow during a period of time. An example of the analogy is given below:



| TREE (CAPITAL) | FRUIT (REVENUE) |
|----------------|-----------------|
| SHARES         | DIVIDENDS       |
| FIXED DEPOSIT  | INTEREST        |
| PROPERTIES     | RENTAL          |

Useful though the analogy,  
However it must not be taken too literally!!!  
(Mason, S. W. & Blacke, S. (1990))

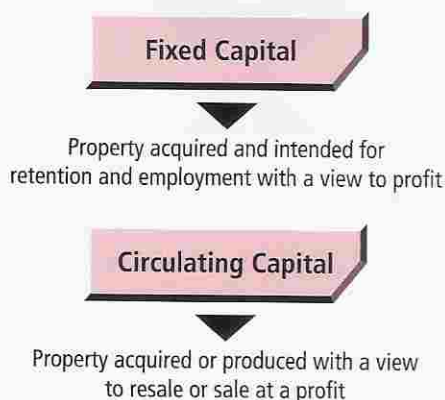
Someone actually bought the trees and the fruits and tried to use this analogy!

In *Saunders v Pilcher* [1949] 2 All ER 1097, the taxpayer bought a cherry orchard for £5,500. This included the year's fruit crop which was valued at £2,500 and which was subsequently disposed for £2,900. The taxpayer sought to deduct the £2,500 as an expense of an income nature on the basis that the cherry trees represent capital whereas the cherries on the trees represent income.

The Court of Appeal held, that the purchase of the cherry crop was merely part of the entire transaction of buying a capital asset - the land and the cherry trees. The whole expense of £5,500 could not be dissected into capital and income parts and therefore, the estimated cost of the crop could not be deducted from the receipt on its sale.

#### FIXED V CIRCULATING CAPITAL

Fixed capital is capital which is tied up in fixed assets, such as land and building, plant and machinery, furniture and fittings, motor vehicles, office equipment, etc; whereas circulating capital or floating capital is capital in assets which the business turns over to produce a profit, eg stocks. For example, in a balance sheet as shown below and similarly, Lord Justice Ronan in *J & R O'Kane and Co V CIR* [12 TC 336] defined:



A balance sheet of an organisation recognises this distinction by grouping fixed capital and circulating capital (or current assets) separately:

#### Balance Sheet as at 31st December 2005

| ASSETS                |               |
|-----------------------|---------------|
| Long Term Investments | FIXED CAPITAL |
| Fixed Assets          |               |
| Current Assets        | CIRCULATING   |

A particular asset cannot be classified as circulating capital (current asset) and fixed capital without identifying the purpose for which it was used. *Romer L.J* Observed in *Golden Horse Shoe (New) Ltd v Thurgood* [1934] 1 KB 548:

*Land may in certain circumstances be circulating capital. A chattel or chose in action may be fixed capital. The determining factor must be the nature of the trade in which the asset is employed. The land upon which a manufacturer carries on his business is part of his fixed capital. The land with which a dealer in real estate carries on his business is part of his circulating capital.*

#### EXAMPLE

IS THE GAIN ARISING FROM  
THE SALE OF A CAR CAPITAL  
OR REVENUE?



The answer depends on what the asset is used for or the activity of the seller.

IS ACCOUNTING EVIDENCE OR  
TREATMENT CONCLUSIVE IN  
DETERMINING WHETHER A  
RECEIPT IS CAPITAL OR  
REVENUE?



An article<sup>1</sup> in Tax Nasional 2nd Quarter / 2001 sheds some light on this issue:

*Odeon Associated Theatres v Jones* 48 TC 257

However, where there is evidence which is accepted by the courts as established sound accounting practice conflicting with no statute, the Court adopts the practice, applies it and decides the case accordingly.

### But the time has changed!!!

*Heather v P.E. consulting Group Ltd* 48 TC 293

The Courts have always been assisted greatly by the evidence of accountants. Their practice should be given due weight, but the Courts have never regarded themselves as being bound by it. It would be wrong to do so. The question of what is capital and what is revenue is a question of law for the Courts. They are not to be deflected from their true course by the evidence of accountants, however eminent.

