Malaysian Institute Of Taxation

TAX NASIONAL

Official Journal of the Malaysian Institute of Taxation

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Malaysian Institute Of Taxation

Continuing Professional Development (CPD)

TRAINING PROGRAMME / EVENTS - 4th QUARTER 2006

Date	Training Programme	Time	Venue	Speaker
	OCTOBER 2006			
6	Workshop: Tax Cases and Appeals	9 am - 5 pm	JB	Dr. Nakha
7	Workshop: Tax Cases and Appeals	9 am - 5 pm	Penang	Dr. Nakha
12	Basic Tax Practice and Principles : Workshop 5	9 am - 5 pm	MAICSA	Vincent Josef
13	Basic Tax Practice and Principles : Workshop 6	9 am - 5 pm	MAICSA	Vincent Josef
14	Workshop: Tax Cases and Appeals	9 am - 5 pm	Kota Kinabalu	Dr. Nakha
16	Workshop: Tax Cases and Appeals	9 am - 5 pm	Kuching	Dr. Nakha
18	Workshop: Cross Border Transactions	9 am - 5 pm	KL	Harvindar Singh
Date	**Training Programme**	**Time**	**Venue**	**Speaker**
	NOVEMBER 2006			
9	Workshop : Basic Corporate Tax Planning	9 am - 5pm	Johor Bahru	Chow Chee Yen
10	Workshop : Advance Corporate Tax Planning	9 am - 5 pm	Johor Bahru	Chow Chee Yen
22	Workshop : Basic Corporate Tax Planning	9 am - 5 pm	Penang	Chow Chee Yen
23	Workshop : Advance Corporate Tax Planning	9 am - 5 pm	Penang	Chow Chee Yen
28	Seminar: Year End Tax Planning	9 am - 5 pm	KL	Various Speakers
Date	**Training Programme**	**Time**	**Venue**	**Speaker**
	DECEMBER 2006			
13	Practitioners Update	9 am - 5pm	KL	Renuka Bhupalan
15	Practitioners Update - Road Show	9 am - 5 pm	JB	Harvindar Singh
16	Practitioners Update - Road Show	9 am - 5 pm	Malacca	Harvindar Singh
18	Practitioners Update - Road Show	9 am - 5 pm	Ipoh	Harvindar Singh
19	Practitioners Update - Road Show	9 am - 5 pm	Penang	Harvindar Singh

DISCLAIMER

The Malaysian Institute of Taxation reserves the right to change the speaker (s)/ date (s), venue and / or cancel the workshop/events without notice at their discretion.

Please contact us at:

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The President's Note

What an exciting quarter this has been. The 2007 Budget Proposals, the National Tax Conference, the AGM, hmmmm.... a never ending ride on a roller coaster of tax issues.

First, the 2007 Budget Proposal appears to a compassionate budget bearing in mind the removal of the petroleum subsidies and its inevitable consequences of rising prices. The 2007 Budget Proposal has deferred the implementation of GST, has categorically provided for a definition of leave passage benefits to include employees family members, food and accomodation. Most importantly it has reduced corporate tax rates. This reduction is most welcome and enables Malaysia to offer a more competitive business environment.

We have passed the middle of the year and appear to be rushing towards the end of 2006. There is still a lot to be acheived and a lot to learn.

The National Tax Conference 2007 was a resounding success, bringing together ever more speakers, guests, panelists and participants. I thank you, members of MIT and readers, for heeding my call in the last President's Note to attend and participate.

MIT is also grateful to APM and LHDN and MOF for being so supportive of us. We only await the time when the powers that be will see fit to review the non-deductablity of tax-agents fees. This remains a thorny issue with our members. On our part we are still trying to put forward your case. Insya Allah!

MIT looks forward to your continued support and encouragement as we move to final of this year. God Bless and God Speed!

President, MIT

THE EDITOR'S NOTE

THE EDITOR'S NOTE

This has been an extremely busy quarter for MIT and consquently Tax Nasional has a lot to offer you.

The main item of interest to tax agents is, of course, the 2007 Budget Proposal. In the last issue of Tax Nasional we had published the joint 2007 National Budget Memorandum. In this issue we see how many of our proposals have actually been acted upon or considered by the powers that be.

The Budget has been a somewhat kind and liberal budget with a fair amount of goodies for the corporate and banking sector. Personal tax releifs were not forgotten but perhaps doled out out on a more limited scale.As a comprehensive commentary on the Budget has been presented by Dr.Nakha Ratnam, I shall go on other things.

The last and biggest event for MIT was our National Tax Conference (NTC 2007). This event just grows from success to success. This year was no exception. Other events include the AGM 2007 and the various workshops.

This issue of Tax Nasional is our first "in house" issue and the publishing manager has requested me to convey her apologies in advance if there are any mistakes or oversights!

We are slowly attempting to revamp the look and style of the magazine and hope that you will assist us by being more interactive. Please, please contribute your ideas, comments, suggestions, articles and thoughts to us. We will do our best to accomodate them bearing in mind the old tale of "The Old Nag and his Master". The story goes like this, a man and his old nag were walking along a street. The aged nag was carrying a heavy load of firewood. In order not to burden his beast, the old master walked beside his nag instead of riding it. A passerby berated the old man for making his poor old nag carry such a heavy load. The old man felt bad and decided to carry the heavy load himself. As he plodded along with his nag beside him, another passerby ridiculed him for carrying the burden instead of riding on the beast of burden. The old man who was by this time rather exhausted decided to climb on his nag with the firewood. Needless to say after a bit, the old decrepit nag collapsed and died. The moral of the story is you can't please everybody!!

On that note I leave you to enjoy this 3rd Quarter issue of Tax Nasional. Adieu!

Harpal S Dhillon
Editor, Tax Nasional

Malaysian Institute Of Taxation

The Malaysian Institute of Taxation (MIT) is a company limited by guarantee incorporated on 1 October 1991 under Section 16(4) of the Companies Act 1965. The Institute s mission is to be the premier body providing effective institutional support to members and promoting convergence of interests with government, using taxation as a tool for the nation s economic advancement and to attain the highest standard of technical and professional competency in revenue law and practice supported by effective secretariat.

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Malaysian Institute Of Taxation

INVITATION TO WRITE

Tax Nasional welcomes original and unpublished contributions which are of interest to tax professionals, lawyers and academicians. It may cover local or international tax development. Articles contributed can be written in English or Bahasa Malaysia. It should be between 2,500 and 5,000 (doubled-spaced, typed pages). They should be submitted in hardcopy and diskette (3.5 inches) from Microsoft Word.

Contributions intended for publication must include the writer's name and address, even if a pseudonym is used. The Editor reserves the right to edit all contributions based on clarity and accuracy of expressions required.

