Malaysian Institute Of Taxation

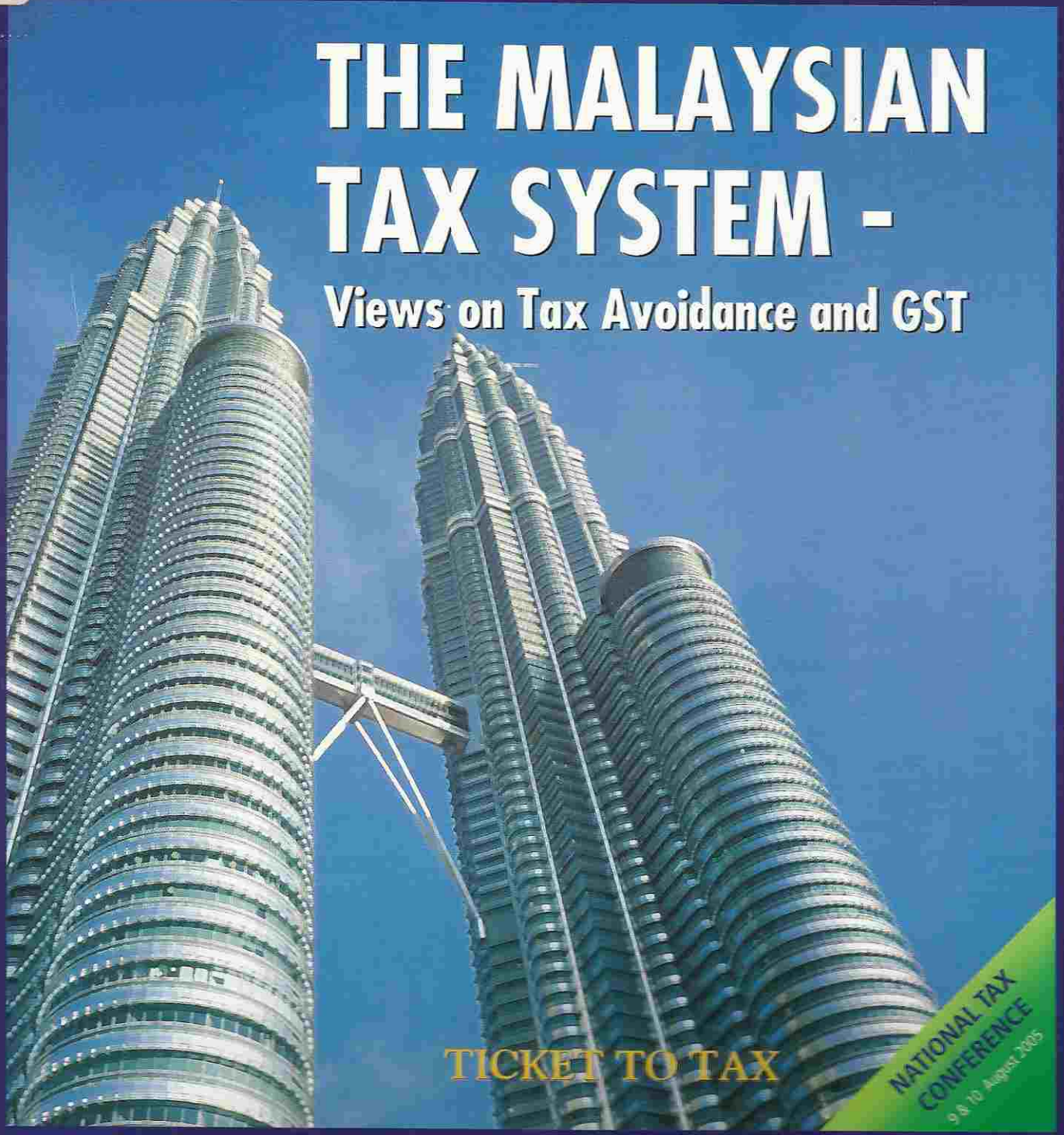
TAX NASIONAL

Official Journal of The Malaysian Institute of Taxation

Vol.14/2005/Q2 RM38.00

THE MALAYSIAN TAX SYSTEM -

Views on Tax Avoidance and GST



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CONFERENCE HIGHLIGHTS

Following the success of the four previous National Tax Conferences, Lembaga Hasil Dalam Negeri (LHDN) Malaysia and the Malaysian Institute of Taxation (MIT) are proud to host once again the National Tax Conference 2005 with the theme, "An Effective Tax Regime, A Joint Responsibility".

This two-day Conference provides a platform for delegates to interact with prominent local and international speakers to keep abreast with current developments in taxation.

GUEST OF HONOUR

The Honourable Prime Minister of Malaysia, Y.A.B Dato' Seri Abdullah bin Hj. Ahmad Badawi has been invited to officiate the Conference.

CONFERENCE TOPICS

- Tax Reform Forum
- LHDN - An Update
- Tax Enforcement Strategies
- Malaysian Self Assessment System - The Way Forward
- Tax Issues
- Goods & Services Tax
- Rulings & Guidelines
- Comparative Study of Malaysian & Regional Incentives
- International Tax Planning
  - Transfer Pricing
  - Registration of Tax Planning Products
  - Conspiracy to Defraud the Revenue
  - Use of Tax Treaties in International Tax Planning
- Outsourcing
- International Money Laundering

SPECIAL GUESTS / CHAIRMEN / SPEAKERS / PANELISTS

- Chief Executive Officer/Director General of Inland Revenue, LHDN
- President MIT
- Senior Government Officials
- International Speakers from OECD, Australian Taxation Office, Inland Revenue Department Hong Kong SAR, US Department of Homeland Security, Her Majesty's Revenue and Customs, U.K. and World Bank.
- Captain of Industries
- Senior Officials, LHDN
- Senior Tax Practitioners

FEES	EARLY BIRD FEE *Payment before 7 July 2005*	NORMAL FEE
LHDN Officer / Member of MIT	RM700.00	RM900.00
Member Firm's Staff / Member of Supporting Body / Member of Sponsor	RM800.00	RM1000.00
Non-Member / Others	RM900.00	RM1200.00
Premier Plus	10 participants registered from the same organisation will get 1 FREE seat	

WHO SHOULD ATTEND

• Tax Practitioners/Tax Agents • Accountants • CEOs / Directors / Managers / Executives / Company Secretaries • Bankers / Financial Planners • Advocates & Solicitors • Investors • Academicians • Government Officials • Other Interested Parties

For further information, please contact:

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How to become a member of the Malaysian Institute of Taxation

Malaysian Institute Of Taxation
http://www.mit.org.my

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.

6. Any person who is registered with MIA as a Chartered Accountant without Practising Certificate and has had not less than three (3) years practical experience in practice or employment relating to taxation matters approved by the Council.

7. Any person who is registered with MIA as a Licensed Accountant and who has had not less than five (5) years practical experience in practice relating to taxation matters approved by the Council after admission as a licensed accountant of the MIA under the Accountants Act, 1967.

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

Fellow Membership

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:

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

	Fellow
(a) Upgrading Fee	*RM300*
(b) Annual Subscription	*RM200*
	Associate
(a) Admission Fee	*RM200*
(b) Annual Subscription	*RM150*

Every member granted a change in status shall thereupon pay such additional fee for the year then current as may be prescribed.

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

The Institute successfully concluded its 13th Annual General Meeting (AGM) on 14 May 2005. This AGM saw new members being elected to the Council and the retirement of some of the longest serving Council Members.

Before I proceed, I would like to take this opportunity to thank my fellow council members for giving me the mandate to lead the Institute. It is indeed an honour for me to accept this responsibility and I wish to assure members of the Institute that your professional needs will be taken care of and the standards of the profession will be upheld and improved where necessary. With so many new developments in the tax fraternity, I foresee challenging and interesting times ahead during my presidency.

On behalf of the Institute and the Council I would like to extend our appreciation to En Ahmad Mustapha Ghazali, our immediate past President and Mr Chow Kee Kan, our immediate past Secretary for their commendable efforts for the past 14 years. Their dedication and perseverance contributed to the success of the Institute and it is the sincere wish of all that they would continue to guide us.

On another note, I am happy to announce that the recent AGM witnessed the admission of new members to the Council namely, Mr Lim Kah Fan, Mr Khoo Chin Guan, Mr Raymond Liew Lee Leong and Mr Adrian Yeo Eng Hui. It is my pleasure to welcome them to the Council and look forward to working with them towards achieving the Institute's objective. I am confident that the new Council is committed to act with integrity and in the best interest of the members.

Also I wish to record a note of appreciation to Mr Quah Poh Keat and Mr Lee Yat Kong, the retiring Council Members for their invaluable contributions to the Institute and the profession.

Taxation has taken a new face with the onset of self-assessment. Fostering a closer working relationship with the Inland Revenue Board and the Royal Customs Malaysia, ensuring the efficient use of our technical resources and the increasing importance of taxation in a global environment are some of the issues which require some thought and action. It is an important and interesting challenge for the Council, but I have every confidence that the outcome will be of great benefit to members of the profession.

On top of our list of things to do is to review the existing strategy/plan and to develop a more contemporary course of action for the next five years given the rapid changes in the tax fraternity.

Of paramount importance is the principle that we remain the leading professional institute for all those involved in the profession. All key aspects of the Institute's work will be examined, considered and debated in developing our strategy. It is imperative for the Council to develop this to enable the Institute to remain competitive and relevant. I look forward to the close support and guidance from my fellow Council members, who will be working with me to chart the future direction of the Institute and the profession.

I foresee that the coming second half of the year should be one of consolidation and growth for the Institute.

Tuan Haji Abdul Hamid bin Mohd Hassan
President

The Editor's Note

The Institute has recently concluded its annual general meeting which witnessed a wind of change in its leadership. We wish to welcome and congratulate the newly appointed council members and to thank past council members who had served the Institute tirelessly.

Understanding the anxiety and uncertainties faced by the public on the implementation of self-assessment for individuals, the Institute and The New Straits Times Press (M) Berhad embarked on nationwide workshops on how to complete the Form BE. For updates on other events conducted by the Institute, please read about these in the Institute News.

Other articles of interest in this issue include:

The Malaysian Tax System – Views on Tax Avoidance and GST
An article by Serjit Singh Mann that considers the relevant changes that may be adopted by the Inland Revenue Board in the area of self-assessment. This article also discusses and explains the fundamental principles and administration of the proposed Goods and Services Tax.

Malaysia's First Self-Assessment Year for Individual Taxpayers
Kenneth Yong presents his views and comments on the first Self-Assessment year for individual taxpayers in Malaysia.

Singapore's 2005 Budget: Creating a Dynamic and Entrepreneurial Economy and Attracting Foreign Talents
Lee Fook Hong comments on the Singapore's Budget 2005 in respect of the tax changes aimed at creating a dynamic and entrepreneurial economy.

Ticket to Tax
An article by Nakha Ratnam Somasundaram examining the issues on source of income and the derivation of income in view of the court's decision in the case of KPHDN v Aneka Jasaramai Ekspress Sdn Bhd .

and that's ...Entertainment
Vincent Josef discusses the deductibility of entertainment expenditure which goes back to the treatment prior to Y/A 1989 and also on the current tax treatment for entertainment with reference to Public Ruling No. 3/2004.

REITs: A Tax Perspective
The development of Real Estate Investment Trusts (REITs) in Malaysia prompts Eow Siew Lee to provide readers with a brief explanation on REITs, its structure and administrative procedures.

The Smuggling of Goods - Proving to be a Lucrative Trade?
In this article, Thomas Selva Doss provides an understanding on the reasons why smuggling has become a lucrative trade and the insights of smuggling activities.

Learning Curve
A continuation from the previous issue, Siva Nair continues his discussion on how to determine whether a receipt is revenue or capital in nature.

Harpal S. Dhillon
Editor of Tax Nasional

Malaysian Institute Of Taxation

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

Council Members

President	: Tuan Haji Abdul Hamid bin Mohd Hassan
Deputy President	: Mr SM Thanneermalai
Vice Presidents	: Mr Lim Heng How En Nujumudin bin Mydin
Honorary Secretary	: Mr Harpal Singh Dhillon

Council Members:

Dr Ahmad Faisal bin Zakaria	Mr Lim Kah Fan
Mr Aruljothi Kanagaretnam	Mr Neoh Chin Wah
Prof Dr Jeyapalan Kasipillai	Dr Veerinderjeet Singh
Mr Khoo Chin Guan	Mr Venkiteswaran Sank
Mr Andrew Kok Keng Siong	Mr Adrian Yeo Eng Hui
Mr Liew Lee Leong @ Raymond Liew	

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Tax Nasional

Official Journal of the Malaysian Institute of Taxation

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CCH Publishing Team

Editor in charge : Chow May Kuan

Contents

2nd Quarter 2005

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.

PERSONAL TAXATION SIMPLIFIED WORKSHOP

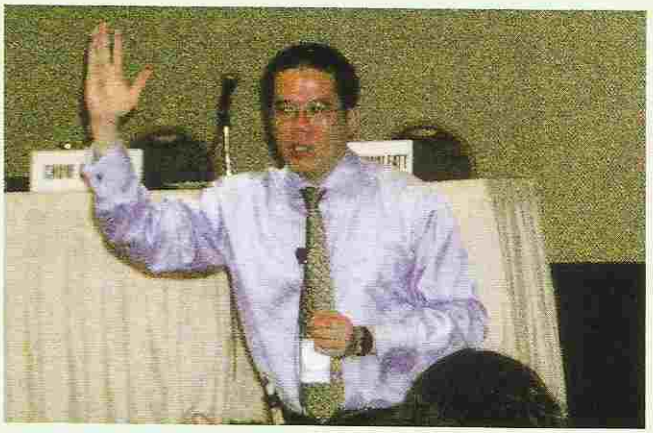
The STAR in cooperation with the Malaysian Institute of Taxation (MIT) organised the Personal Taxation Simplified Workshop on 6 April at the Eastin Hotel, Petaling Jaya.

The objective of the workshop is to enlighten taxpayers on Malaysian tax laws, the responsibilities and rights of a taxpayer. Presenters at the workshop were prominent speakers from the tax profession, Mr Chow Chee Yen and Dr Choong Kwai Fatt.

Mr Chow, a seasonal trainer in tax, covered topics in relation to self assessment and the tax system and administration. The second half of the workshop was utilised by Dr Choong to brief the participants in learning the methology for quick and simplified tax computation.

Participants found the workshop to be useful as it helped them to understand their duties and responsibilities under the new self assessment system and gave them direction on how to carry out these duties and responsibilities.

A total of 110 participants attended the workshop.



Dr Choong Kwai Fatt highlighting a point at the seminar

WORKSHOP ON COMPREHENSIVE TAX PLANNING FOR PROPERTY DEVELOPER & REITS

Dr Choong Kwai Fatt conducted a one-day workshop on Comprehensive Tax Planning for Property Developer and a half-day workshop on Real Estate Investment Trusts (REITs) on 29 and 30 April 2005, respectively.

Dr Choong's workshop on tax planning covered a range of issues which included planning in incorporating a company, income recognition and land transfer to tax structures for maximising profit under the self assessment system. While for REITs, Dr Choong touched on tax implication of setting up a REIT, tax planning and as well as tax administration procedures under self assessment.

Workshop on how to complete form BE

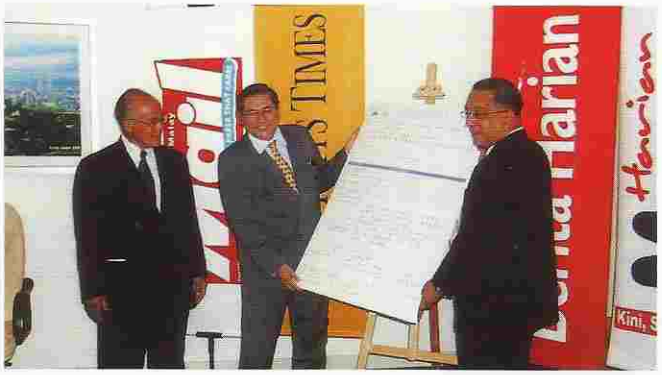
As part of fulfilling its corporate social responsibility, The New Straits Times Press (M) Berhad (NSTP) together with the Malaysian Institute of Taxation (MIT) embarked on a nationwide workshops to educate the taxpayers on how to complete the new income tax return form, Form BE in the month of March and April 2005.

The objective of the workshop is to assist taxpayers in completing their income tax return forms and to address the many enquiries and uncertainties that the taxpayers may have in completing the tax return forms.

These workshops were successfully held in major cities including Kuala Lumpur, Kuantan, Johor Bahru and Georgetown with the assistance from Lembaga Hasil Dalam Negeri officers who provided the training.

A simple ceremony was arranged for the launch of the workshop followed by a press conference on 25 March 2005. The Director General of Inland Revenue Board, Y Bhg Tan Sri Dato' Zainol Abidin Abd Rashid and Tuan Haji Abdul Hamid, representing MIT were present at the ceremony hosted by Y Bhg Dato' Kalimullah Hassan, Group Editor-in-Chief of NSTP.

From left: Mr Ravi Chandran from the LHDN and Mr. Harpal Singh, a Council Member of the MIT briefing participants at the workshop in KL



Y. Bhg Dato' Kalimullah Hassan presenting a mock up of the form BE to Y. Bhg Tan Sri Dato' Zainol Abidin Abd Rashid and witnessed by Tuan Haji Abdul Hamid

Tuan Syed Faisal Albar, Chief Executive Officer of NSTP presenting a souvenir to Y. Bhg. Tan Sri Dato' Zainol Abidin Abd Rashid

Rules and Regulations Governing a Tax Agent

The Malaysian Institute of Taxation (MIT) organised a seminar on "Are You A Licensed Tax Agent" on 24 March 2005. The seminar highlighted the need of a sec 153 licence for tax agents, tax consultants and tax advisors.

The seminar started off with Mr Lim Heng How briefing participants on the definition of Sec 153. The key speaker was Dr Mohd Shukor bin Hj Mahfar, the Director of Revenue Management Department from the Lembaga Hasil Dalam Negeri who presented papers on the "Procedures of Applying as a Tax Agent" and "Consequences of Being Bogus Tax Agents".

Dr Mohd Shukor also sat in as one of the panelists in the forum session of the "Future of the Tax Profession in Malaysia" along with Mr Nagarajan from the Ministry of International Trade and Industry.

Encik Sabin b. Samitah, the Director of Cawangan Syarikat, Lembaga Hasil Dalam Negeri spoke on topics covering the interview process which takes place after the submission of the application forms.

Mr Lim Heng How and Dr Mohd Shukor bin Hj Mahfar

Other speakers include Mr Lim Kah Fan and Mr SM Thanneermalai, who presented "The Law - Definition of Section 153" and "How to Conduct Yourself Professionally", respectively.

Workshop on "My Client is being Audited"

Mr Harvinder Singh, a Senior Manager from Ernst & Young Tax Consultants, conducted a workshop on tax audit on 4 April 2005.

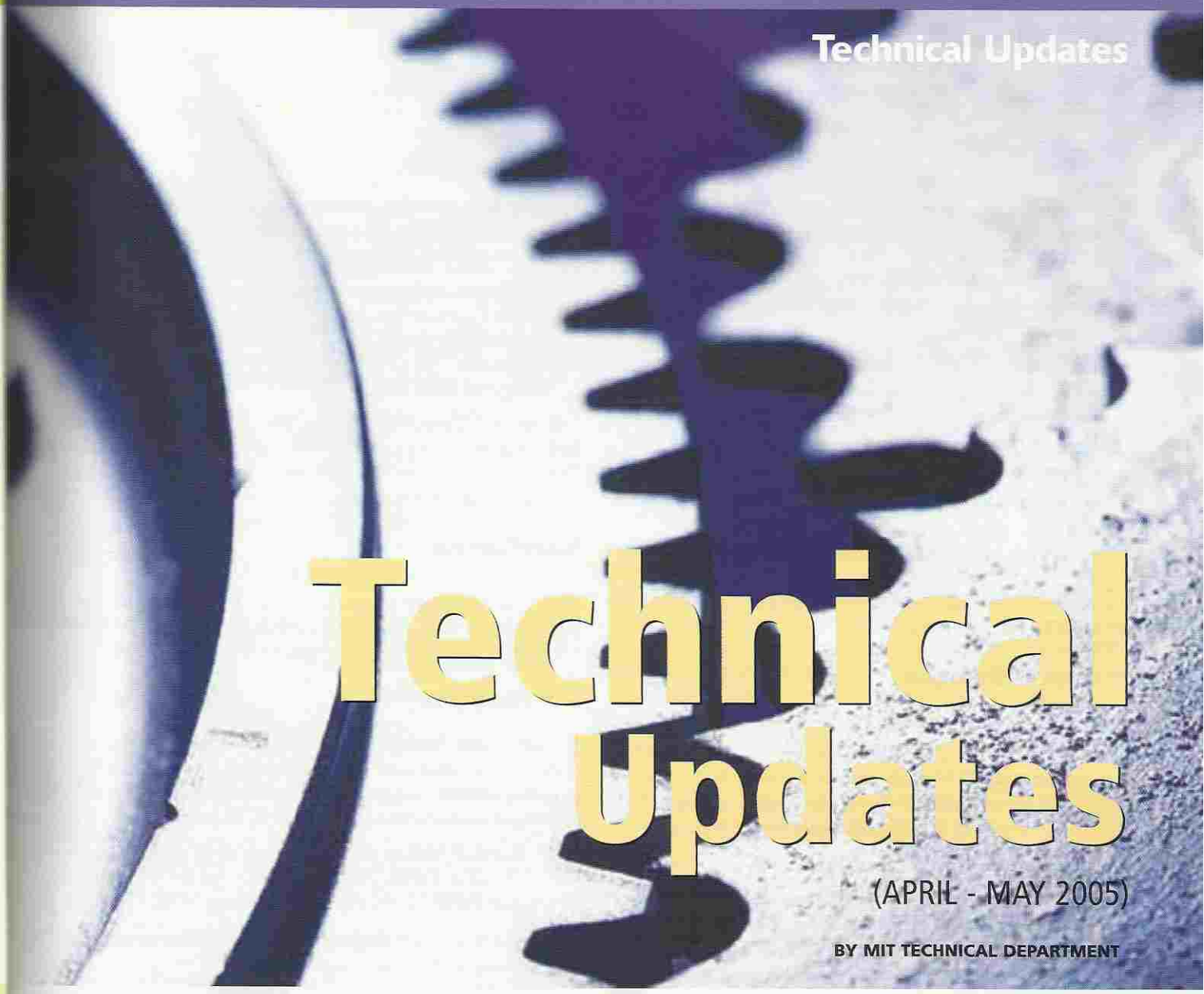
The workshop received overwhelming response from tax practitioners as well as in-house tax advisors of big organisations. Mr Harvinder, being a tax consultant himself, shared some of his personal experiences and tips on matters pertaining to tax audits.