### Sometimes the courts agree -

*I. Investment Ltd v Comptroller general of Inland Revenue*

The asset sold was reflected in the balance sheet as a current asset. The Special Commissioners held that the entry was deliberate and in conformity with the taxpayers intention to trade in land and properties.

*Harvey v Caulott* 33 TC 159

Where two properties that were sold had been removed from trading accounts and kept separate for the past twenty years, the Courts accepted such evidence as an indication that the properties were investments and not trading stock.

*Oliver v Fransworth* 37 TC 51

A partnership of builders retained some houses for more than 20 years and then sold them for a profit. A claim that the profits were from a realisation of an investment was rejected on the ground that they were part of the trading stocks.

### Even in Australia -

*FCT v James Flood Pty Ltd* [(1953) 88 CLR 492]

Commercial and accountancy practice may assist in ascertaining the true nature and incidence of the items.

### BUT NOT ENTIRELY!!

*CIR v Wesleyan & General Assurance Society* [30 TC 11]

The name given to a transaction does not necessarily decide the nature of the transaction, to call an item a capital payment would [not] prevent it from regarded as an income payment if that is its true nature.

### The tax authorities must be fair in using accounting principles -

*J and M Craig (Kilmarnock) Ltd v Cowperthwaite* [13TC669]

The Revenue cannot have it both ways; they cannot accept [accounts] when they find them to be to the advantage of the fiscal and discard them when they are to its disadvantage.

## CAN A PROPERTY DEALER ALSO HOLD PROPERTIES AS A LONG TERM INVESTMENT AND CLAIM THAT PROFITS ARISING FROM THEIR REALISATION ARE CAPITAL GAINS AND NOT TRADING PROFITS?

In *Simmons v IRC* [1980] 2 All ER 798:

A group of property investment companies had been formed with the object of acquiring and developing various properties. Subsequently, when the group went into liquidation, various properties were disposed for a profit. It was held that the sale of properties was not a trading sale but the realisation of capital.

Lord Wilberforce said:

*Was the asset acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? What was first an investment may be put into the trading stock and...vice versa. [but it] is not possible for an asset to be both trading stock and permanent investment at the same time, nor for it to possess an indeterminate status, neither trading stock nor permanent investment. It must be one or the other.*



1. RELEVANT ARTICLE  
Dr. Arjunan Subramanian, - "The Role of Accounting Evidence in Tax Disputes" - Tax Nasional 2nd Quarter / 2001



### MIT TAX IV DEC 1997 Q4(a)

"Adam Smith described fixed capital as what the owner turns to profit by keeping it in his own possession, circulating capital as what he makes a profit of by parting with it and letting it change masters"

*Per Viscount Haldane in John Smith and Son v Moore 12 TC 282.*

#### Required:

With further reference to case law, discuss the above statement in the light of the relevant decisions of the courts in Malaysia and other jurisdictions to distinguish between income and capital receipts.

Actually, in the case of *John Smith and Son v Moore 12 TC 282*, the issue was whether the amounts paid for some forward contracts which formed part of the purchase price for a business was capital or revenue.

#### Facts of the Case:

A coal exporter's business was taken over by his son from the trust estate of his father. Part of the purchase price of £30,000 was in respect of forward contracts for the purchase of coal at a low price. The taxpayer attempted to set-off this £30,000 against the proceeds from the sale of the coal.

In addition to the quotation in the question, the judge also said:

*It was not by selling these contracts of limited duration though they were, it was not by parting with them to other masters, but by retaining them that he was able to employ his circulating capital in buying under them. Although they may have been short in duration, they were none the less part of his fixed capital.*

Other cases suggested in the model answers include:

### Mamor Sdn Bhd V DGIR [1986] 1 MLJ 1

#### Facts of the Case:

A company in business of planting and cultivation of oil palm was allotted about 7,000 acres of virgin jungle land by the Government of Johore. Under the agreement with the government, the company was required to clear the land of the existing trees and develop it as an oil palm plantation. The company paid a capital sum for the land to the government, the sum included payment to the government for the licence to remove the timber. When the company sold the timber at a profit, it was assessed to tax on the basis that the profit was derived from trading.