Contributions may be sent to :
THE EDITOR of TAX NASIONAL,
Malaysian Institute of Taxation.

e-mail: publications@mit.org.my

INVITATION TO WRITE

CONTENTS
3rd Quarter 2006

MIT

National

International

Literature & Education

Malaysian Institute Of Taxation

WORKSHOP on CROSS BORDER TRANSACTIONS

Wednesday, 18 October 2006
Time : 9:00am to 5:00pm
MIT Training Room, Kuala Lumpur

TOPIC OUTLINE

- Withholding tax and permanent establishment considerations
- Double Taxation agreements
- Avoidance of double taxation
- Tax havens and overseas holding company structures
- Anti-avoidance issues
- Transfer pricing considerations
- Financing issues
- Case studies

8 CPD hours

Speaker:

Mr. Harvindar Singh is a member of the Malaysian Institute of Taxation and a Section 153 license holder. He has been in practice for more than fifteen years. He is a regular speaker at seminars on Malaysian taxation at tax and financial conferences.

Registration Form

MIT Member fee : RM 295 **Member firm's staff fee :** RM 345 **Non Member fee :** RM 395

Please register the following person/s for the above event. Enclosed is payment of RM_____ vide Cheque No. _____ made payable to **"MIT-CPE".**

Membership No :_____

Name: Mr/Mrs/Ms : _____ Designation : _____

E-mail :_____

Company :_____ Address :_____

_____

Contact person : _____ Tel :_____ Fax : _____

DISCLAIMER

The Organiser reserves the right to change the speaker, date, venue and / or cancel the event should unavoidable circumstances arise. No refunds will be given for cancellations. Kindly arrange for an alternate participants.

Please complete the registration form and fax or mail with payment to:

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INSTITUTE NEWS Q3/2006

Pretty maids all in a row, manning the AGM registration desk

2007 Annual General Meeting

The Institute's Annual General Meeting was held on 29 July 2006 at the Kuala Lumpur Hilton to a record turn out of members who had come to vote, question and generally give their support to the Institute. The AGM was ably chaired by Tuan Haji Abdul Hamid Bin Mohd Hassan and proceeded smoothly.

Graduation and Prize Winning Ceremony

In keeping with tradition, the Malaysian Institute of Taxation held its Tenth Annual Graduation and Prize Giving Ceremony on the 29 July 2006 at the Kuala Lumpur Hilton. The function witnessed 6 students completing the Foundation Level, 36 students at the Intermediate Level and 7 students in the Final Level. Over 50 people comprising council members, students, parents, friends and well-wishers gathered to witness the certificate presentation ceremony to the deserving students. The occasion was graced by Puan Hasmah Binti Abdullah the Deputy Director General 2, LHDNM who presented the Certificates and awards for best students namely Ong Mun Yee (Taxation I), Tan Sook Mei @ Kathrine (Taxation II) and Chew Shung Terk (Taxation III & Intermediate Level).

Puan Hasmah gracing the prize giving ceremony

2007 National Tax Conference

The premier tax event of the Institute (and the Malaysian tax community at large) was held on 22 and 23 August 2006 at the PUTRA World Trade Centre. The event glittered with tax luminaries , both national and international, who sparkled. This years event recorded the highest number of participants ever!

Intent, attentive, concentrating and .....tired?

2007 Budget Talk by Datuk Aziyah bt Bahauddin

At this annual budget event organised by MIT, Datuk Aziyah bt Bahauddin, the Under Secretary of the Tax Analysis Division of the Ministry of Finance delivered the important features of the 2007 budget proposals. Her presentation included the summary of the budget proposals and the Government's rationale behind the proposals.

To add a different perspective, Dr Mohd Shukor bin Hj Mahfar, Deputy Director, Lembaga Hasil Dalam Negeri Malaysia and Pn Soria Osman, Assistant Director of Customs, Royal Malaysian Customs were present to share their views on the implications of the measures announced. This interactive dialogue was moderated by Dr Veerinderjeet Singh who also contributed his views on the budget.

This synergy of expertise enabled everyone to have a comprehensive discussion of the issues at hand. The Q&A session was definitely an interactive session with many questions on the budget thrown from the floor. An hour dedicated to this session was not enough for the participants to clarify all the relevant issues. However, the majority of the participants applauded MIT in organising such an event as it provided them an opportunity to listen and clarify issues pertaining to the budget with the relevant authorities.

The MIT received an overwhelming response to this talk which registered approximately 230 people.

2007 Budget Highlights by MIT & MIA

With the announcement of the 2007 Budget Proposals on 1st September 2006 by YAB Dato' Seri Abdullah Hj Ahmad Badawi, MIT and MIA jointly organised a series of roadshows, the first of which was held on 2 September 2006 at Holiday Villa Subang.

The major highlights of the 2007 Budget were presented by Mr Harpal Singh Dhillon. In the afternoon, changes since the 2006 budget involving tax planning issues were discussed by Mr Chow Chee Yen.

Following this, half day seminars on 2007 budget proposals and recent developments had been arranged at major towns in the month of September.

Practitioners Update

MIT has introduced this forum as an opportunity for practitioners to know all about the relevant tax related updates and the issue and implications related to such developments. Held at the Putra World Trade Centre on 20 June 2006, the forum focussed on new legislative provisions and practices introduced during the year by the authorities.

Some of the updates include the rulings and guidelines introduced by the Lembaga Hasil Dalam Negeri Malaysia and the dialogues with the authorities.

Ms Renuka Bhupalan and Mr Soh Lian Seng provided participants with the updates. Look out for our next session in December 2006.

Basic and Advanced Corporate Tax Planning Workshop

Mr Chow Chee Yen conducted workshops in Basic and Advanced Corporate Tax Planning in Sabah and Sarawak in the month of August.

Workshop on Public Ruling on Property Development and Construction Contracts & Tax Audits and Investigations

In this audit-based environment, taxpayers are becoming ever more concerned about tax risks and this is no different for property development and construction industry players. MIT organised workshops in Malacca and Johore Bahru in July to bring these tax risks into focus and create an awareness amongst taxpayers. This workshop was facilitated by Mr Harvindar Singh.

He discussed the salient features outlined in the Public Ruling on Property Development and Construction Contracts as well as issues in relation to Tax Audits & Investigations.

TECHNICAL UPDATES

(2nd Quarter – as at 31 August 2006)

Public Ruling(s)

The Lembaga Hasil Dalam Negeri Malaysia (LHDNM) released the following public ruling:-

- **Public Ruling 6/2006 on Tax Treatment on Legal and Professional Fees.** This Ruling was issued on 6 July 2006. This Ruling explains the deductibility and non-deductibility of legal and professional expenses. This Ruling is effective from year of assessment 2006.