Talk on Form B/BE in Mandarin

On 27 March 2005, a total of 360 participants attended the talk on form B/BE conducted in Mandarin language by Mr Chow Kee Kan, Mr Chua Tia Guan and Mr Edward Lim Khing Yam.

Mr Chow Kee Kan is the Honorary Secretary of MIT and Mr Chua and Mr Edward Lim are from Great Vision, a financial planning firm. With extensive experience in the tax field, these speakers were of great assistance to the participants in addressing the queries and issues pertaining to the newly introduced tax return forms.

This talk was co-organised by MIT and the Sin Chew Daily.



Technical Updates

(APRIL - MAY 2005)

BY MIT TECHNICAL DEPARTMENT

Public Ruling

Public Ruling 1/2005 entitled "*Computation of Total Income for Individual*" was released on 5 February 2005. In light of the implementation of the self-assessment system for individuals, this ruling sets out the manner of arriving at the total income for individuals. The Public Ruling is available in www.mit.org.my under the Technical Section - Guidelines/Rulings.

Legislation

Gazette Orders
The following Orders and Rules have been gazetted:-

- *Stamp Duty (Exemption) (No.6) Order 2005 [P.U.(A) 182]*
  - all instruments of agreement for merger or acquisition of higher educational institutions executed on or between 11 September 2004 until 31 December 2006 are exempted from stamp duty.

- *Real Property Gains Tax (Exemption) (No.2) Order 2005 [P.U.(A) 181]*
  - a private higher educational institution is exempted from the payment of real property gains tax on the disposal of any chargeable assets to another such institution pursuant to an approved scheme of merger or acquisition executed on or between 11 September 2004 until 31 December 2006.

- *Income Tax (Exemption) (No.17) Order 2005 [P.U.(A) 158]*
  - exemption from income tax for local resident company carrying on manufacturing or agriculture activities in respect of income derived from export sales.

- *Sales Tax (Exemption) (Amendment) Order 2005 [P.U. (A) 141]*
  - subheadings 4415.20 000, 7907.10 000, 8480.10 000, 8480.20 000, 8480.41 000, 8480.49 000, 8480.50 000, 8480.60 000, 8480.71 000 and 8480.79 000 under Schedule A and the particulars relating to the subheadings are deleted.

- *Income Tax (Accelerated Capital Allowance) (Renewable Energy) Rules 2005 [P.U.(A) 115]*
  - a corrigendum to substitute "two-fifth" with "four-fifth" in the earlier P.U.(A) 88.

- *Income Tax (Exemption) (No.14) Order 2005 [P.U.(A) 103]* (revokes Income Tax (Exemption) (No.12) Order 2000 [P.U.(A) 101/2000]
  - 65% exemption on statutory income received from the provision of qualifying professional services rendered in Labuan to offshore companies.
- *Income Tax (Exemption) (No.13) Order 2005 [P.U. (A) 102]*
  - effective from 1 October 2002, a non-resident company is exempted from payment of income tax on the following income received from an approved MSC status company:-
    (a) payment for technical advice or technical services;
    (b) licensing fees for introducing technological development; and
    (c) interest on loans for technological development.

  - Sections 109 and 109B of the *Income Tax Act, 1967* do not apply to income exempted under this Order.

Minutes of Dialogue

Inland Revenue Board
The Minutes of the Operations Dialogue held by the Inland Revenue Board (IRB) with the professional bodies on 16 February 2005 was released on 22 March 2005. A copy of the dialogue is available in www.mit.org.my under the Technical Section – Published Reports.

A Tax Audit & Investigation Dialogue was held by the IRB with the professional bodies on 10 May 2005.

Royal Malaysian Customs
The Minutes of Meeting of the Customs-Private Section Consultative Panel No. 1/2004 (unresolved issues) held by the Royal Malaysian Customs with the Private Sector on 18 February 2004 was released on 23 March 2005.

The Minutes of Meeting of the Customs-Private Section Consultative Panel No. 1/2005 held on 23 March 2005 was released on 3 May 2005. Copies of the above minutes are available in www.mit.org.my under the Technical Section – Published Reports.

Guidelines

Securities Commission
The Securities Commission (SC) has released the revised Guidelines for Annual Certification for Tax Incentives for the Venture Capital Industry (Guidelines), which would assist the venture capital industry in their application for annual certification from the SC in order to enjoy the tax incentives for the sector.

The revised Guidelines supersede the earlier Guidelines that were issued on 28 August 2001.

The Guidelines have been revised to reflect the following tax incentives, which are effective from the year of assessment 2003:

- tax exemption for venture capital companies (VCC) registered with the SC upon fulfilling the conditions under the Income Tax (Exemption)(No.11) Order 2005; and
- tax deduction for any company or individual that has provided venture capital funding, subject to certain criteria as certified by the SC, upon fulfilling the conditions under the Income Tax (Deduction for Investment in a Venture Company) Rules 2005.

The revised Guidelines set out the qualifying criteria and method of determination in order to qualify for the incentives. The revised Guidelines and application form are available at the SC's website at www.sc.com.my.

Miscellaneous

Bank Negara Malaysia
Effective 1 April 2005, the following foreign exchange administration rules and procedures are liberalised further.

A. Overseas investment

To give greater flexibility for overseas investment, changes are made to the thresholds for investment abroad, including extension of credit facilities to non-residents and placement of funds by residents from the current limit of RM10,000 to the following :-

i. Residents without domestic credit facilities are free to invest abroad in foreign currency, to be funded either from their own foreign currency or from conversion of ringgit funds.

ii. Corporations with domestic credit facilities are also free to use their foreign currency funds or convert ringgit up to RM10 million per annum for investment in foreign currency assets. These corporations must have a minimum shareholders' fund of RM100,000 and must be operating for at least 1 year.

iii. Individuals with domestic credit facilities may invest abroad any amount of their foreign currency funds or convert ringgit up to RM100,000 per annum for such purposes.

iv. The threshold for investing abroad funds attributed to residents by a unit trust company is increased to 30%, from the current 10%, of the Net Asset Value of all resident funds managed by the unit trust company. There continues to be no restriction on investment abroad for funds attributed to non-resident clients.

v. Fund managers may now invest abroad any amount of funds belonging to non-resident clients and resident clients that do not have any domestic credit facilities. They are also free to invest up to 30% of funds of resident clients with domestic credit facilities. Currently they may invest only 10% of resident funds, irrespective whether the resident clients have any domestic credit facilities.

B. Foreign Currency Account (FCA)

Rules on retention of foreign currency by residents are further liberalised :-

i. Residents are free to open FCA onshore or offshore (except for export FCA). No specific prior permission is required.

ii. There is no limit on the amount of foreign currency funds a resident is able to retain onshore or offshore.

iii. A resident without any domestic credit facilities is free to convert any amount of his ringgit funds for credit into his FCA maintained onshore or offshore.

iv. A resident corporation with domestic credit facilities is allowed to convert ringgit up to RM10 million in a calendar year for credit into its FCA.

v. A resident individual with domestic credit facilities is also allowed to convert ringgit for credit into FCA as follows-

For education or overseas employment purposes

- Up to USD150,000 for credit into onshore FCA or FCA maintained with offshore banks in Labuan; and
- Up to USD50,000 for credit into overseas FCA.

For other purposes

- Up to RM100,000 per annum.

vi. Exporters may now retain any amount of their foreign currency export proceeds onshore with licensed banks. The current limits of between USD30 million and USD100 million are abolished. All export proceeds continue to be required to be repatriated to Malaysia onshore.

C Foreign Currency Credit Facilities

To enhance access to foreign currency funding, limits for foreign currency credit facilities that can be obtained by residents from non-residents, licensed onshore banks and licensed merchant banks have been increased as follows :-

i. Resident corporation, on a per corporate group basis, may now obtain foreign currency credit facilities up to the aggregate of RM50 million equivalent. The foreign currency borrowing may be used to finance overseas investment up to RM10 million equivalent.

ii. The aggregate limit for foreign currency borrowing by individuals is also increased from RM5 million to RM10 million equivalent. The funds may be used for any purposes, including financing overseas investments.

D. Hedging

To facilitate better and more efficient risk management of currency exposure, rules on hedging are also liberalised further to allow residents as well as non-residents to enter into hedging arrangements with licensed onshore banks as follows :-

Residents
Any committed or anticipatory current account transactions.

i. Any committed capital account payments, including loan repayment due within 24 months, and committed receipts.

ii. Foreign currency exposures of approved overseas investment (equity hedge).

Non-residents
Any inflow or outflow of funds for firm committed transactions.

E. Domestic borrowing by Non-Resident Controlled Companies

The rules for domestic borrowing by Non-Resident Controlled Companies are fully liberalised by removing the current RM50 million limit and the 3:1 gearing ratio requirement.

Prior registration for statistical purposes

For purpose of compiling balance of payment statistics on the inflow and outflow of funds from the country, transactions involving investment abroad, hedging and foreign currency credit facilities would continue to be reported to Bank Negara Malaysia through a registration process. In summary, the following transactions under the liberalised rules are required to be registered-

- Remittance of funds exceeding RM50,000 equivalent from Malaysia for investment abroad;
- Procurement of foreign currency credit facilities exceeding RM1 million; and
- Proposal by resident to enter into forward foreign exchange contracts to hedge current account transactions on anticipatory basis and all transactions under financial account transactions exceeding the equivalent of USD10 million.

Bank Negara Malaysia has also launched the Exchange Control Approval and Monitoring System (ECAMS) for online submission of application on foreign exchange administration transactions. Information on the foreign exchange administration rules and the application/registration forms for online submission may be obtained on the Bank Negara Malaysia website at www.bnm.gov.my/fxadmin.

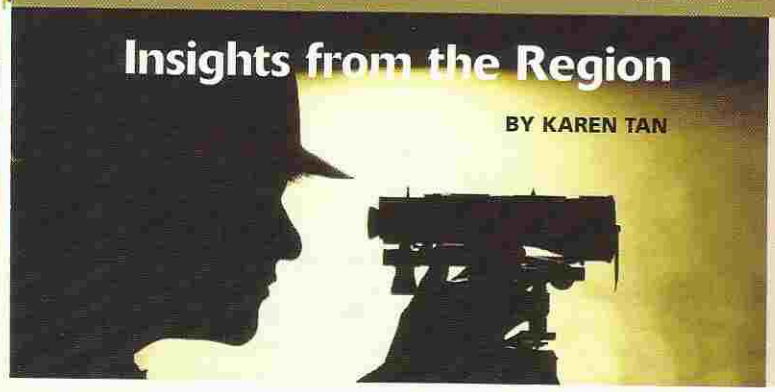
Liberalisation on fixed deposit rates

With immediate effect, fixed deposits placed by non-SME corporations and non-residents, regardless of the amount, will be on a full-negotiated basis and no longer subject to the floor rates prescribed by Bank Negara Malaysia.

Fixed deposits of up to RM1 million placed by individuals, SMEs and other depositors for tenures of 1 to 12 months will continue to be subject to the prescribed floor rates. The prescribed floor rates remain unchanged at 3% per annum for 1-month and 3.70% per annum for 12-month deposits.

Insights from the Region

BY KAREN TAN



This issue focuses on the two key budgets namely the **Singapore Budget 2005** on 18 February 2005 ("Singapore Budget") and the Australian Budget 2005 on 10 May 2005 ("**Australian Budget**") with a discussion on some of the interesting tax changes in both countries.

THE SINGAPORE BUDGET

The Singapore Budget was delivered on 18 February 2005 with the underlying theme of "Creating Opportunity, Building Community" in Singapore. It contains a comprehensive package of measures and includes specific measures to spur the growth of the services sector and encourage the development of small and medium enterprises.

The changes include, among others, the introduction of the loss carry-back system, incentives for the treatment of Real Estate Investment Trusts to encourage its growth, concessions for specific Islamic products and various refinements aimed at promoting an economy brimming with opportunities and fostering a stronger sense of community among Singaporeans.

Reduction in personal tax rates

To make Singapore's personal income tax regime more competitive and attractive to foreign talent, the top marginal tax rate for individuals will be reduced in two phases from 22 per cent to 21 per cent in Year of Assessment ("YA") 2006 and to 20 per cent in YA 2007 respectively. The marginal tax rates for other income bands will also be correspondingly reduced.

CPF contribution cap and tax relief cap for self-employed individuals

To encourage self-employed individuals to save for their retirements, the CPF tax relief cap allowable to a self-employed individual will be increased to align itself with the mandatory 17 months (instead of 12 months) of the CPF salary ceiling. The tax relief on voluntary CPF contributions by the self-employed will also be raised to be aligned with the tax relief cap for employees. Both changes will take effect from YA 2006.

Enhancing the Financial and Treasury Centre ("FTC") incentives

In reinforcing the Government's commitment to develop and strengthen Singapore's position as a premier financial centre, the FTC incentives were further refined and expanded. For instance, the removal of the Singapore dollar restriction would enable income derived by an approved FTC from approved qualifying services and activities denominated in Singapore dollars to qualify for the concessionary rate.

Tax incentive to facilitate growth of Start-up Fund Managers ("SFM")

To encourage the growth of SFMs in Singapore, a grace period of 12 months will be given to meet the requirement that 80 per cent of the share capital or value of their funds must come from foreign investors. This change took effect from 18 February 2005.

Incentives for Real Estate Investment Trusts ("REITS")

In order to strengthen Singapore's bid to be the preferred location for REIT listings in Asia, three key changes were introduced:

(i) Stamp duty on the instruments of transfer of Singapore's immovable properties into REITs to be listed, or already listed on the Singapore Exchange, will be waived for instruments executed from 18 February 2005 to 17 February 2010.

(ii) Reduction in withholding tax rate from 20 per cent to 10 per cent on distributions out of taxable income made to foreign non-individual investors during the period from 18 February 2005 to 17 February 2010.

(iii) Most of the stringent conditions imposed in obtaining a tax transparency ruling (e.g. the requirement of a letter of indemnity to the Comptroller of Income Tax and the investments made by the REITs must be solely in property and property-related assets) have been removed.

Introduction of Loss Carry-back System

In addition to the existing regime for carry-forward losses, a loss carry-back system will be introduced to provide relief for small businesses in managing their cash-flow problems, especially in a cyclical downturn.

A company will be allowed to carry-back its current year unutilised capital allowances and trade losses to the preceding YA (subject to a maximum of $100,000). The carry-back is granted on a due claim basis and will similarly be subject to the shareholder continuity test and the same business test. This newly introduced loss carry-back system will be available to all businesses, including sole proprietors and partners having partnership losses (except for investment holding companies under sec 10E of the Income Tax Act) and will take effect from YA 2006. Implementation details will be released by the Inland Revenue Authority of Singapore ("IRAS") shortly.

Removal of double stamp duties and extension of tax exemptions to payouts from Islamic Bonds

To make the Singapore tax system more conducive for transacting in Islamic financial products, the double imposition of stamp duty for Islamic transactions which involve real property will be removed. This tax treatment shall apply to instruments related to the transaction which are executed on or after 1 January 2005.

In addition, the concessionary tax treatment under the Qualifying Debt Securities Scheme ("QDS") is now extended to Islamic Debt Securities[1]. This will apply to the Islamic securities which are QDS issued from 1 January 2005 to 31 December 2008. The tax exemption on Singapore-sourced investment income has also been extended to the amount payable from Islamic Debt Securities, with effect from 1 January 2005.

Stamp duty changes

Stamp duties paid on aborted property transactions will also be refunded (subject to a $50 administrative charge) from 18 February 2005. Further enhancement to stamp duty relief under sec 15(1)(a) of the Stamp Duties Act was also introduced.

Relief for estate duty

A new relief in estate duty for successive deaths within a short span of time was introduced. Depending on the time period between the two deaths, the relief ranges from full 100 per cent relief to 25 per cent (if the two deaths are 24 months' apart) and

1 Islamic Debt Securities" mean debt securities where there is endorsement by a Sharia council, body or any committee formed to provide guidance on compliance with Sharia laws; and the amount payable from such securities are periodic and supported by a regular stream of receipts from underlying assets.

the assets passed on from the first death to the second death must remain in the same form (as they are on the first death) on the second death. This relief is effective for assets transferred on first deaths occurring on or after 1 January 2006.

Others
Further enhancements were also unveiled for the Approved International Shipping Enterprise ("AISE") Scheme, the Global Trader Programme ("GTP") and the Bonded Warehouse Scheme ("BWS") to expand the scope of the existing incentives. Additional concessions were granted to deepen and broaden capital markets in Singapore. Industry-specific incentives targeted at the tourism and retail sectors were also announced in this Budget.

Overall, many expectations were met by the Singapore Budget - the Budget has fine-tuned and tidied up many loose ends to enable Singapore to remain competitive amidst the global challenges ahead.

THE AUSTRALIAN BUDGET

The Australian Budget was delivered on 10 May 2005 by the Treasurer, The Hon. Peter Costello. With further reductions in personal income tax and significant reform measures introduced to the welfare system aimed at improving workforce participation, the Australian Budget continues to reflect the Government's commitment to achieve strong sustainable growth and keep Australia internationally competitive. Below are highlights from the Australian Budget:

Reduction in personal income tax rates
The personal income tax rates have been reduced further than the proposed reduction announced in last year's Budget. The top two income bands were increased over a 2-year period. The 42% threshold will be increased from AUD$58,000 to AUD$63,000 and the 47% threshold from AUD$70,000 to AUD$95,000 effective 1 July 2005. In addition, the 42% threshold will be increased to AUD$70,000 and the 47% threshold to AUD$125,000 from 1 July 2006.

From 1 July 2005, the lowest marginal tax rate is reduced from 17% to 15%. The personal tax cuts worth approximately AUD$20 billion over a four-year period is aimed at increasing incentives to work and save and also to assist the low-income earners.

Corporate tax – 'blackhole expenditure'
Previously, legitimate business expenditure incurred by businesses were not recognised by the tax system. As a result, such expenditure could not be included in the cost base of an asset for capital gains tax purposes (resulting in a potentially higher capital gain since the number of items which could be included in the cost base were limited).

However, with effect from 1 July 2005, the range of expenditures which form the cost base of an asset has been increased and some of the 'blackhole expenditures' will be recognised. This change is welcomed as this area has caused significant problems for a large number of business taxpayers for many years.

Venture capital
A review will be conducted to assess the impact of the Government's support for venture capital and to also ensure that Australia's regulatory regime is in line with the practices adopted by the other countries. This review will assess the impact of recent reform measures which include changes made to the venture capital limited partnership tax legislation last year.

Foreign source income – Four -year exemption for temporary residents
In an attempt to make Australia a more attractive destination to foreign executives, the Government had previously announced a four-year exemption for first-time temporary residents in respect of their foreign-sourced income and foreign capital gains. This proposed measure was, however, abandoned in 2003 as it was rejected by the Senate twice. However, this measure is now being re-introduced and a temporary resident will be able to enjoy the following for a 4-year period (effective from the Royal Assent of the relevant legislation):

(a) Exemption of foreign source income;
(b) No capital gain or loss arises on the disposal of foreign assets;
(c) No interest withholding tax obligation; and
(d) Extension of the exemption to foreign investment fund (FIF) rules.

International tax reforms – removal of foreign losses and foreign tax credit quarantining rules

The Government continues to introduce various tax reform measures of Australia's international tax regime and seek to enhance Australia's status as an attractive place for businesses. One key change is the removal of quarantine of foreign losses and foreign tax credits. Under the existing regime, a resident taxpayer cannot apply foreign losses against its domestic income but can elect to apply domestic prior year-tax losses against foreign income. Taxpayers cannot apply the excess of the foreign taxes paid in respect of a particular class of foreign income towards the Australian tax payable on the other income. Foreign tax losses and foreign tax credits are therefore quarantined to the extent that they are only able to be used against future assessable foreign income of the same class.

The removal of the foreign loss and foreign tax credit quarantining rules will be welcomed by Australian investors in that the overall tax payable will be reduced and additional relief will be provided from a compliance perspective.

Capital Gains Tax – Non-resident
In aligning its practices more closely with that of the OECD's, the range of assets in which a non-resident is subject to Australian capital gains tax is narrowed. In addition, the capital gains tax rules in Australia have been extended to non-portfolio interests in interposed entities where the value of such an interest is wholly or principally attributable to Australian real property.

It is apparent that the Australian Budget had focussed on ensuring strong and continued economic growth on both the domestic and international fronts. With strong growth prospects for the Australian economy, this Budget would have brought smiles to the faces of many.

The Author
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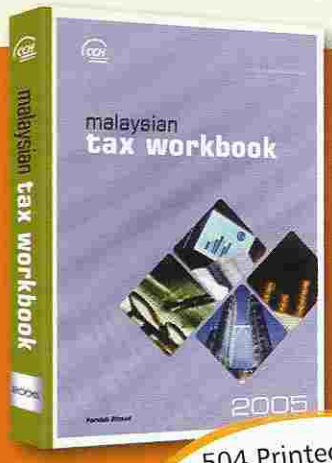

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The Author

Faridah Ahmad is a fellow member of t Association of Chartered Certified Accounta (FCCA, UK), a fellow member of the Malays Institute of Taxation (FTII) and a Charte Accountant of the Malaysian Institute Accountants (CA). She also holds a Diploma Accountancy (DIA) from the Universiti Tekno MARA (UiTM).

She is currently an Associate Professor at the Fac of Accountancy, UiTM, specialising in Malays Taxation. She has been teaching the diplo undergraduate and various professional course ACCA, MICPA and ICSA.

Besides teaching, Faridah is also involved in giv consultancy work in areas of taxation and cash f management to the small and medium enterpr (SME). She is currently a member of ACCA Mala SME committee. She has been conducting semi and workshops organised jointly by ACCA Malay SMEDEC, JELITA and FELDA.

Faridah is the author of other books: "A Percukaian Satu", "Asas Percukaian Dua", "A Perakaunan Perniagaan", "Asas Perakaun Kewangan", "Prinsip Perakaunan", "Percukaian Un Perseorangan", "Cukai Pendapatan & And "Rancangan Kewangan Perniagaan Kec Sederhana", "Strategi Pengurusan Kewan Perniagaan Kecil & Sederhana", "Cukai Pendapata Perniagaan" and Fundamentals of Malays Taxation.