#### Decision – Privy Council:

*The extraction of timber was inseparable from the process of developing the land as an oil palm plantation. The development was impossible without extracting the timber and that is why the taxpayer company was obliged to do so under its agreement with the Government of Johore.*

*Sale of timber was an obviously sound economic course to take with a view to mitigate the cost of development.*

[Naturally if I had an item that was of no use to me and I intended to dispose off, plus someone was willing to pay me for it, I would definitely agree, wouldn't I?]

#### The judge continued:

*The receipts in question are properly to be regarded as having a capital and not an income character. The timber was part of a capital asset that the taxpayer company acquired by payment of a capital sum. It expended further capital sums on the development of the land, and in mitigation of that expenditure, it realised and disposed off timber which formed part of its original capital asset.*

In *CIT v Shaw Wallace 6 ITC 178*, Sir George Lowndes defines income as:

Income connotes a periodical monetary return "coming in" with some sort of regularity or expected regularity from definite sources. The source is not necessarily one that is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall.

In the next article we will look at further concepts relating to the differentiation of capital and revenue receipts and discuss the related tax cases.

#### FURTHER READING

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Chin, Yoong Kheong; – Malaysian Taxation (latest edition) – Butterworths

Choong Kwai Fatt; Malaysian Taxation - Principles and Practice, Infoworld

Kasipillai, Jeyapalan; A Comprehensive Guide to Malaysian Taxation under Self Assessment, McGraw Hill

Malaysian Master Tax Guide, CCH Asia Pte Ltd

Singh, Veerinderjeet; Malaysian Taxation: Administrative and Technical Aspects, Longman

Subramanian, Arjunan; Malaysian Taxation System, Sweet & Maxwell

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Yeo, Miow Cheng Alan; Malaysian Taxation, PAAC Sdn Bhd

#### The Author

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# CUSTOMS REQUIREMENTS FOR PASSENGERS

BY THOMAS SELVA DESS

Whether you are a Malaysian citizen returning to Malaysia from an overseas trip or a foreigner arriving in Malaysia, you are required to declare all dutiable or prohibited goods in your possession to the proper officer of customs at the port, airport or point of entry. This is a standard requirement in practically all countries. The sight of customs officers at the entry point is often a common experience. More often than not the person entering Malaysia has in his or her possession dutiable goods that should be declared. The question is how does one know which good is dutiable and which is not. What are considered to be prohibited goods? Do I enjoy any exemptions? As a passenger arriving in Malaysia, you are required to know the answers to these questions. To begin with, let us study the various points of entry in Malaysia.

### The points of entry

Passengers arriving in Malaysia by air, sea, road or rail can do so only at prescribed ports, airports and points of entry. For those arriving by land from Thailand, they have to enter through Padang Besar, Bukit Kayu Hitam, Wang Kelian, Rantau Panjang and so on. For those arriving from Singapore by land can do so through the Johore causeway or Second Link. Passengers arriving by sea can do so at Port Klang, the jetty of Star Cruise Sdn Bhd, Prai, Tanjong Pelepas Port, Kuantan and so on. Arrival by air is through KLIA, Bayan Lepas, Langkawi, Kuching, Kota Kinabalu and Labuan. At all these points of entry, customs bays are manned 24 hours a day.