- **Second Addendum to Public Ruling 2/2005 on Computation of Income Tax Payable by A Resident Individual.** This addendum was issued on 6 July 2006. This addendum provides clarification on the current tax treatment for the deduction for husband and tax rebate for zakat or fitrah payments.

Legislation

Gazette Orders

The following Orders and Rules have been gazetted. The key features are highlighted below.

- **Income Tax(Deduction for Expenditure Incurred for the Development and Compliance of New Courses by Private Higher Education Institutions) Rules 2006 [P.U.(A) 184]**

- with effect from year of assessment 2006, a private institution of higher education will be allowed to deduct one-third of the expenditure on compliance and development of new courses for a year of assessment and for each of the two following years of assessment such expenditure refers to expenditure incurred in respect of market surveys or needs analysis, external consultation and curriculum preparation, preparation of collaborative agreements with third parties, validation of new courses, staff training in respect of conducting the approved new courses and compliance fees.

- such expenditure is deemed to be incurred in the basis period for the year of assessment in which the approval is issued by the Ministry of Higher Education in respect of the new courses.

- **Income Tax (Industrial Building Allowance) (Approved Multimedia Super Corridor (MSC) Status Company) Rules 2006 [P.U.(A) 202]**

- with effect from year of assessment 2006, qualifying building expenditure incurred by the owner of a building (constructed or purchased) in the Cyberjaya Flagship Zone which is used for the purpose of his business as an approved MSC status company or rented to an approved MSC status company shall qualify for an allowance equal to one tenth for that year of assessment and each year for the nine following years of assessment.

- the renting of building shall be regarded as carrying on a business and the income shall be taxed under section 4(a) of the Income Tax Act 1967 (hereafter referred to as the Act). To qualify for the allowance, the building shall first be occupied by an approved MSC status company.

- building has been defined to mean a new building that provides a world-class physical and information infrastructure as determined by the Multimedia Development Corporation Sdn Bhd which has not been occupied by

any company before the commencement of these Rules and located in the Cyberjaya Flagship Zone but does not include building for the purpose of living accommodation.

- qualifying buildings expenditure means capital expenditure as noted in paragraph 3 of Schedule 3 of the Act.

- the provisions under section 60A and 60F shall not apply. *(It is understood that reference to section 60A is intended to refer to section 60FA pending the issuance of the corrigendum.)*

- **Income Tax (Deduction for Allowances under the Capital Market Unemployed Graduates Training Scheme) Rules 2006 [P.U.(A) 203]**

- with effect from 1 October 2005, a public listed company which participates in the training scheme shall be allowed a double deduction on the amount of allowances paid to a trainee for undergoing the training scheme for a period of three years from the date of certification of that scheme.

- a certification letter from the Securities Commission certifying that the trainee has undergone such training is required .

- training scheme means the Capital Market Graduate Training Scheme for the Unemployed Graduates certified by the Securities Commission from 1 October 2005 until 31 December 2008.

- trainee means an unemployed graduate who is a Malaysian citizen who undergoes the full duration of a training scheme.

- **Income Tax (Exemption)(No.20) Order 2006 [P.U.(A) 205]**

- with effect from 10 September 2004, a qualifying person is exempted from tax on the statutory income derived from the management of an international school.

- qualifying person is defined to mean :-
(a) a body of person or a trust body as defined under Section 2 of the Act or a company limited by guarantee whose function is solely for the purposes of establishing and managing an international school;
(b) a resident in Malaysia; and
(c) not operated or conducted primarily for profit.

- **Income Tax (Exemption)(No.21) Order 2006 [P.U.(A) 206]**

- with effect from 1 October 2005, a non-resident expert is exempted from tax in respect of income derived from Malaysia for providing training in the field of related expert areas, crafts and performing arts as verified by the Ministry of Culture, Arts and Heritage from 1 October 2005 until 30 September 2010.

- related expert areas means music, choreographer, cinematography, prop, set, costume and stage technical.

- crafts means any artistic product which is graced with cultural or traditional appeal and outcome of any process which directly or indirectly solely or partly on manual skill or craftsmanship and includes any batik product. performing arts includes stage performing in theatre, music and dance.

- section 109B of the Act shall not apply under this Order.

- **Income Tax (Exemption)(No.22) Order 2006 [P.U.(A) 207]**

- this Order is effective from year of assessment 2006

- income relating to allocations given by the Federal Government/State Government in the form of a grant or subsidy shall be exempted from tax.

- a statutory authority is exempted from tax in respect of income received relating to an amount chargeable and collectible from any person in accordance with the provisions of the Act regulating the statutory authority or any donation or contribution received.

- the Income Tax (Exemption)(No.17) Order 1995 [P.U.(A) 213/1995] and Income Tax and (Exemption)(No.4) Order 2003 [P.U.(A) 33/2003) are revoked from year of assessment 2006.

- **Double Taxation Relief (The Government of the State of Kuwait) Order 2006 [P.U.(A) 210]**

- Some salient points of the double tax treaty:-

Withholding Tax Rates

interest	–	**10% (Article 11)**
royalties	–	**10%/15% (depending on type of royalties) (Article 12)**

Definition of Permanent Establishment (Article 5)

Includes:-
~ a building or construction site which exists for more than 12 months;
~ an installation or assembly project which exists for more than 6 months;
~ carries on supervisory activities for more than

12 months in connection with a building or construction site or more than 6 months in connection with an installation or assembly project.

- **Double Taxation Relief (The Government of the Kingdom of Saudi Arabia) Order 2006 [P.U.(A) 225]**

- Some salient points of the double tax treaty:-

Withholding Tax Rates

income from debt claims – 5% (Article 11)
royalties – 8% (Article 12)

Definition of Permanent Establishment (Article 5)

Includes:-
a building site, a construction, assembly or installation project or supervisory activities in connection therewith for a period of more than 6 months;

- furnishing of services, including consultancy services, by an enterprise through its employees or other personnel engaged for such purpose (for the same or connected project) for a period or periods aggregating more than 6 months within any 12-month period.

- **Petroleum (Income Tax) (Deduction for Audit Expenditure) Rules 2006 [P.U.(A) 229]**

- with effect from year of assessment 2006, statutory audit fees incurred shall be allowed a deduction in arriving at the adjusted income of a company.

- **Income Tax (Accelerated Capital Allowance)(Mould for the Production of Industrialised Building System Component) Rules 2006 [P.U.(A) 249]**

- with effect from year of assessment 2006, qualifying plant expenditure incurred on the purchase of pre-cast concrete mould used in the production of industrialised building system component of a business of a manufacturing or construction company shall qualify for an initial allowance of two-fifth and annual allowance of one-fifth of the qualifying plant expenditure.