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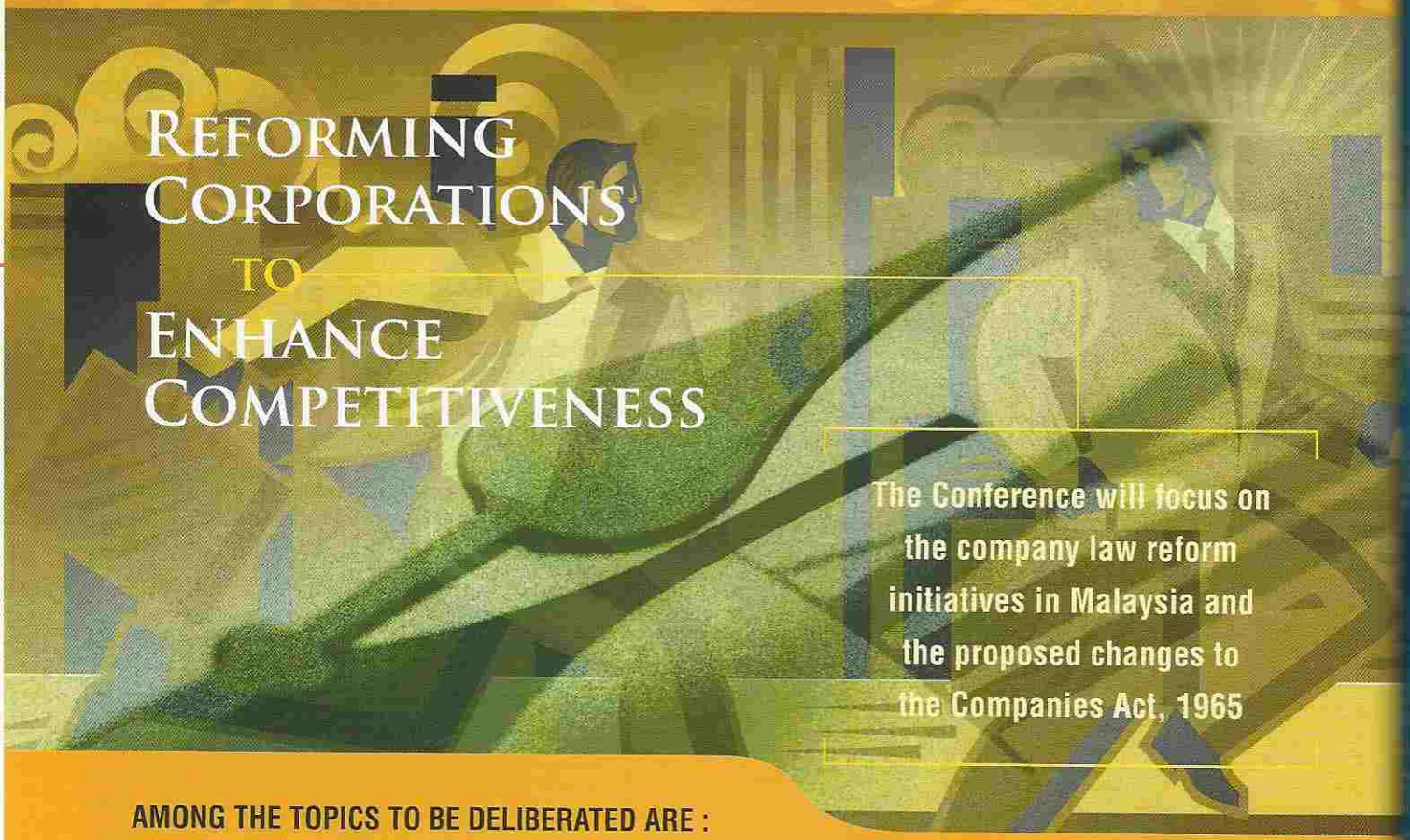

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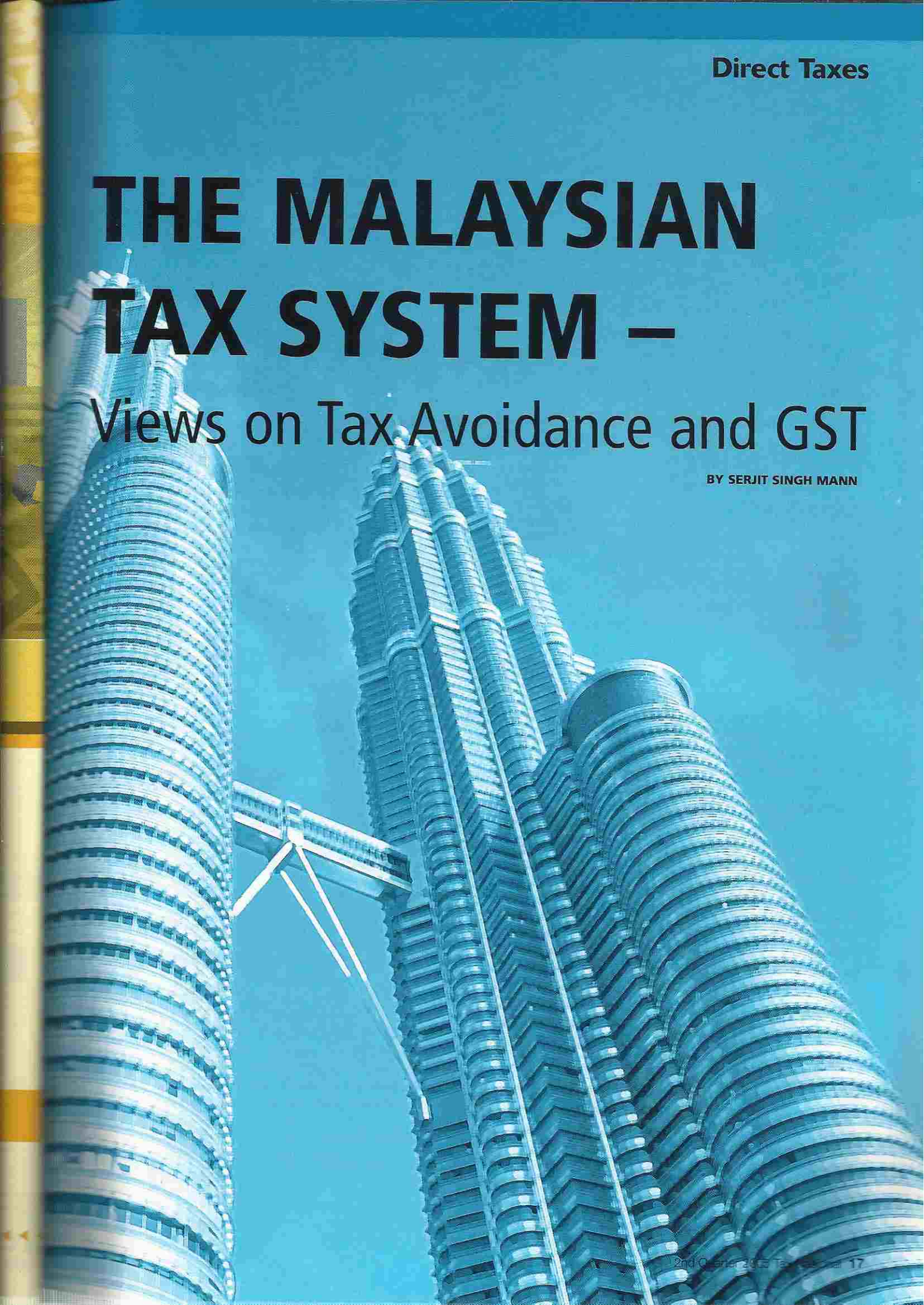
THE MALAYSIAN TAX SYSTEM – Views on Tax Avoidance and GST

BY SERJIT SINGH MANN



Background

This article has been written with the intention of sharing some light on the administration of the Malaysian Tax System, in view of the Malaysian Government's current review of the tax system, which is targeted for re-engineering in the near future.

The purpose of this article is therefore to consider relevant changes that could be considered by the Tax Review Panel particularly in the area of the Self Assessment System (SAS), where tighter anti-avoidance provisions will be needed to protect the Malaysian tax base. This article will also briefly touch on the fundamental principles and administration of the proposed Goods and Services Tax in 2007, which will replace the current Sales and Service Taxes respectively.

Introduction

The Malaysian tax system underwent major reformation in the year 2000 with the change in assessment mode, from Prior Year Basis of assessment to Current Year Basis of assessment. The year 2001 then brought about the introduction of the SAS for companies and in 2004 the SAS had been extended to all other taxpayers other than a company.

Under the SAS, the responsibility for correctly assessing a taxpayer's tax liability is transferred from the IRB to the taxpayer. In this instance, the policing by the IRB are conducted by way of tax audits, to ensure voluntary compliance and to protect the revenue base. As such, tax audits have become an essential component in the SAS.

Role and Purpose of Tax Audits

The objective of tax audits is to examine the tax returns of all business taxpayers in depth in a pre-determined cycle and to lower emphasis on annual checking of tax returns.

The fundamental purpose of a tax audit is to produce its own queries, which are then resolved by way of communication (usually by way of correspondence or sometimes even by interview) between a taxpayer or its agent and the IRB.

There are no set selection criteria for audits; however some of the general criteria revolve around risk analysis, manual checking of return forms, specific industry or location intelligence as well as third party information.

With the introduction of the SAS, the need for an audit is crucial to ensure a more effective check on cases of tax avoidance and the much-dreaded tax evasion. As an indicator, estimates of the size of the hidden economy for Malaysia range from a high of 8.7% of Gross National Product in 1980 to a low of 3.7% in 1993, with tax evasion accounting for an average of just over 20% of actual income tax collections over the period[1]. If tax evasion figures are an indicator of tax dodge activity in Malaysia, one would dread what tax avoidance figures could tantamount to.

Tax Avoidance – The Malaysian Context

A current subject of much discussion amongst the tax administrators of the world is tax avoidance. Malaysia is no exception to this phenomenon, as it operates in an environment where tax avoidance is somewhat, ubiquitous. Tax practitioners and academics have attributed this activity largely to the loose anti-avoidance laws in the Malaysian *Income Tax Act, 1967* (the Act).

Section 140 of the Act

Section 140 of the Act is Malaysia's general anti-avoidance provision, which is a 'catch-all' provision. The Section in a nutshell gives the Commissioner the right to reconstruct any arrangement that alters and changes the incidence of tax. In a tax jurisdiction, where tax avoidance, especially by self-employed individuals and smaller business's are as suggested, ubiquitous, one would think that a more in-depth and specific anti-avoidance law should be in place.

The Concept of Tax Avoidance

The basic principle and offshoot of tax avoidance started in *IRC v Duke of Westminster (1936) AC 1 (HL)*, which in summary is the proposition that taxpayers are entitled to order their affairs so the tax attaching is less than it otherwise would be. The often-quoted passage from Lord Tomlin in that case (pgs 19-20) is:

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

That statement has spurred the enactment of anti-avoidance provisions and legislation in the jurisdictions of the United Kingdom, Australia, Canada and New Zealand, to name a few. It is rife that Malaysia too should enact more defined, stringent and precise laws to combat tax avoidance. When considered, these anti-avoidance provisions (for the Malaysian context) should cover the following notations[2].

1 Kasipillai, J et. al, "Estimating the Size and Determinations of Hidden Income and Tax Evasion in Malaysia" *Asian Review of Accounting*, Vol. 8, No.2 (2000).

2 These notations are the fundamental basis of tax avoidance principles and must be present in order to establish tax avoidance. These notations have been adapted from leading research of case law and guidelines on tax avoidance from the United Kingdom, Australia and New Zealand.

Arrangements[3]

An arrangement by definition provides for varying degrees of enforceability from contractual situations, to agreements, plans and to understandings. In other words, an arrangement is defined to encompass all kinds of concerted action by which persons may organise their affairs for a particular purpose or to produce a particular effect.

In order to prove tax avoidance, there must first be an arrangement.

Consensus and Meeting of minds

An arrangement involves a meeting of minds between parties involving an expectation as to future conduct. The conscious involvement of the parties must exist for there to be an arrangement. In order for tax avoidance to be present, besides the need for an arrangement, there must be a meeting of minds or a consensus that the arrangement was entered into with the intention of tax avoidance. In some instances, consensus could even be deemed to exist, where a significant feature of the arrangement is the obtaining, and sometimes the sharing of tax benefits.

The limbs of tax avoidance

Based on case law from various jurisdictions, the limbs for a test of tax avoidance (once an arrangement, consensus and meeting of minds are proven) include, 'altering incidence of any income tax', 'relieving any person from paying income tax' and 'avoiding, postponing and reducing any liability to income tax'.

The combined effect of the above limbs is a mitigating factor for tax avoidance.

Purpose or effect of a transaction

The fundamental principle of 'purpose or effect' is the concept of determining whether tax avoidance is a *purpose* or *effect* of the arrangement. In simple terms, if a taxpayer enters into a transaction without considering the tax benefits, would he still enter the arrangement? What was the *purpose* or *effect* intended of the transaction? To determine whether tax avoidance is the 'purpose or effect' of an arrangement, the concept of *predication*[4] is used.

Leading tax avoidance cases (such as the *Newton* case) have held that the 'purpose or effect' requirement should be determined objectively. The motive of the parties is irrelevant. Lord Denning in *Newton* said (pg 763): -

> *The word 'purpose' means, not motive, but the effect which it is sought to achieve – the end in view. The word 'effect' means the end accomplished or achieved. The whole set of words denotes concerted action to an end – the end of avoiding tax.*

It is important to consider the ultimate purpose of the transaction, when discussing tax avoidance.

3 Adapted from their Lordships judgements in landmark cases on tax avoidance, *Bell v FCT (1953) CLR 548 (HCA)* and *Newton v FCT (1958) 2 ALL ER 759 (PC)*.

4 The 'predication' approach was articulated by Lord Denning in the Privy Council in the *Newton* (citation provided in footnote 5) case. To predicate means to find or base something on.

More than merely incidental

If there is more than one *purpose* of a transaction, the tax avoidance purpose must be 'more than merely incidental[5]'. This suggests that a 'merely incidental' tax avoidance purpose or effect is something which naturally follows from or is necessarily linked to some other purpose or effect, so that, objectively, it can be regarded as a natural concomitant.

Summary on Tax Avoidance – The Malaysian context

There is much ambiguity and uncertainty in the litigation of tax avoidance cases around the globe. The distinction lies in where to draw the line between tax planning, tax mitigation and tax avoidance, the former two being acceptable in most tax jurisdictions.

The basic steps and fundamental concepts in determining the existence of tax avoidance have been briefly highlighted as above. The Malaysian authorities would need to consider each and every of these steps in great length and detail before attempting to generate its own policies on tax avoidance, as there is a lot of good law and precedence set in tax avoidance as far as case law is concerned. These laws have equal support for the tax authorities as well as taxpayers.

Introduction of Goods and Services Tax in 2007[6]

Background

Goods and Services Tax (GST) is a value-added tax charged on the sale of goods and services made in a home country[7]. GST is an indirect tax charged on expenditure rather than a direct tax charged on income. GST is not a tax on business profits or turnover. GST is a consumption tax and is ultimately paid by the consumer or end user. GST is paid along each step of the chain of ownership, until the goods or services reach the end user.

Taxable Activity

There must be a taxable activity before GST can be imposed. A very crucial component of GST is determining whether an activity is a taxable activity or not. A taxable activity will dictate whether a person must or may register for GST. Determining whether a transaction is subject to GST will depend on whether a taxable activity exists.

A general definition[8] of activity for GST purposes has been termed to be: -

> *'an activity is one that is carried on continuously or regularly by any person whether or not for a pecuniary profit, involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration'*

5 The word incidental as defined in Collins English Dictionary (2004 edition) means occurring in connection with or resulting from something more important.

6 As Malaysia is in the midst of preparing for GST, the only legislative and practical concepts on GST can be adapted from jurisdictions operating in GST. For this purpose, the GST regime in Australia and New Zealand are used for illustration purposes.

7 For the purposes of this article, Malaysia is termed home country.

8 Adapted from the New Zealand Goods and Services Tax Legislation.

If an activity is not continuous or regular, where there is no consideration and where there is no supply of goods or services, then for GST purposes, there should be no taxable activity.

Place of Supply

For GST purposes, the total value of supplies must be made in the home country. In order for this to take effect, residence rules must be considered alongside for charging of GST. For this purpose, the general tax residency rules for individuals and corporate taxpayers should be referred. Basically a supply is made in the home country (regardless of residency implications for GST purposes) if the goods are in the home country at the time of supply and/or the services are physically performed in the home country by a person who is in the home country at the time the services were performed.

Input and Output tax

The GST that registered persons charge is called an output tax and the GST they incur is called input tax. Each registered person is liable to file GST returns showing the net difference between what they collect in GST (output tax) and what they incur in GST (input tax). The difference for a given period will result in either GST to pay the Collector or refund from the Collector.

Supplies and Timing of Supply

It is important to define supply and it's timing, as there could be many items that can be specifically deemed to be a supply. Some examples of controversial supplies could be, goods or services held at time of cessation of business, sale of tokens or vouchers and indemnity payments.

It is also important to distinguish for GST purposes the timing of supply, for example, does a supply occur on the date a payment is received or the date the invoice is issued.

Payment is *usually* considered to have been received for GST purposes when paid by: -

Cash – on the date the money is physically received;
Cheque – on the date the cheque is received, irrespective when it is banked; and
Credit card – on the date the credit card transaction takes place.

It is important to remember that any payment triggers the timing of supply. Therefore when a registered person receives a deposit, the time of supply has occurred.

Invoicing

A tax invoice is usually issued when GST is charged. A tax invoice shows GST charged on a supply that has been made, proves to the purchaser and the Collector that GST has been charged on the supply and must contain certain prescribed information. Only a registered person in the course of their taxable activity may issue a tax invoice.

The invoicing requirement for GST purposes will also ensure proper record keeping for companies and individuals alike registered for GST, as the fundamental document to claim GST input and output credits, will be the tax invoice. This requirement will work in synergy with the initiative of the Malaysian Self Assessment System.

Valuation of Supplies

An important factor for GST purposes is considering the appropriate value of a supply. Some of the tried and proven methods are: -

- Consideration in money – where a supply is made and the consideration received is in the form of money; the value is the whole consideration less GST.

- Consideration in goods or services – where a supply is made and the consideration received is a barter, the value is the open market value of the goods or services received, less GST. No consideration – where a supply is made, but no consideration received, there is NIL value of supply for GST purposes, as the dominant test for charging GST is consideration.

It is also important to establish special valuation rules to combat complicated GST transactions that could potentially lead to abuse. Proven complications for GST purposes (particularly in Australia and New Zealand) have arisen in the following transactions: -

- Supplies made between associated persons;
- Hire purchase agreements;
- Goods taken for private use; and
- Schemes on property transactions.

Zero rated supplies

GST is a tax on consumption in the home country. Therefore, it is necessary to zero-rate the exportation of goods and services, so GST does not form part of the costs to overseas buyers. It is also important to consider other detrimental and crucial supplies that should be zero-rated in order not to burden low-income individuals.

In some jurisdictions, the list of zero-rated supplies for GST is exhaustive. Malaysia would need to closely monitor these lists to gauge its extent of zero-rating and that it meets the purpose and intention of a GST.

Exempt Supplies

Making exempt supplies is one of the specific activities that should be excluded from a taxable activity. In most jurisdictions, this list usually covers financial services, such as exchanging currency, debiting or crediting bank accounts, etc. Malaysia would need to consider its economic and social policies in greater detail prior to establishing what supplies would be exempt for GST purposes.

Taxable periods

A taxable period signifies the start date and end date for calculating the GST on sales and purchases made in a registered person's taxable activity. Depending on factors such as turnover, various taxable periods can be determined dependent on the complexity of the transactions. The suggested taxable periods are monthly or two monthly for high turnover persons and six monthly for all others. This eases compliance costs for taxpayers, as complying with GST can add on significantly to the compliance costs.

Accounting basis

An accounting basis is the method of calculation used by a registered person when compiling their GST returns. Some of the options are: -

Payments basis – a registered person accounts for GST on the date when payments have been received or made. This is commonly called the cash basis of accounting for GST.

Invoice basis – Commonly called the accrual method of accounting for GST. A person on the invoice basis accounts for GST on sales at the earlier point of raising an invoice or payment being received.

Hybrid basis – Mixture of payment and invoice basis. A registered person on this basis accounts for output tax using the invoice basis and claims for deductions for input tax on purchases using the payments basis.

As illustrated, a mismatch in accounting basis can create complicated GST problems and is open to a lot of abuse. It would be very crucial for the Malaysian authorities to cover all loopholes that would arise from the mismatch of accounting basis, between entities and registered persons for GST purposes.

Administration of the GST system

As with the introduction of any new tax system that would potentially affect 25 million people on a daily basis, there are bound to be teething problems. The administration of the system would be a costly affair initially for both taxpayers and the IRB alike. GST refunds would need to be screened accurately and quickly by the IRB to ensure minimal disruption to business finances[9]. This would probably be the biggest challenge for the IRB, i.e. to manage a full proof GST refund system to ensure thorough protection of the tax base. At the same time, holding on too long to GST refunds could also prove economically burdensome on taxpayers. There could potentially be very large input and output taxes claimed by some taxpayers on a regular basis depending on the nature of its taxable activity.

The GST system in Australia and New Zealand, have been the target of much abuse and fraud, especially in the early stages of the implementation of the tax. Issues have arisen especially in the mismatch of accounting basis, sale to related parties and in property transactions. It would be advantageous for Malaysia to consult widely with its counterparts around the region who have a GST system, in order to minimise the occurrence of fraud in particularly vulnerable areas of the tax.

9 As GST is a tax paid at every level of the chain, up to the end user who bears the final tax, refunds for GST registered persons, or persons who are not the end user would be present. These costs could be significant and some businesses especially small businesses rely heavily on refunds to stay in business.

CONCLUSION

There is no better time than now, that the IRB revamp its tax administration system to promote more efficiency, transparency and consistency, in order to provide Malaysia with a sound and compliant tax system. The suggestions provided in this article are geared towards moving the Malaysian tax system one step closer towards excellence and if considered for espousal, Malaysia could be seen as a centre of excellence in tax administration for the South East Asian region.

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Malaysia's First Self Assessment Year for Individual Taxpayers

BY KENNETH YONG

Introduction

A new tax form. A new tax deadline. A new tax payment procedure. These are some of the recent developments that individual taxpayers across Malaysia have had to grapple with as the full force of the Self-Assessment System (SAS) finally takes hold. Arguably the most significant change in the tax system for decades, the SAS which became effective in year of assessment 2004, presents an enormous challenge for both the Inland Revenue Board (IRB) and the individual taxpayers.

The SAS, a product of Malaysia's desire to become more developed in its tax administration, has taken years of careful study in examining and re-examining the features of its Official Assessment System - a way of doing "business" which had remained essentially unchanged for many years.

Prior practices

Pre-SAS (ie. 2003 and before), the strict legal position required individual taxpayers to submit their tax returns within one month from the date of the tax return (the former Section 77). However, considering how restricted such a deadline was, operational concessions from the IRB have consistently extended the filing date till end of May.

So it came to be that the tax-paying community took for granted that no matter what deadlines were initially announced for submitting tax returns, extensions were always forthcoming. The month of May became the *expected* deadline, and taxpayers set their mental calendars tuned to such date. In usual taxpayers' spirit, last-minute submissions were the norm.