### Baggage of passengers

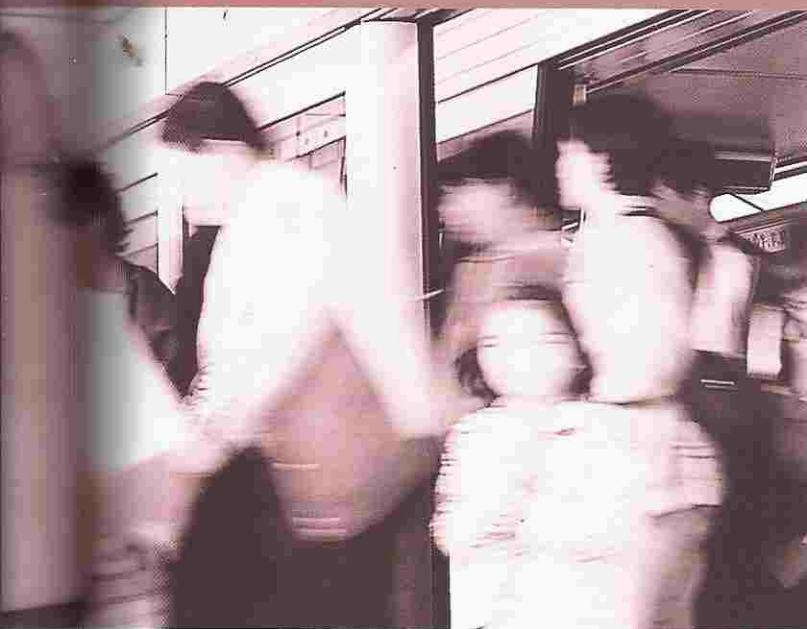
Section 103(1) of the *Customs Act 1967* states that 'every passenger or other person arriving in or leaving Malaysia shall declare all dutiable or prohibited goods in his possession either on his person or in any baggage or in any vehicle, to the proper officer of customs....' The person arriving in Malaysia has to have knowledge of all the dutiable and prohibited goods in his possession either on his person or in any baggage or in any vehicle. Dutiable in this context, can be taken to mean all goods subject to import duty, sales tax or excise duty. Passengers arriving by air have to fill in a customs declaration form, Customs No. 22, giving the true particulars and value of the goods imported. It is also the duty of the passenger to produce,

open, unpack and repack such baggage. More often than not, passengers are reluctant to unpack their luggage and customs officers have to nonchalantly remove their personal belongings from that baggage much to the amusement of the other passengers nearby. This is necessary for the customs officers to identify dutiable and prohibited goods. Failure to declare any dutiable or prohibited goods is an offence. For foreigners who are visiting Malaysia for a period of not less than 72 hours or Malaysian citizens returning to Malaysia after a period of 72 hours the following exemptions are given, subject to conditions:

- i) wine, spirit, beer or malt liquor not exceeding 1 litre in all;
- ii) tobacco not exceeding 225 grams (equivalent to 200 cigarettes);
- iii) wearing apparels not exceeding 3 pieces;
- iv) footwear not exceeding one pair;
- v) food preparations to a total value not exceeding RM75.00;
- vi) portable electrically or battery operated appliances for personal care and hygiene not exceeding 1 unit each;
- vii) all other goods (including souvenirs and gifts) other than i and ii above and tyres and tubes, to a total value not exceeding RM400.00;
- viii) in respect of goods from Labuan, Langkawi or Tioman all other goods (including souvenirs and gifts) other than i and ii above and tyres and tubes, to a total value not exceeding RM500.00.

If the importer imports in excess of the quantity or value of the goods exempted, he shall be liable to pay the duty on the excess only. The interpretation of items i to viii is left to the discretion of the customs officer. For example, portable electrically or battery operated appliances for personal care and hygiene not exceeding 1 unit each means that the importer can bring in as many appliances as possible for personal care and hygiene as long as he does not exceed 1 unit each. He can bring in one shaver, one toothbrush, one hair cutter, one mustache trimmer, one hair remover and so on as long as they are portable and electrically or battery operated. Often, the benefit of the doubt is given to the importer. When passengers arrive by sea or air, they normally rush to the customs bays in big crowds, each





one impatiently waiting to clear customs as fast as possible. This gives little time for the customs officers to conscientiously examine each baggage. They are at times, quite contented with verbal answers from the passengers. The same exemptions are given to anyone visiting Langkawi or Tioman for not less than 48 hours or Labuan for not less than 24 hours. Foreign travel writers and journalists are given exemption on equipment normally used by them. One is expected to verbally claim the exemptions from the customs officer on duty to enjoy these exemptions.