- industrialised building system means building systems in which structural components are manufactured in a controlled condition such as in a factory or on site, transported and assembled into a structure with minimal site works.

- **Income Tax (Exemption) (Amendment) Order 2006 [P.U.(A) 275]**

- with effect from year of assessment 2006, engineering services, printing services and local franchise services are included as part of the qualifying services in relation to the export of qualifying services listed in Income Tax (Exemption) (No.9) Order 2002 [P.U.(A) 57/2002].

- **Real Property Gain Tax (Exemption) (No.7) Order 2006 [P.U.(A) 281]**

- with effect from 1 October 2005, a public company is exempted from real property gains tax in respect of chargeable gains accruing on the disposal of any chargeable assets pursuant to an approved scheme of merger or acquisition.

- the disposal of chargeable assets shall be completed not later than 31 December 2008.

- approved scheme of merger and acquisition means a merger or acquisition of public companies which is approved by the Securities Commission from 1 October 2005 until 31 December 2007.

- **Stamp Duty (Exemption) (No.12) Order 2006 [P.U.(A) 282]**

- with effect from 1 October 2005, all instruments executed pursuant to an approved scheme of merger or acquisition are exempted from stamp duty.

- such instruments shall be executed not later than 31 December 2008.

- approved scheme of merger and acquisition means a merger or acquisition of public companies which is approved by the Securities Commission from 1 October 2005 until 31 December 2007.

- **Double Taxation Relief (The Republic of Indonesia) (Amendment) Order 2006 [P.U.(A) 285]**

- Some salient changes of the protocol:-

Withholding Tax Rates

interest – From 15% to 10% (Article 11)
royalties – From 15% to 10% (Article 12)

- ***Offshore Business Activities***

The benefits of this treaty will not be available to any offshore business activities carried out under the Labuan Offshore Business Activity Tax Act 1990.

2007 BUDGET COMMENTARY

by the MIT Technical Department

This commentary is essentially a brief comparative analysis of the Joint Budget Proposal (hereafter referred to as the "Joint Proposal") submitted to the MOF by the Malaysian Institute of Taxation (MIT), the Malaysian Institute of Accountants, the Malaysian Institute of Certified Public Accountants and the Malaysian Institute of Chartered Secretaries. The submission of this Joint Proposal was published in our last issue of Tax Nasional(Q2/2006).

- TAX PAYERS RIGHTS : The proposal for the establishment of a Tax Audit and Tax Investigation Framework setting out the rights and obligations of both the LHDNM and taxpayer and a general framework as to the procedure of carrying out a a tax audit and tax investigation has been adopted. However the profession hopes to be actively involved in finalising the framework

- REVIEW OF CORPORATE TAX RATES : Although the proposed reduction of Corporate Tax rates to 25% was not implemented, the 2007 Budget Proposal has introduced a staggered reduction i.e. 27% for 2007 and 26% for 2008. It is hoped that this reducing trend will continue in forthcoming years to maintain a competitive tax environment.

- PENALTIES ON NON-COMPLIANCE OF WITHHOLDING TAX UNDER SECTIONS 107A,109 & 109B : The 2007 Budget Proposal has adopted our proposal that a 10% penalty be imposed only on the amount of unpaid tax instead of the present situation where a 10% penalty is imposed on the gross amount liable to deduction.

- WITHOLDING TAX RATE / REVIEW OF INCENTIVES FOR REAL ESTATE INVESTMENT TRUST (REIT): Again in line with but on a more cautious scale, the Joint Proposal's suggestion to reduce the rate of income tax imposed on unitholders receiving distributions from the REIT has been accepted in part.

- WIDENING SCOPE OF DEDUCTION ON DONATION FOR CHARITABLE ACTIVITIES : The 2007 Budget Proposal has included the deduction to contributions made by companies towards sports activities approved by the Minister of Finance and sports bodies approved by the Commissioner of Sports. However the limitation on donations still remains albeit it was increased to 7% from the existing 5% of aggregate incomes.

- RPGT RETURNS - CONDITIONAL CONTRACTS : The 2007 Budget Proposal appears to have considered the Joint Proposal suggestion to review the time lines for submission of the CKHT 1 & 2 Forms to the Director General of the LHDNM specifically with regards to conditional contracts.

- LOCAL LEAVE PASSAGE : The Joint Proposal's suggestion to include expenses for meals and accomodation in respect of local leave passage costs which are exempted from tax for employees has been accepted. Also accepted has been the benefit accruing as a result of the inclusion of an employee's immediate family member(s) as part of the deductible expenses for local leave passage deductions.

- BILATERAL CREDIT : Double tax relief for any income which has been taxed abroad and also subject to tax in Malaysia has been broadly accepted under the 2007 Budget Proposal.

- ISLAMIC WEALTH MANAGEMENT : The Joint Proposal had suggested an enhancement of the tax treatment of Islamic Instruments. This has been incorporated into the 2007 Budget with the objective of making Malaysia the leading international Islamic Banking and Financial centre. Some of the incentives include a ten year tax exemption to all Islamic Banking and Takaful entities and to local and foreign fund managers who manage Islamic funds for foreign investors.

- PERQUISITES FROM EMPLOYMENT : A partial acceptance of the Joint Proposal's suggestion in respect of long service awards being exempted from tax was granted. The 2007 Budget Proposal has allowed a nominal but nevertheless welcome exemption of up to RM1000 per year for employees who have served at least ten years.

Thus it can be seen that in many ways, the Ministry of Finance and LHDNM are doing their best to work on suggestions and feedback provided by the various relevant bodies. On its part, MIT hopes to continue and enhance this relationship in the spirit of of cooperation and well being of the profession and in particular our members.

Readers are invited to comment on the above and on other relevant isssues via letters to the Editor. Please address your letters to ***"The Editor, Tax Nasional" at our business premises "Unit B-13-2, Block B, 13th Floor, Megan Avenue II, No.12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur".*** *Alternatively you may mail us at* ***"publications@mit.org.my".***

THE NATIONAL MISSION and VISION:

THE CONVERGENCE IN THE BUDGET 2007

Dr. Nakha Ratnam Somasundaram

Abstract

The Budget 2007 was finally revealed on 1 September 2006 against the background of much anticipation, a fiscal journey that would face tremendous challenges in the coming months and years, outlining the five key development policy thrusts of the next fifteen years – and moving forward with the theme: Implementing the National Mission Towards Achieving the National Vision. This article examines some of the salient feature of the Budget and its implication for the taxpayers, the tax agents and the country.

The National Missions

The National Mission requires the private sector to resume its role of spearheading the economic development as well as generate new sources of growth – both in technology and knowledge intensive sectors. This entails skilled workers and competency to meet industrial needs. The demand will be met by improving access to quality education and related training at all levels.