Such is the power of recurrent concessions that the true legal requirements of tax filing have been obscured by years of common practice. However, under the SAS the month of May is a non-event as the deadlines are now June (for individual taxpayers with business income) and April (for individual taxpayers with non-business income).

New changes

The SAS brought with it a host of changes: new forms, new deadlines, new processing centre, new payment system, and most important of all, it requires a new mindset. However, to undo years of common practice is not an easy task.

Even till the final week of April 2005, last-minute taxpayers were hopeful of an extension till May. But alas, no extension was announced. The deadline for non-business taxpayers stayed at 30 April 2005, and solidified the notion that this time, the IRB meant business. Penalties are imposed for late submissions thus sending a grim reminder that SAS had truly set in.

Awareness campaign

For all the merits that the SAS has to offer, the most important aspect of any system is that the taxpayers are aware of the changes and new procedures that are being put in place. Toward this end, the IRB has launched an extensive press campaign to build awareness of the SAS and its new deadlines. Articles on tax issues grace newspapers virtually every week, with certain dailies sporting a tax countdown. The IRB website has been updated with downloadable versions of return forms and guidebooks, giving taxpayers little excuse not to file their returns.

Such efforts by the IRB are commendable, but the fundamental issue surrounding a successful introduction of SAS is one of tax *preparedness*, and not just tax *awareness*. Many taxpayers are now aware that they have to file their tax returns. But how many are truly prepared ie. fully equipped with the necessary record-keeping skills and with the proper appreciation of accounting and tax rules? Being able to comply fully with the demands of SAS isn't exactly an overnight assignment.

New forms

One aspect of the SAS that was very apparent was the new Form B (for business owners) and Form BE (for non-business taxpayers). The quality of the paper, the clearer colour scheme, the larger font size and the overall layout all pointed to a very different return form. But the change in aesthetics was accompanied by a fundamental overhaul of the data requirements.

The informational demands of the six pages that constitute the Form BE 2004 could hardly be regarded as simple. Likewise, the 10 pages Form B 2004 is complicated, with information requirements stretching beyond income particulars to financial statistics that would easily puzzle the non-accounting businessman.

Admittedly, a lot of thought had gone into the design of the said forms, and the result is a format which clearly encapsulates the exact requirements of the *Income Tax Act 1967* (the Act) with

regards to arrangement of income, losses, allowances, deductions, relief claims, tax rates and rebates. The completeness and accuracy of the form's structure is commendable, perhaps even instructive, as every major line item from the Act is represented.

However, such technical perfection is not likely to win praise and appreciation from the common taxpayer who views tax filing as another chore that needs to be dealt with. Technical fancies aside, filling the forms represents a daunting task for the first-timer, and is extremely time consuming - even for seasoned tax practitioners.

Another source of confusion was Item A9 of the form which required the taxpayer to indicate if he/she had complied with "Public Rulings". Unfortunately, the average taxpayer has never heard of a Public Ruling. Ticking "Yes" would be an obvious lie. Ticking "No" is more risky as non-compliance is something to be avoided. The other alternative - leaving the check boxes blank - runs the risk of an incomplete return that could attract penalties. Either way, the taxpayer is confounded.

IRB assistance

No doubt, the extended operating hours of IRB offices until 10pm during the peak period provide much-needed convenience, and the IRB's various "educational" sessions on how to complete tax forms are a source of relief, but ultimately, such exercises provide limited assistance.

IRB branches are concentrated in major cities, leaving smaller towns without coverage. The IRB website has been swamped by visitors, rendering downloads to a snail's pace.

The number of tax officers available to assist taxpayers at IRB branches is constrained. So officers have had to be diverted from their usual duties to provide over-the-counter assistance - thus hampering applications for instalments and tax set-off. It was reported that towards the last week of April 2005, an additional 100 employees were re-deployed to cope with last-minute crowds.

Furthermore, imagine the frustration of an IRB officer having to repeatedly explain the same filling instructions to hundreds of visiting taxpayers each day for the months leading up to April 2005 and June 2005. Due to the huge last-minute crowds, it is doubtful that mystified taxpayers will get the time and attention necessary to clarify *all* their tax questions.

New payment procedures

Another departure from the "old-way" is the timing of tax payments. Gone are the days where the individual taxpayer would file Form B and wait for the assessment (Form J) to be issued before paying up outstanding taxes within the 30-day grace period. Now, the taxpayer is entrusted with the responsibility to accurately calculate his tax dues and pay-up by 30 June (business income) or 30 April (non-business taxpayers).

This change in payment procedure has several implications. Firstly, cash flows to the IRB are accelerated as taxes are collected by April 2005 or June 2005, thus avoiding delays resulting from issuing Form J and the 30-day grace period for payments. Secondly, taxpayers who need to apply for instalments are thrown off-guard, as they have to re-learn the new procedures in obtaining approval. Thirdly, monitoring and penalising can now be automated as all outstanding taxes after the respective cut-off dates (April or June) could trigger a penalty notice.

Responsibilities and penalties

One of the most worrisome aspects of the SAS is the added responsibility transferred to taxpayers (and penalties attached to the failure in meeting such responsibility). Under the SAS, the responsibility for accuracy and completeness falls squarely on the taxpayer who must ensure that all aspects of tax reporting rules have been complied with.

More than any other element under the SAS, the penalty system has created much concern among taxpayers. Penalties await taxpayers who did not fill their forms accurately, resulting in tax under-calculated. Worse yet, the penalties are time-dependent: the longer the mistake is kept under the carpets, the higher the potential penalty. While such penalties are aimed at catching tax dodgers, genuine taxpayers who erred may also fall victim.

The thing that innocent taxpayers groan most is - why? Why should they be placed in the same category as fraudsters and tax evaders? All the innocent taxpayer wants is to file the return, clear his taxes and get on with life. In response, the IRB had reiterated that genuine mistakes would be overlooked, but this may spark fresh concerns on how IRB would distinguish a genuine mistake from deliberate understatement.

The IRB has also taken a hard stand on unsettled taxes, threatening to close doors on negotiation and take tax evaders directly to court. The Director General of IRB, Tan Sri Dato' Zainol Abidin Abdul Rashid was reported saying: "Enough is enough. We have given ample warnings ... From next year, we will see them in court once the summonses are issued. They can forget about negotiating for settlements."

Tax professionals

The resulting discomfort created by the complex forms and penalty provisions have prompted more taxpayers to seek the services of professional tax practitioners. Many taxpayers assume, incorrectly, that tax work would be a highly lucrative trade.

However, sec 114(1A) of the Act stipulates that any person who assists in or advises with respect to the preparation of any return resulting in an understatement of tax liability could face penalties between RM2,000 to RM20,000 or imprisonment. The additional responsibilities brought about by sec 114(1A) renders tax practice a precarious occupation.

Then, there is the issue of fees versus penalties. Considering that the minimum penalty that could be imposed on tax agents under

sec 114(1A) is RM2,000, charging a fee of several hundreds seems inadequate when the potential penalties could run into thousands.

Furthermore, taxpayers who have been filling their forms by themselves all their lives may find it difficult to part with the couple of hundreds charged by tax practitioners for what is seen as a routine form-filing exercise.

SAS has also prompted tax professionals to be more selective in their client-acceptance policies, rejecting problematic prospects and risky assignments, thus leaving a handful of taxpayers with no one to turn to for assistance.

Tax Audits

Much to the disappointment of the taxpaying public, the filing of the Form B or Form BE is not the end of the process, but just the beginning. Successful enforcement of SAS requires IRB officers to perform audits on taxpayers' documents/records to verify the calculations and claims made in the tax return. The stated claim is that all taxpayers would be audited within a five-year cycle. This was reiterated by the Deputy Finance Minister (1), Datuk Dr Ng Yen Yen who said that the IRB would conduct its standard annual random audit of 20% of all registered tax files.

However, sec 82A requires taxpayers to maintain records for seven years, so presumably, the audit-cycle could stretch as long as seven years.

Formerly, under the Official Assessment System, taxpayers would submit EA forms, dividend vouchers, copies of insurance statements, medical receipts, computer receipts, quit rent and assessment bills, and other supporting documents in order for the IRB officers to grant relevant deductions/reliefs/rebates and raise an assessment.

These supporting documents would go into the IRB filing system, and occupy precious real estate space for years. Given the rising cost of rentals, storage is becoming a real concern. But the SAS has miraculously solved much of the problem for the IRB - by requiring taxpayers to keep all supporting documents instead. Apart from dividend refund cases (where Item E14 of the return is not NIL), nothing needs to be submitted to the IRB except for the Form B/BE 2004.

This simplification of procedure comes to most people as a surprise, so much so that even the Form EC 2004 (statement of remuneration for government officers) still states *"Borang EC ini perlu disediakan untuk diserahkan kepada pekerja yang mesti melampirkan pada borang nyata cukai pendapatannya"* (This Form EC is prepared to be forwarded to the employee who must attach it to the income tax return form). While the IRB would return wrongly submitted documents (eg. dividend vouchers and original EA/EC forms), such taxpayers run a risk of losing these all-important documents in transit.

During tax audits, it is up to the taxpayer to prove and support all figures in the tax return. Thus, proper record keeping becomes crucial. Losing documents/records due to carelessness, shifting house, moving office or genuine misplacements could be interpreted as deliberate over-claiming of deductions/reliefs/rebates with corresponding penalties attached.

CONCLUSION

The Self-Assessment System is a phenomenon prevalent in certain developed countries and those aspiring to reach such a status. Its objectives are commendable, but it clearly requires a taxpaying population who not only have the basic knowledge required for tax preparedness, but also have the right moral and ethical orientation embedded into its way of life. Tax education and continued support from the IRB will be paramount in ensuring the continued success of SAS.

As with any other system, mistakes and hiccups are inevitable during initial implementation, and it is hoped the IRB will use the gentle approach of educating individual taxpayers rather than letting them learn through penalties. If the IRB pulls through SAS successfully, it could be a cue for our neighbour Singapore, who has been contemplating a similar tax system, to follow suit.

For individual taxpayers, the first leg of SAS has come to a close. Now, all eyes will be on tax audits in the coming years.

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SINGAPORE'S 2005 BUDGET:

Creating a Dynamic and Entrepreneurial Economy and Attracting Foreign Talents

BY LEE FOOK HONG

INTRODUCTION

Singapore's Budget for the year 2005 was unveiled by the Prime Minister and Minister for Finance, Lee Hsien Loong on 18 February 2005.

According to the Minister, in recent years, Singapore has been constantly facing challenges of changes in its economic landscape. The Government's priority on fiscal policy will therefore be to make the economy more dynamic and resilient to achieve long-term goals. Much attention will be to focus on sharpening competitive edge through economic restructuring and upgrading to compete in the global environment. One other aspect of the budgetary measures is to foster the growth of important sectors for economic diversification purposes. This Budget is rightly designed to foster economic restructuring and to enhance Singapore's competitiveness as a place for talent and enterprise.

There are not many changes in direct taxes in this Budget. Probably because the tax rates are already the most competitive in the region, it is difficult to imagine how much more direct taxes can be reduced from the existing rate structures.

This Budget is similar to the previous year's, a fine-tuning budget with no significant changes or major tax incentives. Most measures introduced are designed merely to further boost the growth of certain particular industries or to prevent such industries from declining by maintaining their competitive edge.

The boldest change in this Budget is the introduction of one year loss carry-back. This change is viewed by many businesses that the Government is responding to the feedback from those who had criticised the Government for not sufficiently addressing the concern of Small and Medium Enterprises (SMEs). The implementation of loss carry-back is considered timely by many especially SMEs which have been incurring losses as the loss carry-back may help ease their cashflow needs to a certain extent.

Other incentives introduced in this Budget are all aiming at sharpening Singapore's international competitiveness. This Budget continues to focus on economic restructuring to meet challenges from globalisation for long-term goals. Many measures are focused on making Singapore a global financial centre and logistics hub. In particular, the wealth management industry is gaining more and more attention in recent years.

To eventually align with the corporate tax rate, the top marginal personal tax rate will be reduced by two percentage point in a two-stage process to equalise the corporate tax rate. The top rate for individuals will be cut to 21 per cent for income earned in 2005 and to 20 per cent for income earned in 2006 and thereafter. This is in keeping with the promise to maintain the Republic as one of the most competitive individual tax regimes globally. However, high-income earners are disappointed as they are hoping for an immediate reduction in the top tax rate in 2005 instead of two stages in 2006 and 2007.

The widely anticipated change to Singapore's income tax regime from the present preceding year basis to current year basis has not been proposed in this Budget. Some economists are dismayed that this current year basis pay as you earn (PAYE) tax system is not introduced. According to the Minister, the difference between the current year basis and preceding year basis of assessment is all about timing. One of the benefits of the current year basis of assessment is that in years of high income, tax payments will be higher, putting a brake on discretionary spending. In years of low income, tax payments will be lower enabling some to spend that little bit more to keep the economy going. However, due to high compliance cost, the Government has put the change to the current year basis on hold for the time being.

Due to supportive monetary and fiscal policies, the Minister reported that the Singapore economy rebounded strongly and registered a 8.4 per cent growth in 2004. However, he cautioned that there were some downside risks - a sharper than expected downturn in the global electronics industry, another spike in oil prices, or a terrorist incident in the region that shakes confidence - but overall outlook remained optimistic.

The Budget has generally drawn a mixed response from the business community. Many welcome the introduction of financial services incentive to further enhance Singapore as an international financial centre while others praised the Government for focusing budget on making Singapore an economy of opportunity. They rejoice over these budgetary measures which are timely and bold in the light of challenges from changing economic landscape. However, some lamented that the Budget did not include any cost-cutting measures to bring down business operating costs while some expressed surprise on the Government's decision not to go ahead with the Current Year basis of assessment for income tax.

This article will focus comments only on some of the tax changes aimed at creating a dynamic and entrepreneurial economy for the benefit of foreign investors and talents. (For a summary of the main tax changes of the 2005 Budget, please see Appendix)

TO CREATE A DYNAMIC AND ENTREPRENEURIAL ECONOMY

A. Financial services incentives

The financial services industry has been transformed over the last decade. The Government is taking steps to open up the industry to greater competition, strengthen the market infrastructure and continue to encourage leading financial players to hub their regional operations in Singapore. This Budget continues to focus on promoting financial services by introducing more tax incentives to help further grow the industry.

(1) Start-up fund manager

Singapore already has a thriving asset-management industry with over 230 firms managing over $450 billions of assets. One reason for the steady growth of the industry is likely to be the relative regulatory ease with which the fund managers set up and operate in Singapore as compared to other countries in the region. This is because Singapore adopts risk-focused regulatory regime. Furthermore, the various tax incentives introduced so far has also attracted many foreign fund managers to operate in Singapore.

Generally, income and gains arising from foreign funds managed by Singapore-based fund managers would be regarded as Singapore income and subject to Singapore income tax. However, by virtue of specific tax exemption incentive schemes, the foreign sourced income or gains from foreign fund managed by Singapore-based fund manager can be exempt from income tax provided the fund is not a Singapore tax resident which usually means its control and management is outside Singapore, and not more than 20 per cent of the value of the fund is owned by persons resident in or citizens of Singapore. The latter is known as the "80:20 rule". Furthermore, if the funds qualify under the exemption scheme, the management fees earned by the Singapore based fund manager are subject to a concessionary tax rate of 10 per cent.

However, most start-up fund managers have difficulty to qualify for tax exemption under the incentive scheme because initially they cannot meet the requirements of the 80:20 rule. The initial seed capital needed to set up the fund usually comes from the fund managers themselves who are tax residents in Singapore. They require certain time to build up funds from foreign investors to meet the requirement that 80 per cent of the value of their funds come from foreign investors.

With the introduction of the 12-month grace period granted to the start-up fund managers, it is hoped that most of them can qualify for tax exemption or concessionary tax rate under the incentive scheme as the 12-month period may allow the fund managers more time to market fund from foreign investments. However, many doubt that the 12-month period would be sufficient for the start-up fund managers to build up 80 per cent of their funds from foreign investors knowing that typically it would take several years for a new fund manager to establish.

Until they can build up the foreign ownership to meet the 80 per cent threshold the Singapore-based fund managers managing foreign funds will not be able to enjoy the tax incentives. This may cause them to change decision to move offshore or relocate their funds elsewhere. Therefore, some suggest that it would be better for the Government to remove the rule altogether as very few tax dollars would be lost but the benefits of attracting more fund managers to operate in Singapore would be immense.

(2) Exemption for foreign charitable trusts

With rising affluence in Asia, owing to its stability and good infrastructure, Singapore is an attractive location for foreign philanthropic trusts. The Government has decided to introduce a new tax incentive scheme to exempt all qualifying foreign charitable trusts from tax on specified income. The new scheme will be similar to the treatment under the existing Scheme for Exempt of Income of Foreign Trusts, but without the restrictions on expenditure levels or where the funds may be spent.

The new tax exemption scheme with liberty on expenditure and utilisation of funds may further attract more foreign charitable trusts to locate in Singapore. It gives foreign wealthy individuals or families certainty that their donations and contributions will be used fully for desired charitable purposes or objects. More importantly, organised philanthropic can broaden Singapore's wealth management offerings such as trust services and philanthropic advisory services.

Although not mentioned in the Budget, one would wonder whether tax residents in Singapore donating to such foreign charitable trusts would be granted tax deductions as they do for local Institutions of a Public Character (IPCs).

(3) Securities borrowing and lending arrangement

To encourage more institutions to participate in securities borrowing and lending activities, the Budget introduced a new incentive by conferring a concessionary tax rate of 10 per cent on the income earned by approved companies, including intermediaries, in securities borrowing and lending transactions.

Securities borrowing and lending helps to promote liquidity of debts and equity capital markets. It offers opportunities for financial institutions to generate incremental income from their investment portfolios, while enabling hedge funds and dealers to arbitrage to obtain benefits of short-term performance differentials.

Under the existing scheme termed "Financial Sector Incentive (FSI)", a company may enjoy a 10 per cent concessionary tax rate on its income derived from the securities borrowing and lending, transactions involving foreign securities. The new scheme is therefore an extension of the scope of the existing one to cover the income derived from the transactions involving Singapore securities. In addition, approved companies and financial intermediaries may also qualify for the 10 per cent concessionary tax rate. The change would therefore extend the tax concession to a wider pool of industry players so as to deepen the capital market through enhancing secondary market liquidity.

(4) Real Estate Investment Trust (REITs)

To broaden Singapore's capital market the Government will continue to encourage the development of REITs by strengthening Singapore as the preferred location in Asia for listing REITs given that Australia, Malaysia and Hong Kong are all actively developing their REITs markets.

REITs allow investors in real estate to free up their capital already tied up in real properties for other more profitable investments. REITs market has been developing very well in recent years. Although there have been several REITs listings in Singapore over the last few years, there remain significant opportunities for further growth in this industry in Singapore.

Promoting REITs will not only help enlarge Singapore's capital market but also grow our local fund management business and benefit other sectors of financial industry. To attract more REITs listings, the Budget introduced three measures to adjust the current arrangements to lower their set-up costs and make REITs more attractive to investors.

(a) Stamp duties
One of the incentives proposed is to waive stamp duty on the instruments of transfer of Singapore properties into REITs to be listed, or already listed on the Singapore Exchange (SGX), for a five-year period. Stamp duty has been a substantial cost approximately 3 per cent of the value of real properties to be transferred into the REITs. This has adverse effect on the investment yield of REITs. With the waiver of stamp duty it is hoped that more real estate owners will consider entering the REITs market.

(b) Withholding tax
The second incentive introduced for REITs is a reduction in the withholding tax rate on distributions out of taxable income made to non-resident corporate investors from 20 per cent to 10 per cent for a five-year period. This measure is to attract more foreign non-individual investors to participate in REITs market. But sadly Singapore corporate and financial institutions have been left out. Hopefully by the next Budget, this issue would be addressed.

(c) Removal of qualifying conditions
The last measure on REITs in this Budget is the removal of the qualifying conditions for tax transparency treatment granted to REITs listed on the SGX. At present, under the tax transparency treatment, the trustee is not assessed to tax on the taxable income of the REITs to the extent of the amount distributed to unit holders by way of direct assessment or through withholding tax mechanism. Distribution to non-qualifying unit holders generally non-resident corporate unit holders are subject to a withholding tax at 20 per cent. Distributions to qualifying unit holders but who have not submitted the required documentation are also subject to withholding tax.

The trustee must indemnify the tax authority against any loss of revenue if it fails to recover tax from the unit holders. There are other qualifying conditions imposed on tax transparency treatment for REITs. Although no details have been given in relation to the proposed removal of qualifying conditions, it is hoped that the current requirement for the trustee to provide tax indemnity to the Inland Revenue Authority of Singapore (IRAS) will be among the qualifying conditions to be removed.

With the tax changes made to REITs listings, it is hoped that Singapore will be positioned as a leading location in Asia for REITs market

(5) Islamic finance

Islamic finance, governed by Islamic law, prohibits charging of interest payment; undertaking speculative investment or investment in non-acceptable assets. Various conventional banking products and services in the present forms are therefore not suitable for Islamic investors. Financial transactions would need to be structured in a manner that complies with Islamic requirements. Institutions marketing Islamic financial products to investors

must package financial products that offer payouts not in the form of interest payment and not to be derived from forbidden investment activities

One of the keys Islamic financial products is home financing and mortgages. As payment of interest is not permitted, purchase of real property by a Muslim buyer has to be structured involving the buyer, bank and seller. The buyer signs a lease agreement with the bank and pays rentals to the bank over the lease period. During the lease period, the bank is the registered owner of the property. At the end of lease period, the bank will sell the property to the buyer. Such arrangements attract stamp duties to be levied twice because there are two occasions of transfer – once on the purchase of the property by the bank and again on the sale of property to the buyer.

There has been a surge in demand globally for Islamic financial products in recent years, with global Islamic finance growing 10-20 per cent annually. This appears to be one of the most dynamic segments of global financial market. To make Singapore tax system more conducive to Islamic financial products and sharpen its competitive edge to be an international financial centre, the Government will remove the double imposition of stamp duties incurred in Islamic transactions involving real estate in Singapore.

The Government will also accord payout from Islamic bonds the same concessionary tax treatment that is currently granted to interest arising from conventional financing. Under the existing tax incentive, interest paid on conventional bonds will qualify as Qualifying Debt Securities (QDS) scheme and is tax-exempt in the hands of a Singapore tax resident individual as well as foreign investors or subject to concessionary tax rate of 10 per cent in the hands of a Singapore corporation.

For Islamic reasons, the issuance of bonds with periodic interest coupon is not permitted. Therefore, the payouts from Islamic bonds are not interest from QDS and accordingly the existing tax incentives under QDS scheme shall not apply; hence the need for realignment of the Islamic bonds with qualifying debt securities has been addressed by the budgetary measure to ensure parity of the tax treatment.