For those in possession of dutiable goods, a flat rate of 30 percent import duty on the value of the goods is levied. A receipt is issued once payment is made. Used portable articles, other than household effects, imported on the person or in baggage are exempted. Other articles and accessories such as golf bags, golf gloves, and articles used for horse riding or the maintenance of horses are also exempted. How do the customs officers know that the value of the items declared is correct? Most passengers do not carry receipts for the goods they have purchased overseas, often with the intention of under-declaring the value of the goods. Often, the customs officers will accept the value declared as long as it seems reasonable to them. Of course, if one brings in a Personal Digital Assistant and declares its value at RM100.00 or RM200.00, the officer will definitely not accept the value but use his knowledge and experience and assess the market value. If the importer does not agree with the value, the onus is on him to prove otherwise.

It must be borne in mind that all goods brought in by a passenger must usually be for his personal and private use or for the use of his family. In certain cases, people hand-carry small non-personal items such as machinery and accessories. As long as they are in small quantities, it will be allowed. Goods for commercial use usually need to be brought in through the cargo section where proper customs documentation needs to be filled in.

Those who are in possession of prohibited goods which require an import licence (such as hand phones, hairdryers, etc) have to produce one at the time they declare their goods, or else they will be subject to seizure by customs. Persons who bring in live animals as pets or any species of plants should be in possession of an import licence from the Department of Wildlife or the Department of Agriculture as the case may be. Often the animals or plants need to be quarantined for a period of time to ensure that no new diseases are brought into the country.

Anyone arriving in Malaysia usually by air is not aware of the presence of customs officers in plain clothes who are constantly observing the movement of people. Officers from the narcotics division are on constant surveillance, 24 hours a day looking out for syndicate runners trying to make a fast buck. One must not underestimate the vigilance of the customs officers especially of those who are experienced. One look at a person arriving at the bay and they will be able to tell whether that person is carrying dutiable or prohibited goods. Years of observing the arrival of passengers have taught them on how to interpret body language. Smugglers often mingle with the passengers. They can be members of a syndicate or mere petty smugglers. They have various methods of smuggling goods into the country. Experienced customs officers are often aware of these methods and are able to apprehend these culprits. Furthermore customs authorities around the world often share information on the *modus operandi* of smugglers and this information is frequently disseminated to customs officers at all entry points in Malaysia.

### The powers of search

Any person arriving in Malaysia shall, on demand by a proper officer of customs permit his person, goods and baggage to be searched by such officer. Any person who requests that his person be searched in the presence of a senior officer of customs shall only be searched in the presence of such officer. No female shall be searched except by another female with strict regard to decency. Exercising the powers of search is a touchy issue. The officer conducting the search whether on a male or female must do so in a professional manner and with strict regard to decency, without violating the rights of the individual. Most custom officers are trained in this area and are conscious of the rights of the person. Conducting a search requires a good reason. Usually the customs officer acts on suspicion and has good reasons to believe that the individual has breached the provisions of the Act before he conducts a search.

### Compounding of offences

Any person who is found to have in his baggage or upon his person, or otherwise in his possession, after having denied that he has any dutiable or prohibited goods shall be guilty of an offence. In most cases, he will be compounded. Section 131 of the Act gives any senior officer of customs, the power to compound, an offence which is prescribed to be a compoundable offence, by accepting from the person a sum of money not exceeding five thousand ringgit. Upon payment of the compound, no further proceedings shall be taken against such person. Rarely, a person is arrested for non-declaration of dutiable or prohibited goods.