Socio-economic disparities will have to be attended to in all seriousness if we want to call ourselves a developed nation by the year 2020. It was apparent when presenting the Budget 2007 that the Prime Minister was well aware of the need for a strong delivery system to reduce the socio-economic disparity.

The Malaysian Economic Performance

Economic pundits note that the world economy is generally cooling down, because of persistent high oil prices, inflationary pressures and higher interest rates coupled with geopolitical tensions particularly in the Middle East where most of the oil is obtained.

Table 1

The Global Economic Growth and Trends

	2006 (%)	2007 (%)
World Economy	4.9	4.7
Global Trends	9.6	7.5

Source: The Budget Speech 2007

Against this background, it is heartening to note that Malaysia is expected to perform remarkably well. (See Table 2)

Table 2

Malaysia: Expected Economic Growth Rates for 2006

GDP, Investment & Consumption	Growth Rate (%)
GDP	5.8
Private Investment	10.1
Private Consumption	7.1

Source: The Budget Speech 2007

The various sectors of the economy too have shown some resilience. The Prime Minister mentioned that these sectors of the economy are expected to show positive growth because of the robust domestic demand. (see Table 3)

Table 3

Expected Growth of Selected Sector	
Sector	Growth Rate (%)
Manufacturing	6.8
Servicing	6.1
Agricultural	4.7
Construction	3.7

Source: The Budget Speech 2007

In order to soften the impact of the slower global growth on the Malaysian economy, the 2007 Budget has adopted an expansionary fiscal policy. On the other hand, the increase in the oil prices had made the Federal Government's financial position strong following the increase in petroleum related revenue including higher dividends from PETRONAS. As a result, the Gover nment had managed to reduce the budgetary deficit progressively over the last few years (see Table 4)

Table 4

Budgetary Deficit	
Year	Deficit (%)
2000	5.7
2005	3.8
2006	3.5

Source: The Budget Speech 2007

The 2007 Budget Objectives

According to the Prime Minister, the next 15 years will focus on achieving the Vision 2020 - the main objective of the Budget 2007 being to ensure that the National Mission is translated into programs and projects to be implemented expeditiously and effectively. The National Mission is thus founded on five key thrusts:

FIRST: **To move the economy up the value chain;**

SECOND: **To raise the capacity for knowledge and innovation and nurture "the first class mentality";**

THIRD: **To address persistent socio-economic inequitiesconstructively and productively;**

FOURTH: **To improve the standard and quality of life;**

FIFTH: **To strengthen the institutional and implementation capacity;**

The following paragrapghs will look at some basically qualitative changes introduced by the Budget and its impact.

The Private Sector as the Engine of Economic Development

It is acknowledged in the Budget 2007 that there must be strong collaboration between the Government and the private sector if the National Mission is to be achieved. The private sector must therefore spearhead the nation's economic growth. For this the Government is committed to providing a conducive environment to spur dynamism in the private sector activities while enhancing its competitiveness – a commitment that was shown in reducing the corporate tax rates to 27% for the year of assessment 2007 and 26% for the year of assessment 2008. [New Para 2A, Sch. 1 Income Tax Act 1976 (as amended).] The amendment for the tax rate of 26% effective for the year of assessment 2008 is, however, not in the Finance Bill 2006. The new rates would apply to companies, including small and medium industries, trust body, an executor of an individual domiciled outside Malaysia at the time of his death and the receiver appointed by the court.

There will be a slight reduction in Revenue because of this reduction in the tax rate, but the Government is nevertheless confident that the positive effect of the tax rate reduction on the economy will more than compensate for it.

Special Treatment for the Property Development and Construction Contract Businesses

The Budget 2007 had proposed special treatment for the property development and construction contract businesses. The Finance Bill 2006 proposes that the special regulations be formulated and published in the *Gazette*.

Currently gross income and adjusted income from property development and construction contract businesses are ascertained on the percentage of completion method, the direction coming from the Director General of Inland Revenue (DGIR) under section 36 of the Income Tax Act 1967 (as amended) (ITA). Under Section 36 of the ITA, 'where the Director General is satisfied that there is a need for some treatment in computing ... the adjusted income and statutory income from the business, he may give directions and formulate regulations to be published in the *Gazette* for special treatment with respect to any such transactions...' The direction is specifically contained in the Public Ruling No 3 of 2006 issued on 13 March 2006 – a 43 page document dealing with the taxation of property development and construction contracts. There are a number of contentious issues in the said Ruling and the Budget 2007 proposes to set it right.

The proposal is aimed at providing some certainty in the tax treatment with respect to the computation of the gross income and the adjusted income from the property development and the construction contract business. The Budget 2007 proposes that the special requirements for this industry vis-à-vis the income tax treatment be formulated and published in the *Gazette* with the purpose of bringing the property development and construction contract business within the ambit of the Section 36 of the ITA. The salient features of the regulations will include regulating the recognition of income, commencement of the business, completion of the contracts or development, estimates as well as the revision of the income and the deductibility of the relevant business expenses in the relevant period.

How will this impact the developer or the contractor?

For a start, it is proposed that the gross income of the property development or construction contract business for a basis period for a year of assessment shall be determined using the *percentage of completion method.* Under the Public Ruling No 3 of 2006 it is categorically stated in Para 6.2 that the percentage of completion method '*should be the only basis of profit recognition in all forms of property development and construction contract activities...*'

One might note that in the case of *Sarawak Properties Sdn. Bud. v the Director General of Inland Revenue* [1997] 4 AMR 3181, where the taxpayer had used the completion method to recognize his profits, the court ruled that:

> *'...the shophouse project was recognized pursuant to the completed contract method of accountancy. It was recognized by the respondent (Director General of Inland Revenue) and such recognition was accepted as proper by the Special Commissioners (of Inland Revenue). On the facts and evidence before them, I agree with their finding. In my view, it is not inconsistent with the provisions ... of the Income Tax Act 1967 (as amended) ...'*

As such, it would appear that the Inland Revenue Board by insisting on the profit recognition based on the

'percentage of completion method' has implied that the completed contract method is NOT acceptable. In Para 7.5 of the Public Ruling No. 3 of 2006 it is categorically stated that "It is not permissible to defer the bringing of profits into account until the property development is completed'.

Is the Inland Revenue Board going against the decision of the Malaysian court? Some tax pundits think so. See comments by Dr.Arjunan Subramaniam at the Sixth National Tax Conference 2006 when presenting his paper "Scope and Meaning of 'Incurred' in Section 33(1) Income Tax Act 1967", 22-23 August, 2006, Kuala Lumpur.