It is hoped that with the tax measures announced, Singapore will be a more attractive financial centre for Islamic financial services.

(6) Commodity Derivatives Trading (CDT)

In previous year's Budget 2004, the CDT incentive was introduced effective from 27 January 2004 to encourage the growth of the commodity derivatives market. But the incentive does not cover income from transactions in exchange-traded commodity derivatives. In the 2005 Budget, the Minister announced that to encourage exchange-traded commodity derivatives trading, the CDT incentive will be enhanced to confer a 5% concessionary tax rate on qualifying income from exchange-traded commodity derivatives effective from 18 February 2005.

The extension of qualifying commodity derivatives which eliminates the anomaly between the tax treatment of over the counter and exchange-traded derivatives will be most welcome and thus will enhance Singapore's position as a commodities hub.

(7) Finance and Treasury Centre (FTC)

The FTC tax incentive is designed to encourage more multinational corporations to base in Singapore to conduct their treasury management activities for associated and related companies in the region. Income received from approved network companies for provision of qualifying services by an approved FTC will be taxed at a concessionary tax rate of 10 per cent. Income derived from qualifying activities undertaken by the FTC denominated in non-Singapore dollar will also qualify for the 10 per cent concessionary tax rate.

To enhance Singapore's position as a premier location for regional headquarters, the scope of the FTC incentive will be enhanced in two ways:-

- Associated companies of the FTC in Singapore may now qualify as approved network companies; and
- the scope of the qualifying activities and services will be expanded to include Singapore-dollar denominated transactions.

These two FTC refinement measures will certainly reduce the administrative burden of the FTC in regard to the requirements to keep track of the currency of its voluminous transactions and counterparties with whom the transactions taking place for purposes of enjoying the 10 per cent concessionary tax rate. Furthermore, FTC now may have greater flexibility in manoeuvring funds within the group. However, too much liberalisation may give rise to concerns among Singapore's treaty partners and the Organisation for Economic Co-Operation and Development (OECD) as to whether Singapore is adopting harmful tax practices.

B. Other tax incentives

Loss Carry-back

Due to cyclical downturn, small businesses may find themselves profitable in one year and suffering losses in the

next. To help SMEs to cope with cash flow difficulty arising from such cyclical downturn, this Budget introduces a one-year carry-back of unutilized capital allowances and trade losses, subject to a cap of $100,000.

Loss carry-back may serve as timely financial relief for a small company because having paid tax for the profitable year, it may obtain a tax refund of the tax paid if it suffers losses in the following year. This refund would certainly ease the inherent cash flow problems of small businesses arising from trade losses, because unlike big corporations, small businesses usually do not have sufficient reserves and cash flow to weather losses.

Although the loss carry-back is designed for the benefit of smaller businesses, the Finance Minister has allowed it to apply to all businesses including sole-proprietors and partnerships. The loss carry-back will be given on due claim basis. For corporate taxpayers, the ability to carry back losses will be subject to satisfaction of requirements on substantial shareholding and same business tests.

Although the loss carry-back concept is new to Singapore, it has been adopted by tax regimes in other countries with different models of carry-back. Canada and Netherlands allow a 3-years loss carry-back while United States allows 2-years loss carry-back.

One practical problem foreseen is that it usually takes quite a while for Revenue Authority to finalise and be agreeable to the tax losses. Until the losses for the year concerned are agreed, they will not be able to carry backward to set off the profits of the preceding year for taxpayers to claim a refund. This would mean that the benefit of cash flow from a refund might not materialise if the finalisation of the assessment is delayed or if there is a dispute to the tax assessment.

Expansion of bonded warehouse scheme

As part of an effort to grow the services sector and further strengthen Singapore's position as a logistics hub for global trade flows, the Government will expand the Bonded Warehouse Scheme, under which Goods and Services Tax (GST) is suspended on goods imported into, and traded with, designated bonded warehouse.

To expand the scope of the scheme, the Government will lift the 80 per cent export percentage requirement for qualifying operators, and allow the operators greater flexibility in storing and moving goods between pre-approved warehouses. This will improve cash flow and reduce administrative costs for logistics companies and other importers of goods.

The change may increase the attractiveness of the Bonded Warehouse Scheme and further strengthen Singapore's logistics services sector. However, there are still other costs associated with operating a warehouse and the tax change does not seem significant.

Global Trader Programme (GTP)

Under the Global Trader Programme, an approved global trading company is taxed at a concessionary tax rate of 5 per cent or 10 per cent on income from qualifying trades in specified goods and commodities denominated in a currency other than the Singapore dollar.

To encourage more GTP companies who want to use the Singapore dollar as the transacting currency in their trades to carry out more trading activities in Singapore, the Government has now widened the scope of the GTP by extending the concessionary tax rate to trades denominated in Singapore dollar transactions.

Such change will allow GTP traders the flexibility of choice of currency under the incentive scheme and to better manage their foreign exchange exposures.

Personal income tax reduction

To make Singapore a competitive tax regime for personal income tax and to attract foreign talents, the top personal income tax rate has been cut by two percentage points to be staggered over two years. The tax rate for personal income tax would be lowered from 22 per cent to 21 per cent in Year of Assessment 2006 and further lowered to 20 per cent in Year of Assessment 2007.

According to the Minister, the cut will not only benefit all taxpayers in Singapore, but will also make Singapore more attractive to foreign talents because the income tax regime will be internationally competitive.

Most people are of the view that the cut of 2 per cent in the personal tax rate will benefit only the high-income earners and foreign talents with high pay. Although the cut may not appear to be significant, some businessman feel that it is better than nothing and commend the Government for focusing on the less well off in terms of rebates, giveaways, top-ups rather than tax cuts which typically benefit the more well-off taxpayers. This shows the compassionate and caring side of the Government.

With the latest cut on the personal income tax rate, the consensus appears that Singapore is now more attractive and competitive even compared with Hong Kong in tapping foreign talents. Furthermore, the existing incentive like "Not ordinarily resident (NOR) taxpayer scheme" which also grants attractive tax concession to foreign individuals working in Singapore can serve as another plus factor to attract foreign talents.

CONCLUDING REMARKS

This Budget is not much different from that for the previous year. It is a non-event budget for all without any substantial benefits or sufficient attractions. Most of the tax changes are only fine-tuning in nature aimed at providing incentives to boost growth of certain sectors. The Government will however continue to help develop sectors which have good potentials by giving tax and fiscal incentives through budgetary measures.

It is true that the Government's intention has always been to keep tax burden low so as to free up more resources into the business. However, the Minister admits that as the existing tax structure is already very lean, further major tax reduction will not be possible. Taxpayers should not therefore expect any significant changes to the tax landscape in the near future, bearing in mind any further drastic tax cut may cause concern among tax treaty partners, and OECD to wonder whether Singapore is engaging in harmful tax practices.

Singapore's fiscal measures will now focus on restructuring of economy to adapt to the changing world, enhancing Singapore competitiveness and fostering an entrepreneurial business community. On the whole, the 2005 Budget measures are designed to serve the purpose of building a dynamic and resilient economy with abounding opportunities.

The responses from the public and business community were mixed. Although some businesses may be disappointed that the measures are not bold enough to sustain recovery and new major tax incentives in the corporate tax area could have been introduced to position Singapore favourably as a regional financial centre compared to others, it must be acknowledged that the Government has been bold enough to recognise the important role of the SMEs and the common people and offer some goodies to everyone and not just the financial sector.

The reduction of personal tax rates has been eagerly awaited but the reduction is staggered over two years which was somewhat disappointing to those hoping for an immediate tax cut. Notwithstanding that, most respondents were aware that the Government's need to exercise fiscal prudence. Some agree with the Minister that there is really no pressing need to have the immediate cut as the personal tax rates are already competitive enough in relation to those of our neighbours and there are also schemes in place to attract certain categories of foreign talents and certain types of business.

Another disappointment is that the Budget has not mentioned any significant changes to Singapore's Goods and Services Tax (GST) regime. The current GST system may, in practice, impede Singapore's effort to grow its services sector which is one of Singapore's twin engines of growth. Due to the inherent complexity of the "zero rating" rules, certain export of services may not fulfill the criteria imposed and therefore may not qualify for GST exemption. If GST of 5 per cent is charged to the services exported, the competitiveness of Singapore's services suppliers would be adversely affected. Therefore, if taxation were a key consideration in the setting up of a centre to provide regional and global services, the imposition of a 5 per cent GST charge to such services would impede Singapore's effort to be a global services hub. Improving the "zero-rating" rules should be seriously considered by the Government.

Generally the budget is worth welcoming although it cannot be a perfect one with sufficient tax incentives or reliefs to satisfy every individual and every sector in the business community.

APPENDIX: SUMMARY OF THE MAIN TAX CHANGES IN THE BUDGET FOR 2005

A) Personal income tax reductions

- Top personal income tax rates to be lowered from 22% to 21% with effect from Year of Assessment (Y/A) 2006 and further reduced to 20% in Y/A 2007.
- Marginal tax rate of all other brackets will also be reduced.

B) Wealth management centre

- Start-up fund managers will get a 12-month grace period to meet requirements that 80 per cent of the value of their funds must come from foreign investors.
- Foreign charitable trusts will also be given tax exemption on foreign income earned, without restrictions on expenditure levels or where funds may be spent.

C) Deepen and broaden capital market

- Income earned by approved companies from securities borrowing and lending will enjoy a lower 10 per cent tax rate.
- Removal of double stamp duties for real estate mortgage financing structured in accordance with Islamic practices and concessionary tax treatment extended to payout from "Islamic" bonds.
- Qualifying income from derivatives trading will enjoy a 5 per cent concessionary tax rate.

D) Real Estate Investment Trust (REITS)

- Stamp duty for transfers of Singapore properties into listed REITs or REITs to be listed, will be waived for 5 years.
- Withholding tax on trust distributions to be reduced from 20 per cent to 10 per cent for 5 years.

E) Logistics Hub

- Bonded Warehouse Scheme to be expanded by lifting the 80 per cent export requirement for qualifying operators.
- Approved International Shipping Enterprises (AIS) incentive extended to ship leasing companies
- Global Trader Programmer (GTP) will be widened to allow companies to use the Singapore dollar as their transacting currency.

F) Losses Carry-Back

- One year loss carry-back for corporate tax to be introduced in Y/A 2006, subject to a cap of $100,000 in losses carried back.

G) Stamp duties

- Remission of stamp duties paid on aborted transactions.

H) Tourism and retail sectors

- Investment allowance incentive for flagship concept projects in retails, food and beverage and entertainment.
- Concessionary tax rate of 10 per cent extended to event companies that bring in approved tourism events

I.) Others

- Skilled Foreign Worker Levy to be raised from $50 to $80 from 1 July 2005 and to $100 from 1 January 2006. Company can hire foreign workers above quota but has to pay more levy.
- Double tax deduction for donation with naming opportunities. Sport groups will enjoy charity status. Double tax deduction for donation of computer hardware and software to Institutions for a Public Character (IPCS) under the existing computer Donation scheme.
- Edusave top-up, CPF top-up for older Singaporean, Medifund top-up and Medisave top-up.
- Baby Bonus Scheme enhancements.
- Reduction of foreign maid levy.
- Lifelong Learning Fund top-up and Comcare Fund top-up.
- Enhancement on tax relief for Central Provident Fund (CPF) contribution.
- Increase in excise duty on cigarettes.
- Adjustment to horse-betting duty.
- Utilities-Save benefits for Housing Development Board (HDB) households.

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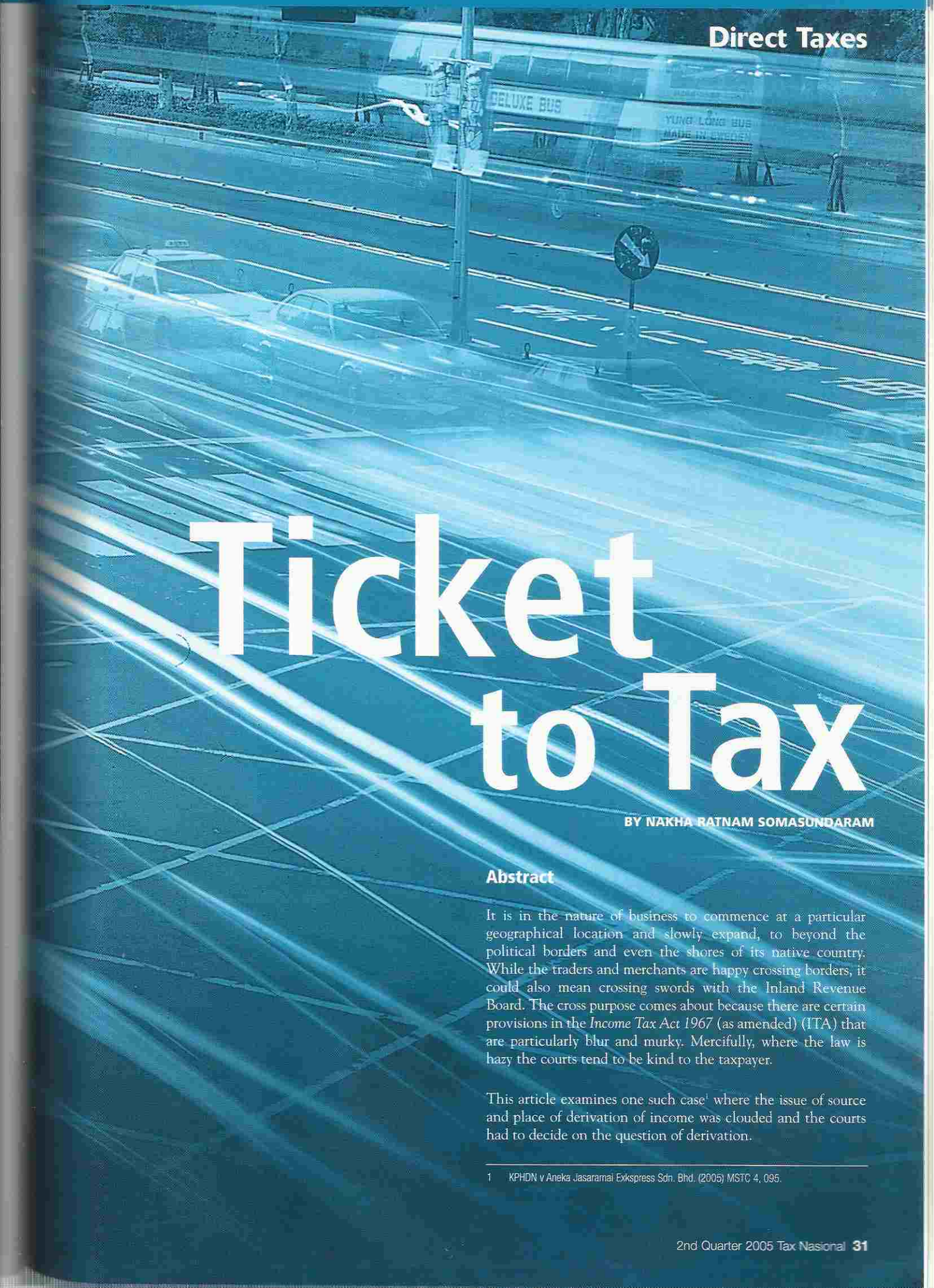

Ticket to Tax

BY NAKHA RATNAM SOMASUNDARAM

Abstract

It is in the nature of business to commence at a particular geographical location and slowly expand, to beyond the political borders and even the shores of its native country. While the traders and merchants are happy crossing borders, it could also mean crossing swords with the Inland Revenue Board. The cross purpose comes about because there are certain provisions in the *Income Tax Act 1967* (as amended) (ITA) that are particularly blur and murky. Mercifully, where the law is hazy the courts tend to be kind to the taxpayer.

This article examines one such case[1] where the issue of source and place of derivation of income was clouded and the courts had to decide on the question of derivation.

1 KPHDN v Aneka Jasaramai Exkspress Sdn. Bhd. (2005) MSTC 4, 095.

Facts of the case

Aneka Jasaramai Ekspress Sdn Bhd (the taxpayer) is a company incorporated in Malaysia operating express bus services between various major towns in Malaysia, including Johore Bharu. For routes that ended in Johore Bharu, the company was given special permission by the Singapore authorities to operate the buses into Singapore. However, a condition was attached that passengers embarking in Singapore must purchase their tickets from the Singapore agents using Singapore currency.

For the years of assessment (Y/A) 1990 to 1998, the Malaysian Inland Revenue Board (IRB) assessed the income from the sale of the bus tickets in Singapore, together with the income from the sale of the bus tickets in Malaysia.

Appeal

The taxpayer appealed on the grounds that the sale of the bus tickets in Singapore is not income accruing in or derived from Malaysia. It is therefore not assessable to Malaysian income tax.

The issue

The issue for the Special Commissioners of Income Tax (SC) was to determine whether the income of the taxpayer from Y/A 1990 to 1998 from the sale of tickets in Singapore is income accruing in or derived from Malaysia, and therefore subject to Malaysian income tax.

The law on income derivation

The statutory provisions as to the circumstances under which income is derived or deemed to be derived from Malaysia, is contained in sec 12 of the ITA. The provisions are considered briefly in the following paragraphs:

- Gross income as is not attributable to operations of the business carried on outside Malaysia is deemed to be derived from Malaysia.[2]
- If the business consists wholly or partly of manufacturing, growing, mining, producing or harvesting in Malaysia of any article, products, produce or other things, the income from the sale of these will be deemed to be derived from Malaysia.[3]
- Where the above does not apply then the market value at the time of export shall be deemed to be the gross income derived from Malaysia.[4]
- Where the business or part of the business is carried on in Malaysia, the gross income of the business from wherever derived consists of dividends or interest which relate to a share, debenture, mortgage or the source which forms the stock in trade of the business carried on in Malaysia or to a loan granted in the course of the business, the interest or dividend is deemed to be derived from Malaysia.[5]

2 sec 12(1)(a) subject to sec 12(2).
3 sec 12(1)(b)(i).
4 sec 12(b)(b)(ii)

It could be observed from the wording of the sec 12 that the critical question is to define the '*operations of the business carried on outside Malaysia*'. If the operations are carried on outside Malaysia, then the income is *not* derived from Malaysia, and consequently is *not* subject to Malaysian tax.

The income of course will be subject to Malaysian income tax if it is remitted to Malaysia. However, with effect from Y/A 1995, tax shall not be charged on income derived from sources outside Malaysia and received in Malaysia by a resident company.[6]

The Singapore income

The taxpayer proved to the satisfaction of the SC that the income derived from the sale of the tickets in Singapore is net of expenses (agent's commission, workers' salaries, rental of premises and utilities etc). These income and expenses were reflected separately from the Malaysian operations.

The taxpayer did not sell return tickets in Singapore. However, tickets sold in Malaysia for the journey from Malaysia to Singapore were treated in the accounts as Malaysian income and was reported accordingly.

The legal arguments

The taxpayer argued that income from the sale of the bus tickets in Singapore was not Malaysian income accruing in or derived from Malaysia. As such, it is not subject to Malaysian income tax for the said years of assessment. The contention was that the source of income is where the recipient of the income has to do, or provide services, in order to receive the income. The act of earning the income was by the sale of the bus tickets. Moreover, the selling of these tickets took place in Singapore. The source of income is therefore in Singapore.

The IRB on the other hand admitted that under sec 3C income arising from sources outside Malaysia and received in Malaysia by a resident company other than a company carrying on the business of banking, insurance, shipping and air transport will not be taxable. Nevertheless, in the instant case the source is in Malaysia because the business was registered in Malaysia, the operations are in Malaysia and therefore the income earned falls to be taxed in Malaysia.[7]

5 sec 12(2)
6 Under sec 3C, inserted by Act 531 of 1995 sec 4, and effective from the year of assessment 1995, tax shall not be charged under the ITA on income arising from sources outside Malaysia and received in Malaysia by a resident company (other than a company carrying on the business of banking, insurance , shipping and air transport). This section was deleted by Act 578 of 1998, effective from the year of assessment 1998. In its place was issued the Income Tax (Exemption) (No. 48) Order 1997 dated 31 October 1997 under PU (A) 469 exempting a resident company (other than a company carrying on the business of banking, insurance , shipping and air transport) and a unit trust from the payment of income tax in respect of income derived from sources outside Malaysia and received in Malaysia by the resident company or unit trust. This Order took effect from the Y/A 1998. This last Order was revoked by the Income Tax (Exemption) (Revocation) Order 2004 (PU (A) 10/2004). The current law on the non-taxability of remittances is contained in para 28 of Sch 6.
7 These arguments were contained in the IRB's letter dated 4 September 1996 to the company's tax agents, and were later produced as arguments for the IRB at the SC's hearing.

The source rules

Apparently, the source rules had been muddied up even way back in 1918, as it is today. For example, *Issac* J. in the case of *Nathan v FCT*[8] said:

> *'...The legislature in using the word 'source' meant not a legal concept but something which a practical man would regard as a real source of income... the actual source of a given income is a practical, hard matter of fact...'*

In the 1938 Australian case of *Tariff Reinsurance Ltd v The Commissioners of Taxes*[9], it was determined that the locus of the contract was the locus of the income.

In the case of *CIR v Hang Seng Bank Ltd*[10] the question of the locus was considered and Lord Bridge said:

> *'...The question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always ...a question of fact depending on the nature of the transaction... the broad guiding principle (being) that one looks to see what the taxpayer has done to earn his profits in question...'*

The SC observed that there is no definition of the words *'accruing in or derived from'* in the ITA, thus giving rise to the current ambiguity:

> *'...There is some ambiguity in this area which needs to be solved either by the legislature or by the superior courts particularly so in view of trading activities between neighbouring countries such as Malaysia and Singapore...'*

Interpretation of ambiguous laws

In *Humes v CIT*[11] Justice *Brown* said:

> *'...As in every case it is the duty of the court to ascertain the intention of the legislature from the language used. If the language used is ambiguous, and is capable of two differing constructions, it would be my duty to adopt a construction which is favourable to the taxpayer...'*

Justice *Brown* is not alone in taking such a stand. Lord *Wilberforce* for example took a similar stand in the case of *Vesty v IRC*[12] when His Lordship emphasized as follows:

> *'...A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined. A proposition that ...a subject is to be taxed or not...(is)...to be decided by an administrative body represents a radical departure from the constitutional principle...(and this the courts) cannot validate...'*

8 (1918) CLR 183
9 59 CLR 194
10 (1990) STC 733
11 (1952) 18 MLJ 245
12 54 TC 503

The decision of the SC

The SC took the view that there is an ambiguity in the language pertaining to the interpretation of the source of income and therefore there is an alternative interpretation of the statutory language, which is tenable. Accordingly given the fact that the taxpayer had discharged his onus that the assessment as raised was erroneous, the SC gave a decision in favour of the taxpayer.