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1

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- Effects of double tax agreements
- Collection and recovery mechanism
- Penalties for non-compliance

2

WORKSHOP

### Corporate Tax Planning

- 11 May 2005, Wednesday (9am-5pm)

- Objectives and principles of tax planning
- Types of group structure
- Corporate reorganisation, restructuring and mergers
- Year end tax planning
- Tax treaties shopping
- Tax planning for overseas investments
- Transfer Pricing
- Case study

3

WORKSHOP

### Taxation for shares in Real Property Companies

- 25 May 2005, Wednesday (1pm-5pm)

- The concept of Real Property Company
- Acquisition price of Real Property Company shares
- Date of acquisition of Real Property Company shares
- Practical issues on Real Property Company shares
- Tax planning for Real Property Company shares
- Case law developments

4

WORKSHOP

### Tax Planning for Merger and Acquisitions and Initial Public Offer (IPO)

- 31 May 2005, Tuesday (9am-5pm)

- Tax implications on transfer of assets
- Tax implications on transfer of shares
- Stamp duty exemptions
- RPGT exemptions
- Tax planning for merger and acquisitions
- Tax planning for IPO exercise

5

WORKSHOP

Tax is a vast fluid subject matter and it is imperative under the Self Assessment tax regime for tax staff to be competently aware of advanced tax fundamentals and principles. The Malaysian Institute of Taxation will be conducting the tax workshops in response to the need for creating qualified and competent tax personnel. The topic of each workshop has been carefully selected to meet the need for a better understanding of the subject matter. After attending the workshops, participants are expected to have a better understanding of the subject matter. The Malaysian Institute of Taxation would like to invite you to join us and learn more about each of the following topics.

## the speaker:

### Chow Chee Yen

**Chow Chee Yen** is a Fellow Member of the Chartered Association of Certified Accountants (FCCA), an Associate Member of the Malaysian Institute of Taxation (ATII) and a Chartered Accountant of the Malaysian Institute of Accountants (CA). He is also a graduate of the Malaysian Institute of Certified Public Accountants (MICPA) Examinations and successfully completed the Certified Financial Planner (CFP) conversion programme. He was an Associate Director with an international firm in Kuala Lumpur, specialising in corporate taxation. He has more than 14 years of tax experience and was involved in tax engagements concerning cross border transactions, tax due diligence review, restructuring schemes, corporate tax planning, group tax review and inbound investments. He is also involved in tax workshops and seminars organised by MIT on a regular basis. In addition, he has been lecturing extensively in various colleges and university in the Klang Valley for the past 10 years, specialising in taxation papers for professional examinations namely ACCA, MICPA, ICSA and MIT. He was also the Chief Examiner for a taxation paper of a professional examination body.

## Human Resource Development Council (HRDC)

Companies that contribute to the Human Resource Development Fund (HRDF) is entitled to obtain a training grant from HRDC under the SBL Scheme. Application is subject to HRDC's approval.



## Who Should Attend

- ✓ Tax Practitioners
- ✓ Tax Advisors
- ✓ Tax Agents
- ✓ Tax Accountants
- ✓ Tax Managers/ Executives
- ✓ Accountants
- ✓ Finance Managers
- ✓ Company Directors
- ✓ Business Owners
- ✓ Other Interested Parties

## IMPORTANT NOTES



### Contact Ms Latha / Cik Nur

Tel : 03-7729 8989  
Fax : 03-7729 1631  
E-mail : secretariat@mit.org.my



### Malaysian Institute of Taxation

41A, 1st Floor,  
Jalan Wan Kadir 2,  
Taman Tun Dr Ismail,  
60000 Kuala Lumpur.



All participants will be presented with a Certificate of Attendance upon successful completion of the workshop for use in registering CPD hours.



Please inform us in writing if you intend to cancel. No refunds are given for cancellation by delegates less than 7 days before the workshop. A 20% administration charge will be retained on other cancellations. Please substitute an alternative delegate if you wish to avoid cancellation penalties. Cancelled unpaid registrations will also be liable for full payment of the course fee.



Malaysian Institute of Taxation reserves the right to change the speaker, date and to cancel the workshops should unavoidable circumstances arise.



This registration form serves as our official invoice. No further invoice will be issued.