Choosing a method of recognizing profit is not the taxpayer's prerogative. They must follow the provisions of the ITA – a principle established in *Ostime v Duple Motors Bodies Ltd*: [1961] 2 All 167

> *'...it can never rest with the taxpayer to decide on what principles his income is to be assessed for tax purposes... the assessment in addition to being consistent with normal accounting practice, must be made in accordance with the provisions of the Income Tax Act...'*

It would therefore appear that the IRB has now taken steps to incorporate the manner of recognizing the income of a developer and contractor through a proposal in the Budget 2007 by validating the method vide a *Gazette* notification. This move by the IRB on the recognition of the gross income based on the percentage of completion method will certainly introduce some measure of consistency and certainty. And 'consistency and certainty' is one of the fundamental requirements of a good tax system as propounded by Adam Smith in his famous book ***'The Wealth of Nations'.*** Smith, A (1776) *An Inquiry into the Nature and Causes of the Wealth of Nations*, Modern Library Edition, Random House, New York.

The proposal also touches on the date of commencement of business in the property development sector. This is one of the areas many taxpayers may not be happy since the date of commencement is not spelt out clearly or in any definite terms. It remains as vague as ever with 'pronouncements' that it (the date of commencement) is a 'question of fact'. As the commencement of business in the case of a developer is not a definitive event, the approach by the Inland Revenue Board adds more confusion. It would help if the Inland Revenue Board comes out with some definitive indicators so that the industry could apply these with some consistency and certainty. It is very important for the taxpayer in view of the claim for business expenses – these are allowable only *after* the business has commenced. Any business expenditure incurred *before* the date of commencement may not qualify for a tax deduction.

When is a project deemed completed?

This question is very important for the development company since one of the requirement of the percentage of completion method for the Inland Revenue Board purposes is that the anticipated profits of the project, which may take several years to complete must be *estimated* first at the beginning of the project to determine the adjusted income in the relevant basis period or basis year for the relevant year of assessment.

Overestimate of the profits may require a downward revision. This could be done only from the year it is realized that the profit as ascertained earlier could be or is lower than previously estimated. In the case where losses are incurred the revision could be made only after the project has been completed. In Para 7.7 of the Pubic Ruling No. 3 of 2006 'It is only upon completion of the project when the actual loss is finally ascertained that the loss would be set off against the income from other sources in the basis period for the year of assessment in which the project is completed'.

The Budget 2007 proposal would now also allow for a revision of the estimated gross profit from a property development where there is an increase in development or contract cost due to escalating costs, or a reduction in selling price, or for some commercial reasons acceptable to the Director General of Inland Revenue. This is indeed a positive measure that would assist the taxpayer in arranging his cash flow, particularly with regard to tax payments. It might help very much, however, if the DGIR could tell what 'commercial reasons' are acceptable to him.

On the other hand, the question asked by the industry players is: If the estimated profits could be taxed, why is the estimated losses not considered for a tax deduction?

To the consternation of the industry, both the Public Ruling No. 3 of 2006 and the proposals under the Budget 2007 do not address the issue of deductibility of estimated losses in cases of development other

than low cost projects.

Can the estimates be revised backwards? Not until now.

The proposal has in this sense created tax history – by allowing adjustments both forward ***and backward.*** Under the proposal, expenses incurred during the defect liability or warranty period shall be allowed against the income of the year of assessment in which the expenses are incurred; or shall be carried forward to the following year of assessment. However the property developer or the construction contractor ***may elect to carry back the expenses to the basis period for the year of assessment in which the project or contract is completed.*** Where the income in the relevant year is insufficient to set off the expenses incurred, the expense is allowed to be ***carried back*** further to be deducted from the income for the immediately preceding years of assessment for the duration of the project or contract. This option is now made available to the developer or contractor for each year of assessment for the duration of the defect liability or warranty period.

Overall the proposals are revolutionary from a tax angle and are probably designed to give the required impetus to the construction sector particularly in view of the government's focus on making the private sector the engine of growth.

There is no doubt that the construction industry will see a brighter future - with a little help now from the taxman.

Public Rulings

The Inland Revenue Board issues Public Rulings to make known the Director General's interpretation of certain provisions of the ITA that have general application. However, Public Rulings, as issued so far, have no force in law because they have not complied fully with the requirements of section 36, and are therefore not binding on the taxpayer. Under Section 36 of the ITA the Director General **may** 'give direction and formulate regulations to be published in the *Gazette* for special treatment with respect to any such transaction either in relation to a particular business or in relation to any business having any such transaction'. However all the public rulings issued to date have not been published in the *Gazette* and therefore their validity is questionable. The word 'may' was held to mean 'shall' in the context of Para 15 of Sch 7 of the ITA – in other words no discretion vests with the Director General [see *LCC v Ketua Pengarah Hasil Dalam Negeri* - Special Commissioners of Income Tax. Rayuan No. PKCP (R) 86/99].

The legislative authority is expressly and exclusively reserved for Parliament; and Article 44 of the Federal Constitution vests the legislative function and the powers in the Parliament of the Federation of Malaysia. In the specific context of the tax legislation, Article 96 of the Federal Constitution provides as follows:

> *'No tax or rate shall be levied by or for the purpose of the Federation except by or under the authority of the federal laws...'*

Under section 134 of the ITA, the DGIR has only the 'care and management 'of the income tax. It is therefore only an administrative function and not a legislative function. Even though section 36 and section 127 of the ITA grants specific powers to the DGIR and the Minister of Finance respectively, neither of the two sections empowers the DGIR or the Minister of Finance to issue any guidelines nor rules. That power is reserved for Parliament. Under section 127 the Minister of Finance may, for example, by statutory order exempt any income or any person from the provisions of the ITA but such orders '*shall be laid before the Dewan Rakyat'*.

In the case of *The Director General of Inland Revenue v Kok Fai Yin* (unreported), his Lordship Tan Sri Dato' Hj. Mohd. Eusoff b Chin, J. (as he was then) held that:

> *'The DGIR ...should not assume authority or exercise power which is not expressly given to him by the law, and if he does so, the exercise of such power is invalid, and must be declared illegal...'*

Issuing Public Rulings without any legislative authority is therefore tantamount to '*a naked usurption of the legislative function under a thin guise of interpretation'*. Dicta of Viscounts Simmonds in *Magor and St. Mellons RDC v Newport Corporation* [1952] AC 189 at p. 190

As all the public rulings issued until now have no basis in law, a new section 138A in Chapter 1A has been introduced vide the Finance Bill 2006 to ratify retrospectively the legal status of all the rulings issued to date. The special provisions relating to section 138A reads as follows: 'Notwithstanding the

provisions of section 138A of the principal Act, any public ruling that has been issued by the Director-General prior to the coming into operation of the section, is deemed to have been made under that section and have effect for the year of assessment 2007 and subsequent year of assessment' (see Clause 27 of the Finance Bill 2006)

Advance Rulings

Under the self assessment system, it is imperative that some large and significant trading arrangements that have considerable impact on the tax payable by the taxpayer should have, preferably, the 'assurance of acceptability' by the Director General of Inland Revenue.