The Director General of Inland Revenue was of course, not satisfied and appealed to the High Court. Justice *Raus Shariff dismissed* the appeal stating that:

> *'...I am of the view that the Special Commissioners of Income Tax did not act without any evidence or have misdirected themselves in concluding that the income from the sale of tickets in Singapore did not accrue or derive from Malaysia...(therefore) the case does not suffer any infirmities justifying the intervention of this court...'*

CONCLUSION

The courts have shown mercy and justice had prevailed (if you are looking from the taxpayer's point of view, of course).

Given such beneficial decisions, it may be tempting for taxpayers to wish that the provisions of the *Income Tax Act 1967* (as amended) would continue to remain murky and ambiguous so that the courts would continue giving decisions beneficial to them.

Or is it a ticket to fantasy?

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Note : The views expressed are the personal views of the writer only.

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8:15 - 9:00 am	Registration
9:00 - 9:15 am	Chairman's Opening Comments
	Part 1 The Law - Definition of Section 153
9:15 - 9:55 am	Part 2 Procedures of applying for a Tax Agent License • Eligibility • Filling up forms (Form D) • Response time **Speaker: Dr. Mohd Shukor bin Hj Mahfar Revenue Management Department, LHDN**
9:55 - 10:35 am	Part 3 Interview Process • Before the interview • During the interview • After the interview **Speaker: Director, Cawangan Johor/ Penang, LHDN**
10:35 - 11:00 am	Morning refreshments
11:00 - 11:45 am	Part 4 The Consequences of being "unlicensed" (Bogus Tax Agent) **Speaker: Dr. Mohd Shukor bin Hj Mahfar Revenue Management Department, LHDN**
11:45 - 12:45 pm	Part 5 The Future of Tax Profession in Malaysia • A widening scope for tax agents **Panelist 1: Dr. Mohd Shukor bin Hj Mahfar Revenue Management Department, LHDN Panelist 2: Director, Cawangan Johor/ Penang, LHDN**
12:45 - 2:00 pm	Networking Lunch

TAX AUDITS & INVESTIGATIONS
(Afternoon Session)

Programme Outline

2:00 - 3:15 pm	Part 1 Differences between tax audits and investigations • Taxpayer's perception - An effective enforcement measure? • Going forward - what to expect
	Part 2 An Overview of Legal Issues in Tax Audits & Investigations • Powers of the Revenue • Rights of the Taxpayer • Penal Provisions • Judicial and Appellate Recourse **Speaker: Mr. Vincent Josef Former Assistant Director General, LHDN**
3:15 - 3:45 pm	Afternoon refreshments
3:45 - 4:45 pm	Part 3 Audits or Investigations • When does an audit become investigation? • Criminal investigation - what to expect • Are we on the right track? **Speaker: Director, Cawangan Johor/ Penang, LHDN**
4:45 pm	End of seminar

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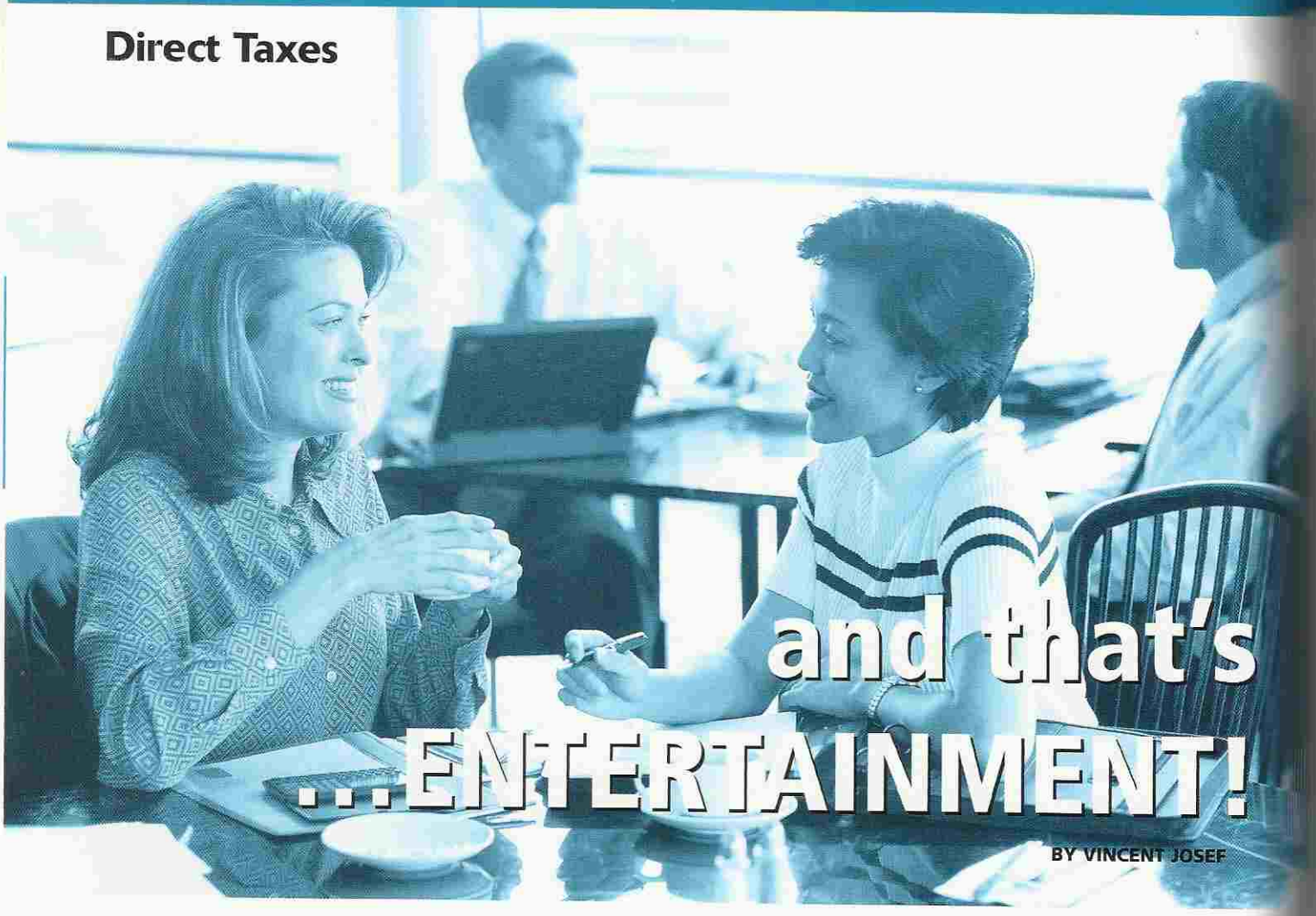

...and that's ENTERTAINMENT!

BY VINCENT JOSEF

Effective from Year of Assessment (Y/A) 2004 and keeping in line with the present philosophy of granting more benefits within the Malaysian taxation regime, the *Income Tax Act 1967* has been amended to expand the range of entertainment expenses that are deductible. Henceforth, and subject to certain conditions, expenditure on entertainment can be claimed against gross income from a business. Strictly speaking, the deductibility of such expenses is not something new. It may be recalled that in the distant past when a mouse was a rodent, entertainment expenses qualified for deduction just like any other expense incurred wholly and exclusively in the production of income.

It would be interesting to go back into history and consider the position when entertainment was allowable. The stand was very straightforward and as long as entertainment met the basic test of being incurred in the production of income as demanded by sec 33 of the *Income Tax Act 1967*, it would be deductible. However, the Inland Revenue Department[1](IRD), as it was then, reviewed its generosity and decided that allowing entertainment expenditure freely brought with it a host of negative features. Accordingly, entertainment expenses were disallowed with effect from Y/A 1989 and justifiably so, as later events would prove. As was to be expected, there were howls of protest from accountants, tax agents and the general business community. Their biggest complaint was that disallowing entertainment would be extremely unfair and against the grain of sec 33 as such expenses were very relevant and crucial to the success of their business. Nevertheless, the tax department held firm to its decision. What sec 33 permits in general, sec 39 (1)(l) specifically disallowed.

But the story does not end here, because the following year, in Y/A 1990 when the tax returns were submitted, it was noted that hardly anyone charged entertainment expenses to the accounts! Now if entertainment was such a necessary inevitable feature of doing business as the public was claiming, it should still have been reflected in the accounts, notwithstanding the fact that it might not be deductible. So where were the "very relevant and crucial" expenses concealed? This 'disappearance' would indicate quite irrefutably that at least in this instance, the IRD WAS correct in its stand!

Whatever the historical aspects, taxpayers would of course welcome the more liberal stand now being taken regarding the treatment of entertainment. This arises from the recent amendments to subsection 39(1) of the *Income Tax Act 1967*, effective from Y/A 2004. Entertainment had been allowed previously of course, but under severely restrictive conditions. The Inland Revenue Board (IRB) believed strongly that there was no such thing as a free lunch! The concession now granted under proviso (vii) did not exist. This time however, the subject is more clearly defined and while there is no blanket 'right to deduction', a wider application is possible. With the inclusion of proviso (vii) in respect of "Entertainment relating wholly to sales", expenses in connection with the more everyday aspects of entertainment rank for deduction. To offer better understanding of the amendments to the Act, the IRB has issued a guideline on the matter and subject to the parameters set on it; entertainment expenses would accord further relief from the weight of tax. The guidelines issued by IRB come in the form of Public Ruling No. 3/2004 on "Entertainment Expense".

1 The Inland Revenue Board (IRB) was formerly known as the Inland Revenue Department (IRD).

The public, particularly businessmen, would be well-advised to understand this Ruling as it would greatly assist in ensuring they enjoy the deductions they are entitled to and reduce any fall-out arising from an audit.

This paper summarises the principal aspects of the Ruling so as to render it better and easier understood. The issues that will be explored and examined are the 3 categories that entertainment expenditure can generally be placed into:

a. those that are not allowed at all;
b. expenses that would be allowed 50%; and
c. expenditure that would be fully allowable.

These can be represented 'pictorially' in the following readily understood manner:

NOT incurred for business (private or personal)	Wholly and exclusively for the production of income	Within proviso (i) to (vii) of sec 39(1)(l)
NOT Allowable	**50% Allowable**	**100% Allowable**

Obviously, an important first step is to ascertain what constitutes **'entertainment'** and the Ruling repeats the definition given in sec 18, as follows:

(i) The provision of food, drink, recreation or hospitality of any kind; or
(ii) The provision of accommodation or travel in connection with facilitating entertainment as in (i) above.

by a person or an employee of his in connection with a business.

Attention should also be paid to two other definitions given in the Public Ruling:

a. "Entertainment related wholly to sales" means entertainment which is directly related to sales provided to customers, dealers and distributors excluding suppliers.

b. "Recreation and Hospitality" would include:
   (i) Trips to theme parks or recreation centres
   (ii) Stays at holiday resorts
   (iii) Tickets to shows or theatres
   (iv) Gifts and give-aways

Regarding "recreation centres", it would be interesting to see how wide an interpretation the IRB adopts. After all, these centres are not limited to Genting Highlands or Sunway Lagoon, institutions providing "recreation" can be found right in the centre of Kuala Lumpur, often throughout the night!

What Public Ruling No. 3/2004 says in essence is that where an entertainment expense is not private or personal [in which case it would not be allowable at all], is indeed incurred wholly and exclusively in the production of income, and does NOT fall within proviso (i) to (vii) of sec 39(1)(l), 50% of such expenses would be deductible. But the best has yet to come! The Ruling goes on to say that on the other hand, if the expenditure DOES coincide with the proviso, a 100% deduction is possible. This provides another perspective to the "Three Allowance Boxes" given earlier.

The question then is, "What is the proviso to sec 39(1)(l)?" Proviso (i) to (vii) can be summarised as follows:

(i) Providing Entertainment to Employees

This includes food, drink, and recreation to employees; however travelling expenses, even though captured in the definition of 'entertainment', would not be allowed. The main objective of the entertainment event would have to be towards giving entertainment to employees. If a few suppliers are also present, the entire expenditure would still be deductible, but if the real purpose is to entertain suppliers and some employees also attend, only 50% of the amount spent can be claimed.

(ii) Entertainment Provided in the Ordinary Course of Business

This refers to situations where the nature of business itself is the provision of entertainment for payment. Nightclubs would fall within this category and it can be extended to include hotels, restaurants, and pubs, and even transport companies. The next time you fly Malaysia Airlines and indulge in their food and drinks, remember that you are assisting them make an appropriate claim for entertainment.

The example that the Public Ruling offers under this heading is that of a car service centre providing refreshments to waiting customers. How about the more common method of taking a client or customer to lunch or dinner? Would entertainment be only allowable if given at the person's business premises? It is hoped that the tax authorities take a more liberal view than that suggested in the public ruling. It would seem that the bulk of common allowable entertainment would fall under proviso (vii).

(iii) Promotional Gifts at Trade Fairs Outside Malaysia

The gifts that would rank for deduction would be samples of the products that the relevant company deals in and also non-related items like souvenirs, bags and travel tickets given to those who visit the company's booth at the fair or exhibition.

(iv) Promotional Samples of Products

Where a person provides promotional samples of the products of his business, the relevant expenditure would be allowable and examples of such samples would include:

a. Complimentary meals or stay given by a restaurant or hotel.
b. Free drinks given to schools and at other functions. This of course brings to mind Milo's iced drinks given to thirsty children on Sports Day!

c. Free samples of the products handled by the business, something commonly encountered in supermarkets where enthusiastic young ladies put snacks in your mouth as you walk by.

It must be noted that such promotions are not restricted to events overseas and can be carried out locally.

(v) **Cultural or Sporting Events Open to the Public**
The crucial condition here is that the event must be open to the public; being open only to members would make the expenditure not deductible.

Examples of such events would be:

a. Events for the promotion of arts, such as music, drama, dance, painting, and sculpture.
b. Sporting events like football, golf, or badminton tournaments and motor racing.

It is possible that participation in some of these events would require the payment of fees. Under such circumstances, the acceptable treatment would be to reduce the entertainment expenses incurred by the entrance fees received.

(vi) **Promotional Gifts with Business Logos**
The gifts being provided under this category should carry a "conspicuous' advertisement or logo of the business and such gifts need not be produced by the company. They should be available to the public at large and not given on an exclusive basis. Thus presenting a favoured personality a Rolex watch with the company's log stuck on by cellophane tape may not be the wisest of moves.

(vii) **Entertainment Related Wholly to Sales**
As mentioned earlier, "entertainment related wholly to sales" refers to entertainment provided to customers, dealers, and distributors. Inexplicably, suppliers are excluded! The Public Ruling lists the various expenses that could be claimed and these include:

a. Food and drinks at a new product launch.
b. Redemption, shopping, meals, gift, or cash vouchers.
c. Free gifts and lucky draw prizes.
d. Incentive trips to dealers for achieving sales targets.
e. Meals and refreshments given to customers.

Sub-paragraph (e) above may capture the kind of entertainment a businessman usually provides to a client. Nevertheless, the comments given in respect of proviso (ii) should be kept in mind.

It must be noted that while "travelling" falls within the ambit of "entertainment", it would wholly be not allowable whatever the circumstances under which it was incurred, as the amendment does not cater to this feature of entertainment. However, this total restriction is only applicable to "travelling within entertainment". Travelling per se for business purposes will be considered separately on its own merits, as would any other expense.

Another issue that must be remembered is that while recognising the fact that giving gifts form an essential part of entertainment within business circles, the public ruling imposes conditions not just on the relationship of the recipient to the business, but also on the nature of the gift itself. The three conditions that deductible gifts would fall into are:

a. Promotional gifts given at trade fairs and exhibitions held overseas.
b. Samples of products manufactured or dealt in by the businessman.
c. Promotional gifts that feature the giver's logo or advertisement.

An example of gifts falling under (c) above would be financial planners and insurance agents giving diaries or calendars carrying either their logo or the relevant company's emblem. From the IRB's guidelines, it appears that "personal" gifts like hampers and bouquets would not qualify. Similarly, a gift of, say, a gold bracelet to a customer who has just had a baby would not qualify.

It would have helped considerably if the Public Ruling focussed on more common instances and gave explicit direct advice, rather than often making implications and leaving the public to draw inferences from the guidelines given. What is the link between the example in proviso (ii) and sub-paragraph (e) to proviso (vii)? Clearer information and examples would have greatly assisted in such simple matters as lunch and dinners to clients and customers. In the face of such ambiguity, the taxpayer may run the risk of forming the wrong interpretation in respect of what is allowable and what is not.

At the end of the day, it is incumbent on the taxpayer to be cautious and make the right decision when making a claim for entertainment expenses. Should he come under audit and the tax authorities discover that he has been making a big song and dance about his entertainment expenditure, the consequences may not be that much fun nor enjoyable!

The above article is reprinted with the permission from the author and the 4E Journal, the official publication of the Financial Planning Association of Malaysia.

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Vincent Josef

Vincent Josef is a former Assistant Director General of the Inland Revenue Board (IRB) and has served in various divisions during his 35 years of services. His responsibilities included Corporate and Business Taxation, Investigation, Civil Suit and Prosecution, and Schedular Tax Deductions. In addition, Vincent Josef has wide experience in lecturing at IRB events and professional institutions. Apart from being a member of the Examination Panel of the Financial Planners Association of Malaysia, Vincent Josef lectures on Malaysian Taxation at various institutions and provides taxation consultancy services.

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Malaysian Institute Of Taxation

REITs: A Tax Perspective

BY EOW SIEW LEE

What are REITs

The latest buzzword in the real property sector is REITs. or those of you who have not caught on, REITs stand for Real Estate Investment Trusts which are essentially vehicles that own and most often actively manage income-generating commercial real estate. A more technical definition is contained in the REITs Guidelines released by the Securities Commission (SC) on 3 January 2005. The Guidelines essentially set out the do's and don'ts of a REIT. It is very comprehensive and includes detailed reporting requirements required of the parties concerned as well as the application procedures.

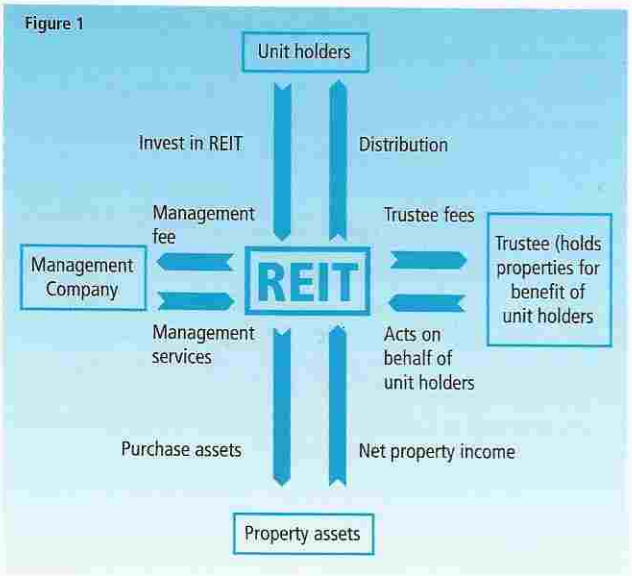
The use of REIT is not new. REITs were created in the 1960's in the USA. Its importance was only recognised when it outperformed most other major markets benchmarks over three decades. In 2001, Standard & Poor added REITs to its major indexes and it has continued to gain popularity.

Hopefully before 2005 is over, Malaysia will have its first REIT debut. This is possible considering that Axis-REIT has received the SC's approval for listing on the Main Board of Bursa Malaysia Securities Bhd. The Axis-REIT is estimated to have an open market value of RM300 million.

What does a REIT structure look like

Mr Kumar Tharmalingam, the former President of the International Real Estate Federation (Fiabci) Malaysian Chapter depicted the structure very comprehensively in one of his articles published in the New Straits Times. The structure is reproduced in Figure 1 for reference.

Figure 1



Let us examine each of the parties involved.

REIT

Based on the Guidelines, the initial minimum size of a REIT is RM100 million. For subsequent funds launched, the minimum size of the fund is RM25 million. A REIT may issue units by any of the following methods:-

An offer for sale;
A restricted offer for sale;
An offer for subscription;
A restricted offer for subscription;
A placement;
A rights issue;
A bonus issue;
A consideration issue for subscription; or
Such other methods as may be accepted by the SC.

Approvals from the SC and trustee are required for issuance of new units or subsequent issues.

A REIT may invest in any of the following:-

Real estate;
Single-purpose companies (i.e. unlisted companies whose principal assets comprise of real estate);
Real estate-related assets;
Liquid assets
Non-real estate-related assets; and
Asset-backed securities

According to the Guidelines, a listed REIT must invest at least 75% of its total assets in real estate, single-purpose companies, real estate-related assets or liquid assets of which at least 50% must be invested in real estate or single-purpose companies. For an unlisted REIT, at least 70% of its total assets must be invested in real estate, single-purpose companies or real estate-related assets.

The term "real estate" above includes registered leasehold property. Subject to the approval of the SC, a listed REIT may also acquire real estate located outside Malaysia.

REITs are allowed to borrow to acquire real estate and single-purpose companies, subject to the approval of the trustee and SC. The total borrowings of the fund shall not exceed 35% of the total asset value of the fund at the time the borrowings are incurred. As can be seen, it is a highly regulated market.

The Ministry of Finance, in the 2005 Budget, proposed tax incentives to make investments in REITs more attractive. These

proposals have subsequently been gazetted under the Finance Act 2004 (Act 639) on 30 December 2004.

Under the new sec 61A of the *Income Tax Act 1967* (the Act), the total income of the unit trust (defined to mean an approved REIT or Property Trust Fund) which is equivalent to the amount of income distributed to the unit holder (in the same basis period) shall be exempt from tax. This "income distributed to the unit holders" shall be ascertained by reference to the unit holder's share of that income. This would then mean that the *undistributed* income of the REIT would be taxable.

In arriving at the adjusted income, all expenses deductible pursuant to sec 33(1) will be allowed. In a post-budget dialogue on 20 October 2004, the Inland Revenue Board (IRB) clarified that the provisions of sec 34 of the Act will also be relevant to a REIT. Notwithstanding that the IRB, as a concession, treats the rental income received by the REIT as a business source [sec 63C(2)], any excess of the deductions over the income from that source will be disregarded. Where that source does not produce any income, the expenditure incurred in relation to that source is lost. As such, losses, if any, would not be allowed to be carried forward. This seems ironic considering that the rental income is treated as a business source.

Similarly with unit trusts, capital allowances are claimable by the REITs on any qualifying capital expenditure used in the business against its respective sources of income. Again, another "disadvantage" is that unabsorbed capital allowances are not allowed to be carried forward.

It should be noted that sec 63A and 63B do not apply to a REIT.

Management Company

The management company manages and administers the REIT according to the trust deed setting up the fund. To ensure credibility, the management company has to be approved by the SC. The SC, in its Guidelines has set out the eligibility criteria of a management company.