### Member Firm's Staff

Member Firm's Staff, is the staff of a MIT member within the same firm.



### BASIC TAX PRACTICE & PRINCIPLES

Date: 10 Feb, 12 Mar, 9 Apr, 12 Apr

### WORKSHOP: TAX INCENTIVES

Date: 2 Mar 2005

### MY CLIENTS IS BEING AUDITED

Date: 4 Apr 2005

### WORKSHOP: TRANSFER PRICING IN SALES TAX

Date: 30 Mar 2005

### CUSTOM VALUATION

Date: 14 Apr 2005

### CUSTOMS FACILITIES & EXEMPTIONS

Date: 9 May 2005

### Individual Workshop

#### One-day workshop

(inclusive of materials, lunch and 2 tea breaks for each workshop)

|                                       |          |
|---------------------------------------|----------|
| Member of MIT                         | RM280.00 |
| Member Firm's Staff / Supporting Body | RM330.00 |
| Non-Member                            | RM390.00 |

#### Half-day workshop

(inclusive of materials and 1 tea break for each workshop)

|                                       |          |
|---------------------------------------|----------|
| Member of MIT                         | RM195.00 |
| Member Firm's Staff / Supporting Body | RM250.00 |
| Non-Member                            | RM300.00 |

### Attend all 5 Workshops

|                                       |            |
|---------------------------------------|------------|
| Member of MIT                         | RM1,160.00 |
| Member Firm's Staff / Supporting Body | RM1,440.00 |
| Non-Member                            | RM1,730.00 |



## Registration Form

1. Full Name \_\_\_\_\_  
(As per IC)

Designation \_\_\_\_\_

Membership No. \_\_\_\_\_

2. Full Name \_\_\_\_\_  
(As per IC)

Designation \_\_\_\_\_

Membership No. \_\_\_\_\_

Contact Person \_\_\_\_\_

Designation \_\_\_\_\_

Organisation \_\_\_\_\_

Address \_\_\_\_\_

Tel \_\_\_\_\_ Fax \_\_\_\_\_

E-mail \_\_\_\_\_

I / we hereby enclose

☐ Cash ☐ Personal Cheque ☐ Company Cheque

No \_\_\_\_\_ for (RM) \_\_\_\_\_

Please tick the workshop(s) you wish to register

- ☐ **Workshop 1** (30 Mar 2005, Wednesday)
- ☐ **Workshop 2** (13 Apr 2005, Wednesday)
- ☐ **Workshop 3** (11 May 2005, Wednesday)
- ☐ **Workshop 4** (25 May 2005, Wednesday)
- ☐ **Workshop 5** (31 May 2005, Tuesday)

**Fee is made payable to MIT-CPD. Admission will only be permitted upon receipt of full payment. Registration can be made via fax.**

Half-day workshop

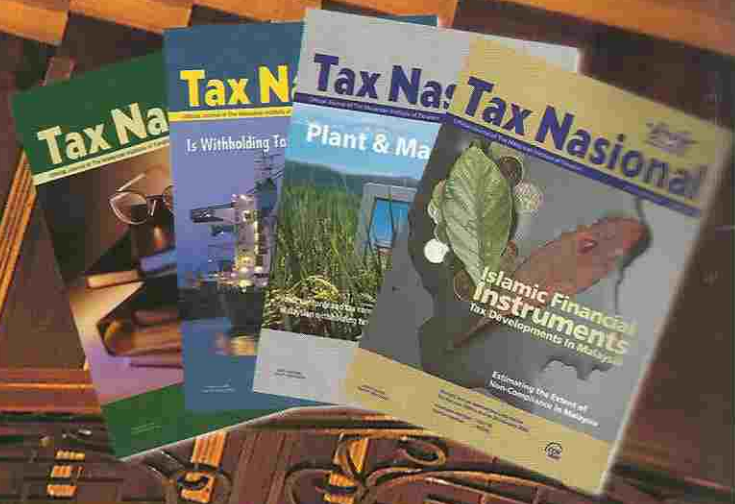


One-day workshop





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