That assurance, and therefore the clarity and certainty in the interpretation and application of the tax law could be obtained with an 'advance ruling'.

What is an advance ruling?

It is a written statement given by the Director General of Inland Revenue on the tax treatment of an arrangement to be undertaken by the taxpayer. It is made on the application of any provisions of the Income Tax Act 1976 to the person and to the arrangement for which the ruling is sought. Under Section 138B(1) incorporated in the new Chapter 1A, '...on the application made by any person, the Director-General shall make an advance ruling on the application of any provision of this Act to the person and to the arrangement for which the ruling is sought' (see Clause 26 of the Finance Bill 2006).

The taxpayer may make the application in the prescribed form and provide such particulars as may be required by the Director General of Inland Revenue. Where an advance ruling is made, it shall apply to the person in relation to an arrangement, and where the person applies the provision in the manner stated in the ruling, the Director General of Inland Revenue shall apply the provision in relation to the person and that arrangement in accordance with the ruling.

In relation to a particular provision in the Income Tax Act 1976, an advance ruling shall apply to a person in relation to an arrangement if the particular provision is expressly referred to in the ruling and for the basis period for a year of assessment for which the ruling applies.

Is the advance ruling a form of tax guarantee by the DGIR and therefore risk free for the taxpayer?

It appears to be not so. Even if the taxpayer has made an arrangement with the Director General of Inland Revenue i.e. the taxpayer has obtained an advance ruling on a particular arrangement, there is no guarantee that it would be accepted and applied to the particular arrangement. The advance ruling made may not apply to a person in relation to an arrangement, for example, if the any of following occurs:

The arrangement is materially different from the arrangement stated in the ruling;

There was a material omission or misrepresentation in or in connection with the application of the ruling;

The Director General makes an assumption about a future event or another matter that is material to the ruling, and that assumption subsequently proves to be incorrect; or

The person fails to satisfy any of the conditions stipulated by the Director General.

The Director General may at any time withdraw any advance ruling made by giving notice in writing of such withdrawal to the person to whom the ruling applies. Under the new section 138B(3) the '... Director General may at any time withdraw any advance ruling by giving a notice in writing of such withdrawal to the person to whom the ruling applies' (see Clause 26 of the Finance Bill 2006).

While an advance ruling may be useful for an 'arrangement', it seems to be founded on rather shaky grounds for the taxpayer, with the odds all stacked in favor of the Director General of Inland Revenue, since he could at any time upset the arrangement by giving a notice in writing of a withdrawal of the advance ruling.

It is not known whether the Director General will give any reason in the notice for such a withdrawal, nor whether the taxpayer has any right of appeal if the Director General withdraws the advance ruling as regards a particular arrangement. No such rights appear to have been incorporated in the Finance Bill 2006. Maybe it was an oversight? In the Budget 2006 it was mentioned that where the surrendering company gives incorrect information in the return furnished under section 77A in respect of the amount of adjusted loss surrendered the DGIR may require by notice in writing to the surrendering company to pay a penalty. No right of appeal was mentioned.

Such a right was however incorporated in a new subsection (b) of Sec 44A (9) in the Budget 2007 (see Clause 16 of the Finance Bill 2006).

While it is important for the Director General to be vigilant and act against any mischief by the taxpayer, it is hoped that this provision (of withdrawing an advance ruling) will not be used in vain to the point where its legal presence is merely notional. One is tempted to think, however, that it would be used in manner similar to how the potent section 140 is used by the authorities presently.

Conclusion

There is no doubt some major strides have been achieved in the Budget 2007, particularly on the law pertaining to property developers and advance ruling; but its practical implementation has to be closely observed to gauge its effectiveness in the smooth implementation of the self assessment system, and thus its usefulness as a legal tool for the taxpayer.

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COMPANY/SHAREHOLDER Tax Systems

KANG BENG HOE

Introduction

The treatment of dividends under a company/shareholder system is an area of company income tax reform. Other areas of reform include corporate tax rate reductions, base broadening i.e. curtailing of incentives, relief(s) and deductions, and elimination of tax shelters also known as tax avoidance practices or arrangements. Whilst the global activity in rate reduction was clearly seen to be vibrant in the past two or three decades or so, the change in company/ shareholder systems were nevertheless also taking place , albeit at a reduced scale and pace. Chinese Taipei, Australia and New Zealand adopted the imputation system in the last decade or two whereas Singapore has recently moved away from the imputation system. The United States has announced its proposal to change its dividend system too. This illustrates the point that tax reform is universal and takes place all over the globe and on an on-going basis.

This commentary reviews in broad outline the three main company shareholder tax systems for dividends viz: the Classical , the Imputation ,and the Dividend exemption, sometimes called the "single- tier" system. There are other systems but these are really variants of the three main systems. For example from 1973 to 1999. the United Kingdom operated a partial imputation system where shareholders are able to claim credit for the ACT(Advance Corporation Tax) paid by the company when dividends are distributed. Canada has a system which is characterized as a tax credit system since shareholders are give a credit on dividends received even though full company tax has not been paid at the nominal rate. The Netherlands operates a participation exemption under which certain distributions are exempt from tax.

The Classical, Imputation, Dividend Exemption Systems

A simple numerical example is given below to illustrate the way each system works. The example assumes the company derives income of 100, pays tax of 28 with an assumed company tax rate of 28 per cent and an assumed maximum individual tax rate of 28 per cent.

	Imputation	Classical	Div Exemption
Company			
Company income	100	100	100
Company tax(28%)	28	28	28
After-tax income	72	72	72
Shareholder			
Dividend	72	72	72
Gross-up for company tax	28	na	na
Individual's income	100	72	0
Individual's tax	28	20	0
Imputation credit	28	na	na
Net shareholder tax	0	20	0
Results			
Total tax	28	48	28
Shareholder income after tax	72	52	72

It is apparent that for both the Imputation and Exemption systems double taxation will be eliminated. Under the Exemption system, income will be effectively taxed at the top individual rate where the company and top individual rates are aligned.

Comments and observations

Classical system

Under this system, the company is taxed on its income and individual shareholders are taxed on dividends received at their normal individual rates without regard being given to the tax paid at the company level. Dividends paid are often subject to tax witholding which is credited in full to the shareholder.The long held argument against the Classical system which really treats the tax at the company level separate from the tax at the shareholder level is that it creates a number of economic distortions.