Some of the criteria are listed below:

Firstly, the management company must be a subsidiary of a company involved in the financial services industry in Malaysia, a property development company, a property-investment holding company or any other institution which the SC may permit. The Bumiputera equity must not be less than 30% on an effective basis and where there is foreign equity participation, it must not exceed 49% on an effective basis.

The management company must also maintain at all times a minimum shareholders' funds of RM1 million.

The management company may only engage in the following activities unless otherwise approved by the SC:-

- The business of managing investment portfolio and administering unit trust funds;
- The business of marketing and distributing unit trust funds;
- The business of providing investment advisory services; and
- The activities allowed for a universal broker (where the management company is a universal broker).

The shareholders, directors, chief executive officer and key personnel must be persons of integrity and accountability. They must also possess the relevant qualifications, expertise and experience in real estate management and investment.

According to the Guidelines, the management company has the discretion in the pricing of all units issued, except where units are issued to related parties. However, it is expected that the units be priced using market-based principles and at a price which is in the best interest of the fund and the unit holders.

The management company should consider the implication of the Second Schedule of the *Service Tax Regulations 1975* which requires a 5% service tax to be levied on management services once total annual sales turnover of more than RM150,000 is reached.

Trustee

Another party to the structure is the trustee. The trustee acts as a custodian of the trust's assets and safeguards the interests of the unit holders in return for a fee. It must ensure that the management company keeps proper accounting records. The terms and conditions between the parties will be documented in a deed of trust.

Who can be the trustee? The approved trustee must be independent from the fund and shall not hold shares in the management company. The trustee must have a minimum issued and paid-up capital of not less than RM500,000 and employ personnel with the necessary qualifications, experience and expertise.

The trustee fees received shall be taxable in the hands of the trustee.

Unit holders

It goes without saying that investors must exercise their discretion when they invest. In the Guidelines, the SC has set out comprehensive requirements for the merchant bankers or submitting party to comply with when the applications are submitted to SC for approval.

What would be of interest to unit holders is whether the income received from investing in a REIT is taxable in their hands. Unfortunately, the income received from the exempt distributed income of the REIT is still taxable in the hands of the unit holders. Resident unit holders will be taxed at their respective tax brackets whilst for non-residents, tax at 28% will be withheld by the REIT pursuant to sec 109D. The REIT will then pay the amount withheld to the IRB within one month after distributing such income. Where the REIT fails to pay within the stipulated time frame, a penalty of 10% will be imposed and considered a debt due to the Government.

How about the undistributed income of the REIT which is subsequently distributed to unit holders? The accumulated income that has been taxed and subsequently distributed is eligible for tax credit under sec 110 in the hands of the unit holders [sec 109D(4)]. This would be similar to the treatment for receiving taxable dividends from shares.

Transfer of Property Assets to REITs

Another perk is the real property gains tax (RPGT) exemption. Generally, RPGT is applicable on any chargeable gain arising from the disposal of chargeable assets. Therefore, to provide a boost to the use of REITs and encourage a fluid flow of assets, the disposer, who would otherwise be subject to RPGT, is exempted from payment of RPGT on any chargeable gains accruing on the disposal of any chargeable assets to a REIT approved by the SC. This exemption is provided for under the *Real Property Gains Tax (Exemption) (No.4) Order 2003* and is effective from 13 September 2003.

The *Stamp Duty (Exemption) (No.4) Order 2004* provides that all instruments of transfer of real property to a REIT or a property trust fund approved by the SC are exempted from stamp duty. This will reduce the cost of acquisition to the trustee.

Administrative Procedures

Based on the legislation, the tax incentives seem fairly straightforward. However, pending the issuance of the eagerly awaited IRB's guidelines, the administrative procedures seem overwhelming. The REIT is required to inform the IRB on the distributions to each resident unit holder for each year of assessment. Therefore, it looks like the investors will have to declare their tax residence status when investing. How about the maintenance of the REIT's funds – can it be a mixed pool or should the distributed and undistributed income be kept in separate pools?

Future REITs

A major conglomerate, the Sunway City Bhd Group is considering the setting up of a REIT. With high-yielding properties in the Klang Valley like the Sunway Pyramid Shopping Mall, Sunway Lagoon Resort Hotel (currently in an asset-backed securities vehicle) and Sunway Resort Hotel-Pyramid Tower, the Sunway REIT looks very promising. Once the Sunway Pyramid 2 (due for completion in 2007) and Monash University Campus costing RM500 million and RM165 million respectively are completed, this will add further to the "basket" to promote higher returns for the unit holder.

CIMB Real Estate Sdn Bhd, a wholly owned subsidiary of CIMB Bhd together with Mapletree Capital Management Pte Ltd, a wholly owned subsidiary of Mapletree Investments Pte Ltd, have recently teamed up to form CIMB-Mapletree Management Bhd which will be involved, inter alia in the business of a management company for REITs and property trust funds. Other possible players have been reported to include YTL Corporation Bhd with properties like Starhill, Lot 10, JW Marriot and Ritz-Carlton and not forgetting Malayan Banking Bhd with Capital Land Singapore.

CONCLUSION

It is hoped that the robustness of the property sector will be revived following the introduction of the tax incentives for REITs. It is a good opportunity for real estate owners to use the REIT to unlock their investment. There are plenty of tax planning opportunities and I am sure tax consultants have wasted no time in putting pen to paper. This is just the beginning of REITs in Malaysia and it would be interesting to see if there will be more goodies on the table come the 2006 Budget later this year!

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9.00 a.m. - 5.00 p.m

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- FRS 138 - Intangible Assets
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- FRS 116 - Property, Plant and Equipment
- FRS 117 - Leases
- FRS 136 - Impairment of Assets
- FRS 101 - Presentation of Financial Statements
- FRS 108 - Accounting Policies, Changes in Accounting Estimates and Errors
- FRS 110 - Events After the Balance Sheet Date
- FRS 124 - Related Party Disclosure

Day 2

NEW STANDARDS

- FRS 1 - First-time Adoption of Financial Reporting Standards
- FRS 2 - Share-based Payment
- FRS 3 - Business Combinations
- FRS 139 - Financial Instruments: Recognition & Measurement

UPDATED STANDARDS

- FRS 133 - Earnings per Share
- FRS 121 - The Effects of Changes in Foreign Exchange Rates
- FRS 127 - Consolidated Financial Statements and Investments in Subsidiaries
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ABOUT THE WORKSHOP LEADER

Danny Tan is currently a Partner of a firm providing financial training and consulting for firms in public practice and industry. He has over 20 years of experience in public practice, as well as in commerce and industry. He is a regular speaker in financial reporting, auditing and corporate financial management for several professional institutions and government departments. He lectures extensively for various universities both at home and abroad including Universiti Sains Malaysia, University Abertey Dundee, UK and Heriot-Watt University, UK. At present, he is serving as a Project Manager for the Malaysian Accounting Standard Board.

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VENUE : **The Ritz - Carlton Hotel, K. L.**

EARLY BIRD FEE by 8 June 2005	
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RECEIPTS – REVENUE OR CAPITAL (Part II)

BY SIVA NAIR

In this issue we shall continue with the discussion on how to determine whether a receipt is revenue or capital. To echo the words of Lord MacDermott in *Ferguson (Harry) (Motors) Ltd v CIR [33 TC 15]*

> *"There is so far as we are aware no single infallible test for settling the vexed question whether a receipt is income or capital nature. Each case must depend upon its particular facts... one has to look to all relevant circumstances"*

In this discussion we shall use the affairs of one Mr Revecap, an Englishman who has been a freelance accounting lecturer teaching at various colleges and universities. He has been conducting his profession under the banner of Revecap and Co in Malaysia for the past 10 years. Having received all kinds of receipts and compensations for the year ended 31 December 2004, he has come to you for tax advice to determine which of the receipts are taxable since under the self assessment system he is required to compute his own tax payable to enable the submission of his Form B by 30 June 2005.

SALE OF FIXED ASSETS

Example 1

Mr Revecap had sold his car for a profit of RM 5,300.
The gains would not be taxable since it would be capital gains.

We had discussed in the last article that generally, profits arising from the sale of fixed assets would constitute a capital gain. However we had also established that profit arising from the use of fixed assets would be revenue gains and therefore, taxable.

Example 2

Mr Revecap also buys manuals in bulk from the publishers in the UK and sells individual copies to students thus making a profit on the sale.
The profits would be taxable since they constitute revenue gains.

The issue gets a bit more complicated in the case of communication of specialised information, sale of secret processes and transfer of technical know-how, but the general rule would still apply ie gains arising from an outright disposal (where there is a loss of the asset), will be a capital gain and not subject to tax, as shown below.

Example 3

Mr. Revecap argues that his knowledge of accounting is of course his fixed asset and therefore, the fees that he receives from the educational institutions that he lectures at are capital receipts and in consequence, NOT taxable!!!!

Let's look at some cases relating to the disposal of fixed assets.

MORIARTY V EVANS MEDICAL SUPPLIES [(1957) 3 ALL ER 718]

Facts of the Case

The taxpayers manufactured pharmaceutical products partly through a Burmese agency. The Burmese government had decided to establish its own pharmaceutical industry; therefore, with the prospect of competition from the government imminent, the taxpayer supplied the Burmese Government with secret information about their products and other information in consideration for the payment of "a capital sum of £100,000."

Judgment:

The House of Lords held that this was a capital receipt. Viscount Simonds remarked that "by imparting the secret to another, its owner does something which could not fairly be described as rendering service." The whole of the knowledge was given away once and for all and no part of it was retained therefore, "...the company has parted with its property for a purchase price."

Lord Reid in *Musker v English Electric Co Ltd* commented on this case:

> *..."know-how " is imparted as one element of a comprehensive arrangement by virtue of which a trader effectively gives up his business in a particular area, the monies paid for the "know-how", whether or not independently qualified, may properly rank as capital receipt.*

This is also the case in WOLF ELECTRIC TOOLS LTD v WILSON [45 TC 326].

Facts of the Case

The taxpayers carried on business as electrical and mechanical engineers. 10% of their export sales was to India through an agency. When the Indian government started to encourage the setting up of local factories for making tools, the taxpayers decided to incorporate a company in India for fear of losing the Indian export market. Approval was obtained on condition that the local agent held a majority shareholding. The taxpayers received shares as consideration for the supply of drawings, design, technical knowledge etc.

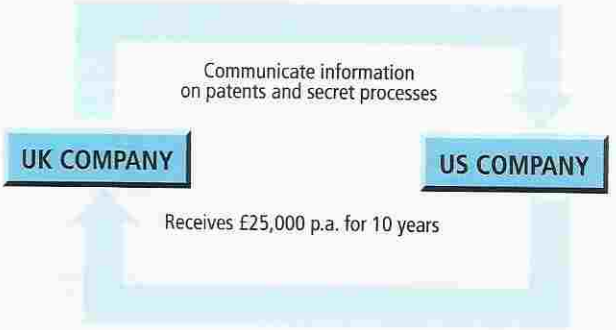
Judgment:

The judge viewed the transaction as a loss of part of a capital asset because it "was simply to alter the company's profit-making structure... instead of having its own goodwill in India as regards the selected tools, the company acquired a 45% interest in the new company and hence derived its profits through those shares."

However, sometimes profit may be generated from the "sale of an asset" but the asset is still intact and can be exploited further to generate income

BRITISH DYESTUFFS CORPORATION (BLACKLEY) LTD V CIR [12 TC 586]

Facts of the Case



Revenue's argument: It was an income receipt received in the course of trade
Taxpayer's argument: A fixed capital asset had been sold for capital sum payable in 10 instalments

Judgment:

The question raised was :
Is the transaction in substance a parting by the company with part of its property for a purchase price or is it a method of trading by which it acquires this particular sum of money as part of its profits and gains of trade? It was answered in the favour of the Revenue.

It was stated that the company was using the property to generate an annual return "roughly corresponding probably to its average life and not a sale once and for all of a capital asset."

ROLLS-ROYCE LTD v JEFFEREY [(1962) 1 ALL ER 801]

Facts of the Case

Rolls Royce over a period of years had entered into several agreements with foreign governments and companies to divulge its know-how and to licence the other parties to manufacture aero engines in return for capital sum and royalties. This was because the countries were unwilling to buy the aero engines from the company, as they have been doing in the past, but instead wished to manufacture the engines themselves. Was the capital sum really "capital"?

Judgment:

The House of Lords held that the sums received were taxable as trading receipts. The company was **NOT** disposing of a capital asset, but was exploiting its "know-how". Viscount Simonds said he fully agreed with the Court of Appeal that the company was pursuing a deliberate and continuous policy of disseminating technical knowledge and lost no capital asset or market for its products.

Another point raised was that the granting of the licences was a mere extension of their current trade of selling the engines.

Since they could not sell their engines, it was another method of deriving profit from the use of its technical knowledge, experience and ability by imparting them to others.

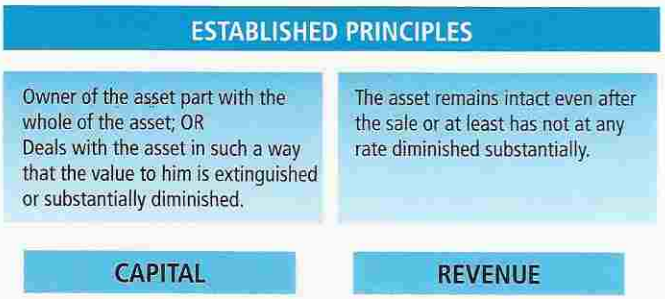
MUSKER V ENGLISH ELECTRIC CO LTD [(1964) 41 TC 556]

Facts of the Case

A company carrying on the trade of engineering manufacturers entered into an agreement to design and develop a marine turbine and licensed its manufacture by other companies in the UK, Australia and Canada for a consideration.

Judgment:

The House of Lords held that the consideration was an income receipt. There was no loss of a market or a capital asset but a mere exploitation of a manufacturing technique.



Therefore, although when Mr Revecap lectures, he is imparting his accounting knowledge (his fixed asset) to his students; there is no diminution in his reservoir of technical knowledge. He does not "cut the knowledge" from his brain and offer it in a platter to the students. He is not losing an asset but merely utilising the knowledge to generate income. He would probably be using the knowledge to teach other students in the future. Therefore the fees he receives will be a revenue receipt and subject to income tax.

PAYMENTS RECEIVED FOR THE DESTRUCTION OF THE PROFIT - MAKING APPARATUS OF THE RECIPIENT

Example 4

Mr Revecap had a difference in opinion with the management of one of the colleges and when all attempts at arbitration and reconciliation proved to be futile, his contract was terminated but he was compensated handsomely. Mr Revecap has lost a source of income. Has his "profit - making apparatus" been crippled? Is the compensation taxable?

We will review principles established in tax cases to decide what constitutes destruction of one's profit - making apparatus.

VAN DEN BERGH LTD V CLARK [(1935) AC 431]

Facts of the Case

The taxpayer had entered into a series of agreements with a Dutch company, both companies being involved in the business of manufacturing and dealing in margarine. The marriage did not last as disputes arose– and arbitration became protracted. A settlement was reached when the Dutch company paid a sum of £450,000 to the taxpayer as compensation for premature (13 years) termination of the contractual relationship.

Judgment:

The House of Lords held that the sums received were capital receipts. The reasons being:

- The agreements were not ordinary commercial contracts made in the course of carrying on their trade such as for the disposal of products or engagement of agents or employees. They had a further 13 years to run.
- The cancelled agreements related to the whole structure of the appellant's profit-making apparatus; regulated their activities, defined what they might or might not do and affected the whole conduct of their business.
- The agreements formed part of the fixed framework within which the company's circulating capital operated; they were not incidental to the working of their profit-making machine but were essential parts of the mechanism itself. They provided the means of making profits, but they themselves did not yield profits.

A similar situation arose in SABINE V LOOKERS LTD [(1958) 38 TC 120] as detailed below:

Facts of the Case

The company was the main distributor for Austin Motor Co Ltd and was not allowed to act as distributor for other manufacturers. A material variation affecting the "continuity clause" of the agreement was made and compensation was paid to the company. The taxpayer argued that the compensation was for a variation that gave them less security and affected their profit - making structure.

Judgment:

The Court of Appeal held that the compensation was a capital receipt since the variations were of a material character and the whole agreement related to the framework of the company. Obviously, since they could not act as distributor for other manufacturers, the whole business entity is crippled. They had lost their ONLY source of income.

CALIFORNIAN OIL PRODUCTS LTD (IN LIQ.) V FC of T [(1934) 52 CLR 28]

Facts of the Case

The taxpayer had been appointed as the exclusive distributor and agent in a particular area for an overseas oil company's products. The agreement was to run for five years and the agency was the taxpayer's ONLY business. When the agreement was cancelled, the taxpayer's whole business ceased and it went into liquidation. They received compensation which was paid in 10 half-yearly instalments.

Judgment:
The sums received were held to be capital receipts because the cancellation of the contract resulted directly in the termination of the taxpayer's business.

Similarly in **BARR CROMBIE & CO LTD V CIR [26 TC 406]**

Facts of the Case
The taxpayer's business consists almost entirely of managing the vessels of a particular shipping company under a 15-year agreement from which it derives around 97% of its operating income. The shipping company went into liquidation and the contract was terminated after eight years.

Judgment:
The court held that the sums received were capital receipts as it was for the loss of the company's only major asset and it seriously affected the structure of the organisation. The judge stated:

> *"When the agreement was surrendered or abandoned practically nothing remained of the company's business. It was forced to reduce its staff and to transfer into other premises and it really started a new trading life."*

The scenario was almost identical in **CHIBBETT V JOSEPH ROBINSON & SON [9 TC 48].**

Facts of the Case
Almost the whole income of the taxpayer arose from the management of the business of a steamship company. Unfortunately the company went into liquidation and paid compensation to the taxpayer for the loss of business.

Judgment:
The compensation was held to be capital.

So far we have seen the "good news" ie compensations are not taxable but before we start shouting with ecstatic rapture, there are cases which have shown that certain compensations received can be revenue receipts and are TAXABLE!!!

CIR V FLEMING & CO (MACHINERY) LTD [(1961) 33 TC 57]
Facts of the Case
One of the taxpayer's nine agencies was terminated and the taxpayer was duly compensated. The revenue from the terminated agency was between 30% and 45% of the taxpayer's total profits.

Judgment:
The House of Lords characterised the cancellation of an agency and the receipt of the consequential lump sum compensation as simply a normal trading risk in that type of business and therefore, was assessable as income.

Same story in **KELSALL PARSONS & CO v CIR [21 TC 608].**

Facts of the Case
The taxpayer had many agency agreements. One lucrative three-year agency was terminated and the taxpayer was paid compensation.

Judgment:
The compensation was held to be income in nature. Why?

- It was incidental to the normal course of business.
- The business was to obtain as many contracts of this kind as they could.
- They were NOT acting as an exclusive agent for a single principal.
- It is normal incident of business that the contracts may be modified, altered or discharged from time to time.
- The appellant were NOT parting with "an enduring asset" of the business.

From New Zealand we have **K R GREENSLADE LTD v CIR [(1986) 8 NZTC 5197].**

Facts of the Case
The taxpayer had a supply contract with a brewery for various goods. The brewer wishing to be released from the contract, cancelled the contract and compensated the taxpayer.

Judgment:
It was held that since the sales to the brewer contributed only about 20% of the taxpayer's gross income, they represented compensation for loss of profits and were therefore taxable.

In **SHORT BROS LTD v CIR [12 TC 955]:**

Facts of the Case
The taxpayer, a company of shipbuilders was paid compensation for the cancellation of a contract for the construction of a ship.

Judgment:
The sum was held to be trading receipts having been received in the ordinary course of business in connection with a trading contract. It was NOT in any material sense

- compensation for not being allowed to make their profits;
- received in respect of the termination of any part of their business; nor
- received in respect of any capital assets.

However, in **BUSH, BEACH AND GENT LTD V ROAD [22 TC 519]:**

Facts of the Case
The taxpayer, who normally deals with industrial chemicals, entered into a single five-year contract to purchase and sell agricultural chemicals. Compensation was received when the contract was cancelled after two years.

Judgment:
The sum was held to be trading receipts ie the profits that the company would or might have made under the contract and not the purchase price of the contract itself. The court did not accept the argument that the structure of the appellant company was affected and although there was only one contract the court distinguished it from cases such as Van Den Bergh because it considered the taxpayer to be carrying on the business of chemical merchants.

An interesting twist of events took place in CIR V GEORGE THOMPSON & CO LTD [12 TC 1091].

Facts of the Case

The taxpayer, shipowners, entered into contracts for the supply of coal. Unfortunately, some of their ships were requisitioned by the Australian Government, thus the coal contracted for was in excess of requirements. The benefit of the contracts was transferred to another company at an increased price resulting in a profit for the taxpayer but they retained the right to recall coal under the contracts if their own requirements made it necessary.

Judgment:

The courts held that the profits represented income of the trade and therefore, were taxable. The reasons being "this is simply a case of a person who is bound to buy a certain amount of consumable stores, who overbuys and is lucky enough to dispose of those consumable stores which he got in the way of his business in relief of his business, at a profit." The taxpayer did not sell the contracts as the taxpayer could in fact still take delivery if it is found that they needed the coal.

ESTABLISHED PRINCIPLES

CAPITAL	REVENUE
• Cancellation of contract necessarily results in the termination of the recipient's business	• It is incidental to the recipient's business that contracts are cancelled from time to time
• The taxpayer has made special arrangements and incurred considerable expenditure solely for that particular cancelled contract	• It is in the ordinary course of business-one of the many conracts
• The cancellation forces the taxpayer to reduce activities, retrench employees, close branches etc	• The business survives the cancellation ie the profit making structure is not destroyed instead the structure of the business is organised so as to absorb the shock of the cancellation
• The taxpayer is seriously restricted in its business activities	• It is not the loss of an enduring asset
• A very long unexpired term remaining of the cancelled contract	• Compensation is a mere replacement for the future profits surrended

So, now that we have reviewed the relevant cases and ascertained the pertinent principles established in these cases, what advice would we give Mr. Revecap? (remember all this started with his query as per example 4)

We probably have to scrutinise the facts of the case. Assuming that the termination does not affect his lecturing at the other educational institutions, his profit - making apparatus is not destroyed. He can still lecture at another college. Therefore, the compensation would constitute a present value of loss of future earnings if he had not been prematurely terminated from that particular college and would be taxable.

However, if the termination was so serious that he would automatically be relieved of his lecturing position at all the educational institutions and he is barred from lecturing anywhere in Malaysia, then his whole income generating mechanism would have been crippled, at least in Malaysia and therefore, the compensation would be a capital receipt not subject to income tax.

This issue is frequently visited by MIT examiners as shown in the questions below

MIT TAX IV DEC 1995 Q2 reads

Compensation received from the cancellation of contracts is assessable to income tax depending on whether the cancellation of the contract affects the profit - making structure of the recipient and involves loss by him of an enduring trading asset.

Required:

Discuss the validity of this statement by reference to decided cases.

The examiner explains that the general rule is that compensation received from the cancellation of a business contract will be treated as a capital receipt where the cancellation radically affects the framework and structure of the profit - making apparatus of the business. On the other hand, compensation received on cancellation of ordinary trading contracts will be taxed as trading income.

Factors discussed in the model answer include:

1 **Compensation payment received on cancellation of a contract which results in the termination of the recipient's business will usually be capital receipt.**

California Oil Products Ltd (in Liquidation) vs Federal Commissioner of Taxation [52 CIR 28]

2 **Cancellation of a contract which does not lead to closing down of the business but nevertheless affected adversely the whole structure of the recipient's profit - making apparatus of the business will be treated as a capital receipt.**

Sabine v Lookers Ltd [38 TC 120]

3 **The longer the unexpired term of the contract when it was cancelled, the more likely the compensation payment is treated as a capital receipt.**

Van Den Bergh Ltd v Clark [19 TC 390]

4 **Compensation received for cancellation of ordinary trading contracts is normally treated as trading receipt, particularly where it is one of the many existing contracts of a similar nature.**

Short Brothers v IRC [12 TC 955]

5 **Compensation received for cancellation of agency contract is generally taxable as trading receipt unless the termination practically causes the business to close down or the agency contract cancelled substantially affects the gross revenue of the business.**

Kelsall Parsons & Co v CIR [21 TC 608];
CIR v Fleming [33 TC 57;
Bush, Beach and Gent Ltd v Road [22 TC 519];
Barr Crombie & Co Ltd v CIR [21 TC 608];
Wisebugh v Domville; and
Fleming v Bellow Masline Co Ltd [42 TC 308].

Another related question is in MIT TAX IV DEC 2002 Q3.

Compensation payment received on the cancellation of a (business) contract would be a revenue receipt subject to (income) tax where the damages recovered are meant "to fill a hole in the profits" whereas it would be a capital receipt not subject to tax if the cancellation of contract affects the "whole structure of the taxpayer's profit - making apparatus".

Required:

Discuss the above statement by reference to decided cases and the relevant provisions of the ITA. Illustrate your answers by considering the principles laid down in decided cases in determining whether the compensation payment received on the cancellation of a contract constitute a revenue receipt which is subject to tax or capital receipt which is not taxable.

The examiner has indicated that candidates should consider the following provisions of the *Income Tax Act 1967*:-

- Compensation received for loss of income from that source is to be treated as gross income under sec 22(2)(b).
- The compensation received will be subject to tax under sec 4 (a) as gains/profits from business.
- Compensation from cancellation of contract to be treated as gross income under sec 22(2) and accordingly assessed to tax as gains or profits under sec 4(a) must be revenue in nature.
- Compensation received of capital nature is not subject to tax.

To determine whether compensation received is revenue or capital in nature, candidates are required to review the relevant case law authorities. In this regard, candidates should briefly consider the facts and more importantly, the principles applied in some of the cases, some of which are stated below, in determining whether the compensation constitute a revenue receipt or capital receipt.

The following principles laid down in decided cases to determine whether compensation received from cancellation of contract is revenue or capital receipt should be mentioned.

1. Cancellation of contract which results in termination of recipient's business will be a capital receipt. (*California Oil Products Ltd (in liquidation) v Federal Commissioner of Taxation 52 CIR 28.*)

2. Cancellation of contract which does not lead to the closing down of business but nevertheless affected adversely the whole structure of the recipient's profit - making apparatus will be capital in nature (*Sabina v. Lookers Ltd 38 TC 120*). For instance in *Barr Crombie & Co Ltd v CIR 26 TC 406*, the termination of the management service agreement which constitute 98% of the recipient's income was held to be capital since the recipient was compelled to substantially reduce its activities, cut staff and move to smaller premises.

3. The longer the unexpired term of the contract when it was cancelled, the more likely the compensation is treated as a capital receipt. For instance in *Van Den Bergh Ltd v Clark 19 TC 390*, the compensation was held to be capital in nature since the contract had 13 years to run.

4. Compensation received for cancellation of agency contract is generally taxable as trading receipt, particularly where the agency agreement cancelled is one of the many agencies contract of the recipient. The reason for this being the loss of the single agency did not fundamentally affect the business structure of the recipient.

5. However, where the cancelled agency contract contributed substantially to the income and had substantial period to run, the compensation may be capital in nature. (*Barr Crombie & Co. Ltd v. CIR 26 TC 406.*)

6. Compensation received from the cancellation of trading contract is taxable trading receipt. In *Short Bros Ltd v CIR 12 TC 955*, compensation received by the shipbuilding company from contract to build ship was cancelled at the request of the customer was held to be trading receipt received from cancellation of trading contract in the ordinary course of the recipient's business.

The examiner has also indicated that candidates may also quote other decided cases to support their answer.

In the next article, we will continue with this discussion of capital versus revenue receipt.

FURTHER READING

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Malaysian Master Tax Guide 2005, CCH Asia Pte. Ltd

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Thornton, Richard; Thorntons Malaysian Tax Commentaries, *Sweet & Maxwell, Asia.*

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

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Siva Nair

holds an Honours Degree in Accounting and a MBA (Accountancy)from University of Malaya. He is a Chartered Accountant (Malaysia) and a fellow of the Malaysian Institute of Taxation. He has gained extensive experience in the field of taxation whilst being employed in one of the big five firms and again as a Senior Finance and Tax Executive in an established property development company. Currently he is a freelance lecturer preparing students for the examination of ACCA, ICSA, MIT, AIA and also tutoring undergraduates undertaking Accountancy Degree programmes in both local and foreign universities.

THE SMUGGLING OF GOODS

PROVING TO BE A LUCRATIVE TRADE?

BY THOMAS SELVA DOSS

Smuggling is a form of defiance that has received relatively little attention from criminologists. It can be defined as the clandestine importation of goods from one jurisdiction to another. This can involve the importation or exportation of prohibited goods eg drugs, or the evasion of customs duties on legal goods that are liable to duty. Price disparities and differential customs duties between jurisdictions or across different periods in time determine the likelihood of smuggling. Most typically, smuggling occurs between the jurisdictions of different national states. Revenue laws and customs duties are precisely proclaimed to protect the economic strength of states. Hence smuggling goes hand in hand with taxation systems and can be observed to take place wherever revenue duties are imposed. Among the classic examples of smuggled goods are highly taxed products such as tobacco and liquor. Basically, smuggling can be classified into two categories – commercial smuggling and petty smuggling. Commercial smuggling involves the transportation of large quantities to be sold for profit. Petty smuggling applies to individual people crossing a border to purchase goods at a cheaper price.

In Malaysia, prevention of smuggling is the main responsibility of the Royal Customs, the Federal Government Department charged with the control of import and export of goods. At present, smuggling in Malaysia is regulated under the *Customs Act 1967* and *Customs Regulations 1977*. Smuggling here has undergone considerable transformation during the last few decades. From petty smuggling of goods across the Thai border into Malaysia in the 1960s, smuggling is much more sophisticated now with the existence of well organised syndicates with elaborate networks and equipment. High level funding, often from foreign sources, greatly accelerate the process. On 28th October 2004, the STAR reported that smuggling at the Malaysian-Thai border has evolved with time to become a sophisticated venture. Gone are the days of the 'tentera semut' where groups of Thai border residents trailed into the country through gaps in security fences, lugging sacks of rice, glutinous rice and other essential items without paying taxes. The Perlis Customs Director who was interviewed said border authorities were now geared towards stopping big time smugglers, as petty smuggling had become less of a threat. He also said the new breed of smugglers with regional networking were resorting to fraud, bribery and other tactics to get goods across the border. Items are smuggled using containers together with other declared goods to evade Customs checks. Smugglers know that with trade liberalisation, cargo movement has grown so rapidly that it is impossible to check every single shipment coming and leaving the checkpoint, he said. With the open border policy to facilitate growing trade between Thailand and Malaysia, cargo clearance has to be smooth to avoid disruption in trade.

But smuggling activities at the Malaysian-Thai border is not a *one-way traffic from South Thailand into Malaysia. On the 28th* October 2004, the STAR reported, that lately a new trend has emerged where Malaysian products are being smuggled across the border to Thailand. In disclosing this, Perlis Anti-smuggling Unit Acting Commander stated that statistics showed a decline in rice smuggling cases from Thailand this year, compared to 2003. However, there is a dramatic increase in the number of cases including VCDs, DVDs, fish products and diesel being smuggled into Thailand. Malaysia, the commander said, is now a top nation for producing pirated VCDs and DVDs. With the government's clampdown on piracy, peddlers had turned to Southern Thailand where there was a high demand for the discs. Smuggling of diesel across the border had also become more rampant in recent years due to the higher fuel prices in Thailand. The commander also said that the Thais also seemed to prefer processed food from Malaysia which was cheaper and of a higher quality. Cooking oil packs, flour, biscuits and noodles are constantly being ferried in sacks across to Thailand by petty smugglers. A Thai plantation worker who was interviewed said that he had a full-time job but relied on petty smuggling for extra income.

Further down south, goods such as alcohol, tobacco products, and textiles are often smuggled in from a neighbouring country. Alcohol and tobacco attract high rates of import duty, sales tax and excise duty. The long coastline in the west lined with thick mangrove swamps provides excellent hiding places for smuggled goods. Well-organized syndicates, often with help from locals, know exactly when and where to land their goods without being detected. Such activities normally take place in the wee hours of the morning when there is little or no light. Mangrove flats have numerous well-camouflaged nooks and crevices where goods can be concealed effectively. Once deposited, it is practically impossible for the authorities to detect the contraband which is packed in waterproof containers which are of the same colour as the mangrove mud. Even though regular patrols are conducted by the Marine police and Customs, lack of patrol boats by both parties often hinder effective enforcement. Moreover, these syndicates are well versed with the routes these authorities take and they know exactly when to strike.

On 1st April 2005, a Customs team made a massive haul of smuggled cigarettes and fireworks at a factory in Shah Alam which was only guarded by dogs. The raiding team broke open the lock of the factory's shutter door at 12.30 p.m. and found 1,701 boxes of smuggled cigarettes and 1,825 boxes of fireworks worth more than RM600,000 stacked inside. Duty for both items was estimated to be about RM4.5 million. The Deputy Directory-General of Customs, of the Preventive Division stated that the cigarettes bore the name of a popular brand and were believed to be imitations. The cigarette boxes also carried the tax stamp of a neighbouring country. This is believed to be a counterfeit stamp used to dupe buyers in the rural areas into believing the cigarettes came in through the proper channels. The most common brands smuggled into Malaysia are Gudang Garam Surya, Gudang Garam Kretek, Gudang Garam Signature, Gudang Garam International, Dji Sam Soe, Ardath, Marlboro and Dunhill.

The Malaysian Customs, in a new move to combat the smuggling of cigarettes issued a new ruling on 1st August 2004 which stated that smokers of smuggled cigarettes would be fined RM100 per box for evading tax. They will be fined RM2,000 for a second offence. Those found committing the offence for a third time could be fined and jailed up to three years.

The Director-General of Customs told reporters that Customs officers would go to public places, shops, food and entertainment outlets and five-foot ways to check on smokers of locally produced cigarettes, packed in boxes without the security ink. He also said that Customs officers would be equipped with a special hand-held device to read the security ink on the cigarette boxes. The detectors were handy and efficient, as they only required the officers several seconds to verify the nature of the cigarettes.

The sea unit of the Preventive Division is equipped with a number of efficient patrol boats including speedboats. Last year, four new high-powered boats were added to the taskforce costing a total of RM162 million (STAR 7 May 2004). Besides being fast and silent, the boats were also equipped with multi-purpose machine guns and would act as mother boats for other patrol vessels during operations. Each boat will have seven or eight officers at the time and they will be fully trained in various skills including unarmed combat and survival at sea. Most of these boats will be stationed along the Straits of Malacca.

One often wonders whether the high duties and taxes are the main reason why the smuggling of cigarettes and liquor is so lucrative. While the tobacco industry claims that high taxes cause smuggling and the logical solution is to reduce duties and taxes, international studies have shown that the reasons for cigarette smuggling are more complex than price differentials. A World Bank report stated that the magnitude of smuggling is more closely related to organised syndicates and the existence of informal distribution networks. The lure of making a quick buck often attracts new entrants to this trade. According to local newspaper reports, these 'agents' can make about RM100,000 a week selling these items to sundry shops, wayside traders and entertainment outlets.

Big amount of cigarettes are also smuggled into Sabah and Sarawak which are conducive places for the entry of contraband cigarettes as these places are frequented by foreigners. But what is most mind boggling is the manner in which these illegal cigarettes mostly Dunhill, Marlboro, Salem, Perillys and kretek are being openly sold. Checks by a local newspaper showed imported brands such as Marco Polo, Kennedy, Rave, Premium International and Limos are readily available and sold for between RM1.60 and RM2.00. The common brands sold here by peddlers, mostly Filipinos are smuggled Dunhill and Kretek such as Gudang Garam, Sampoerna A and LA. The tobacco industry says it is impossible for these imported cigarettes to be sold at such low prices based on the prevailing import duties.

Other than cigarettes and liquor, the smuggling of drugs has also become a rising trend. On the 1st of October 2004, the Customs Department foiled attempts by four persons to smuggle in RM2.7 million worth of ecstacy and eramin pills at the K.L. International Airport after it recently decided to randomly check passengers using the green lane. The attempted smuggling came to light after a Taiwanese woman was found to have 9,750 ecstacy pills stashed under a false bottom of her baggage. The Customs Director-General said that after questioning, " she told us to expect a few more deliveries." He also stated that on September 25 and 26, 2004, the Customs caught three Malaysian men, including a key syndicate member trying to smuggle in the pills on flights from Paris. The pills were hidden in cosmetic green tea and Hello Kitty boxes. The green lane is a facility provided by Customs to expedite the clearance of passengers. Passengers who are in possession of non-dutiable or non-prohibited goods and those without baggage are allowed to use the green lane. Often this facility is grossly abused by travelers who take the opportunity to quickly pass through the green lane when there is a massive congestion of human traffic at the Customs bays. Customs has installed two x-ray machines at the green lane at present but the Director-General said more x-ray machines will be installed soon.

Apart from smuggling of goods, cases involving the use of false documents to declare goods had started to increase. The Deputy-Director General, Preventive Division stated the fraudulent declaration of goods and under-declaration of value poses a pressing problem for Customs. Smugglers often under-declare or forge Customs forms for large consignments. Some even work in cahoots with a small number of 'questionable' officers or freight forwarders to evade detection. Due to massive movement of containers at the ports, the Customs officers find it virtually impossible to check each and every box. More often than not, the contents of a container are under-declared or wrongly declared. Recently with the installation of scanners at the major ports, Customs was able to screen the contents of a container without having the need to open it. But again, containers are only scanned at random or if the declaration seems to be suspicious. Most of the time, Customs officers rely on tip-offs from informers. Without information, it is quite impossible to apprehend the culprits.

The preventive officers of the Customs Department are continuously on the look out for smuggled goods. All of them have to receive some form of training at the Malaysian Customs Academy before being assigned to their respective jobs in the Preventive Division. Some are sent overseas for training. These specially trained officers operate round the clock at the various points of entry into Peninsular Malaysia, Sabah and Sarawak. Smuggling is a risky business especially when the *Customs Act 1967* imposes severe penalties on smugglers. But again, few get caught by the authorities as most of them escape the eyes of the ever-vigilant officers and are quite contented with the gains made from this lucrative trade.

The Author

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Malaysian Institute Of Taxation

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

TRAINING PROGRAMMES/EVENTS -2005

Date	Training Programme	Time	Venue	Speaker
July				
4	S153 and Dispute Resolution with the IRB	9 am - 1 pm	JB	Various Speakers
5	S153 and Dispute Resolution with the IRB	9 am - 5 pm	Penang	Various Speakers
Aug				
9 & 10	National Tax Conference 2005	9 am - 5 pm	PICC	
25	Workshop on Basic Tax Practice & Principles (Jointly organised with MAICSA)	9 am - 5 pm	MAICSA	Vincent Josef
26	Workshop on Basic Tax Practice & Principles (Jointly organised with MAICSA)	9 am - 5 pm	MAICSA	Vincent Josef
27	Workshop: Taxation for Agriculture Companies	9 am - 1 pm	KL	Chow Chee Yen
Sept				
7	Workshop: Taxation for Manufacturing Companies	9 am - 5 pm	KL	Chow Chee Yen
15	Seminar: GST - Implementation and Implications	9 am - 5 pm	KL	Various Speakers
15	Workshop on Basic Tax Practice & Principles (Jointly organised with MAICSA)	9 am - 5 pm	MAICSA	Vincent Josef
16	Workshop on Basic Tax Practice & Principles (Jointly organised with MAICSA)	9 am - 5 pm	MAICSA	Vincent Josef
21	Workshop: Tax Planning and Strategies for Cross Border Transactions	9 pm - 5 pm	KL	Chow Chee Yen
29	Workshop on Basic Tax Practice & Principles (Jointly organised with MAICSA)	9 am - 5 pm	MAICSA	Vincent Josef
30	Workshop on Basic Tax Practice & Principles (Jointly organised with MAICSA)	9 am - 5 pm	MAICSA	Vincent Josef
Oct				
4	Budget Breakfast	8 am - 11 am		Puan Aziyah bt Bahauddin (MOF)
to be confirmed	Budget 2006 Seminar (Jointly organised with IROU)	9 am - 5 pm	KL	Various Speakers
to be confirmed	Budget 2006 Roadshow (Jointly organised with MIA)	9 am - 5 pm	Major cities	Various Speakers

Recovery of Taxes Due and Payable

A restriction was imposed on the taxpayer by the Director-General pursuant to sec 104 of the Income Tax Act 1967 ("the Act") to prevent him from leaving the country unless he settles the outstanding tax due.

The taxpayer applied to have the ban lifted to allow him to leave the country for a medical check-up in Australia and alleged that he was wrongfully assessed.

The High Court dismissed the appeal.

1. Section 104 of the Act is a mode authorised under the Act for recovery of a tax payable under sec 103 and it was the Director-General's claim that the taxpayer was truly and justly indebted to the Director-General of the sum stipulated in the certificate.

2. The Court was in agreement with the cases of *Chong Woo Yit v Government of Malaysia* [1989] 1 CLJ (Rep) 9 and *Sun Man Tobacco v Government of Malaysia* [1973] 2 MLJ 163 where it was held that the Court, unlike the Special Commissioners of Income Tax, had no power to entertain the taxpayer's plea by reason of sec 106(3) of the Act.

Alexander John Shek Kwok Bun v Ketua Pengarah Lembaga Hasil Dalam Negeri.
High Court in Sabah and Sarawak at Kuching. Originating Motion No. OM-25-11-2004-11.

Judgment delivered on 16 August 2004.

Norhisham bin Ahmad (Legal Officer, Inland Revenue Board) for the Director-General of Inland Revenue.

Fabian Sigar (Advocate & Solicitor) for the taxpayer.

Before: Judicial Commissioner Lau Bee Lan.

"Editorial Note: This case will be reported in the forthcoming issue of the Malaysia and Singapore Tax Cases."

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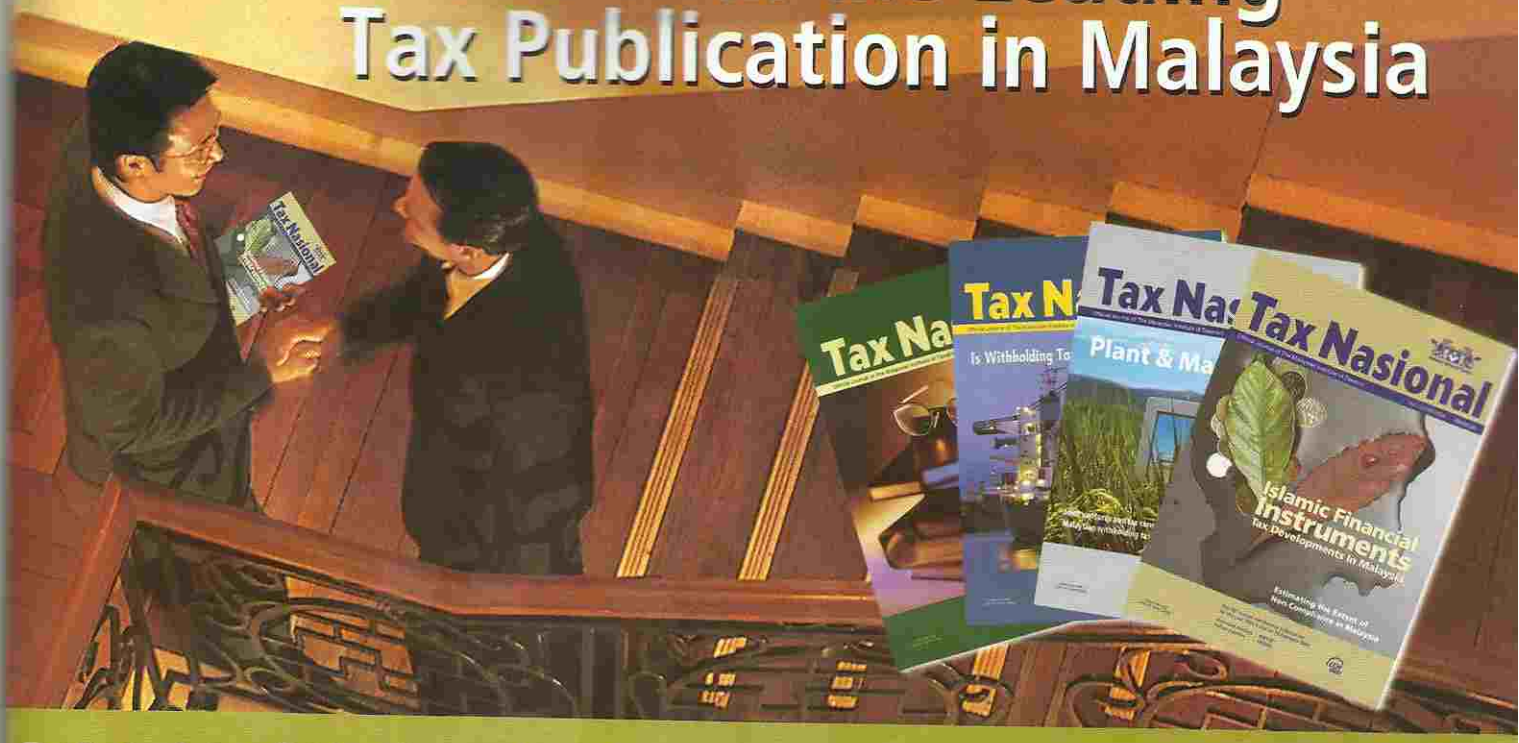

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