- It creates a bias against the raising of share capital in favour of debt since interest on borrowings are deductible and dividends paid are not. This point is really relevant where one considers alternative ways of doing business such as partnerships and sole-proprietorships.
- Profits are more likely to be retained in order to avoid the second level of tax on dividends especially when there is no capital gains tax on shares.
- There is an absence of tax neutrality since the system leads to an advantage or disadvantage over the use of the business structure i.e. either a company, partnership or sole-proprietorship depending on the relative tax rates for companies and individuals.

The compelling reason for moving away from the Classical system is the policy goal to avoid economic double taxation of company/shareholder income.

Assuming that the corporate tax rate remains at 28%, then the double taxation impact will mean that more tax will become payable. All shareholders whether exempt or otherwise, will not have the corporate tax credited to them under the Classical system.

The SME sector should be given special focus under the Classical system. This is because the impact of double taxation will be more direct since the link between the business enterprise and its shareholders are closer. Countries which recognize this tend to introduce specific relief provisions to address this or to apply a concessionary corporate tax rate for SME's.

Imputation system

Under the imputation system, the company tax paid is attributed to the shareholders when dividends are paid. There are variants to this but full imputation arises when the system seeks to specifically relate actual company tax paid to the imputation credits available to shareholders.

Thus full imputation addresses the problem of double taxation present in the Classical system. It achieved this well from a domestic perspective .A resident shareholder investing in a resident company with a domestic income will benefit from full relief from double taxation. The imputation system does not achieve this when viewed from an international perspective This is because imputation tax credits are only available for dividends paid by resident companies to resident shareholders in respect of company tax paid in the resident country. Non-resident shareholders receiving dividends with imputation credits attached do not receive relief.

This discriminatory feature is considered serious enough in the EU; its tax treaties make distinctions based on nationality as discrimination. In contrast Malaysia's tax treaties , as do those of the OECD countries ,do not treat distinctions between residents and non-residents as relevant discrimination.

Dividend exemption

Countries which seek a system which combines the benefit of avoidance of double taxation of shareholder income with international neutrality tend to adopt the Dividend exemption system .The US in a proposal made in 2003 by President Bush when implemented will adopt a dividend exemption measure .It is notable that the US system is a Classical system.

From a Malaysian perspective a dividend exemption system would mean that individual shareholders would suffer tax at the rate of 28%, the prevailing corporate rate. This is a relatively high rate and could discourage the broader public in investing in both private and public companies.

Exempt bodies and individuals whose top marginal rate is below 28% will no longer be entitled to a tax refund. Companies' position will remain unchanged as compared to their position under the imputation system.

A further consequence is that under the exemption system, a non-resident shareholder will not be able to claim double taxation relief under Malaysia's tax treaties since there will not be double taxation of income where dividends are only taxed once. Articles in the treaties providing for underlying tax credit relief will no longer have effect since the credit is on the premise that the dividends are taxed. This means that non-resident shareholders will not get relief for the corporate tax suffered on the profits of the Malaysian company.

The Malaysian Imputation System

The system has functioned well over the many years although there are weaknesses. Thus:

The imputation system results in high compliance and administrative costs to Malaysian resident companies as well as to the Revenue which is charged with the monitoring role of the system.

- ~ Companies could increasingly find themselves restricted from distributing profits to shareholders. This could be a problem when accounting and tax profits diverge which will become more the caset with the advent of new accounting rules and standards.
- ~ The imputation system will not promote the use of Malaysia as a holding company to carry out regional activities.
- ~ The system can lead to sophisticated tax planning transactions to circumvent the franking requirements under the system in order to achieve business objectives. These would add to business costs and lead to leakages in tax revenue
- ~ Redemption arrangements involving redeemable preference shares, share buy-back schemes and capital reduction schemes are some examples.

The system is biased against portfolio investors resident outside Malaysia since dividends received by them are treated less favorably when compared to those received by foreign direct investors. Foreign direct investors resident in a country with a tax treaty with Malaysia will be able to claim underlying tax credit in respect of dividends paid out of profits which have suffered Malaysian tax. For portfolio investors resident in a tax treaty country, the article in Malaysia's tax treaties operate on the underlining premise that. a classical system is adopted in Malaysia which is not the case .This is no doubt due to the fact that Malaysia's tax treaties follow to a large extent the OECD Model Convention. The current international tax system for companies and shareholders are reflected in that model which in turn is premised on the Classical system. The position of foreign portfolio investors will need to be addressed to complement efforts to develop the depth and sophistication of Malaysia's stock exchange..

International Developments

Whilst many countries in the mid 1980's moved to the imputation system, the trend in recent years appears to be going into reverse .On the other hand the US may move away from the Classical system. In his report on the IFA (International Fiscal Association) 2003 Congress subject " Trends in Company/Shareholder Taxation" Professor Richard Vann of Sydney University made the following observation: *"It may be thought that in recent changes to company shareholder and international relief systems for direct investment, there can be detected a general convergence of countries' company shareholder tax system in an international setting. The convergence is toward dividend relief systems that are more neutral than imputation internationally yet retain some of the benefits of imputation. The ongoing debate between exemption and credit systems for international double tax relief may in practice if not in theory be drifting towards exemption..."* Singapore appears to be a recent adherent to this view.

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Kang Beng Hoe is an executive director of VS ON TAX Sdn Bhd which is a member firm of the TAXAND Global Alliance, the first international network comprised of tax firms in countries around the world that is completely independent from any audit practice or legal network. He has been in the forefront of professional tax practice for many years having headed the leading tax practice of a major international firm for over 30 years. He is a fellow of the Malaysian Institute of Taxation and was a past council member.

COMPARATIVE REITs PART I

SINGAPORE AND JAPAN

Singapore

Development and Taxation of Real Investment Trust*

Leonard Ong

INTRODUCTION

Singapore's real estate investment trust ("REIT") sector came into existence in July 2002 when the first public-listed REIT was established. The next four years saw the listing of 12 other REITs on the Singapore Exchange, and more REITs are currently being contemplated for listing. The 13 existing REITs in Singapore, namely CapitaMall Trust (July 2002), Ascendas REIT (November 2002), Fortune REIT (August 2003), CapitaCommercial Trust (May 2004), Suntec REIT (December 2004), Mapletree Logistics Trust (July 2005), Prime REIT (August 2005), Keppel REIT (Feb 2006), Allco REIT (Mar 2006), Ascott Residence Trust (Mar 2006), Frasers Centrepoint Trust (Jun 2006), CDL Hospitality Trusts (Jul 2006) and Cambridge Industrial Trust (Jul 2006) have a current combined market capitalisation in excess of SGD 15 billion.

The underlying assets of the existing REITs in Singapore are largely retail, industrial, logistics and office buildings. A couple of them even have hotels and serviced residences as their asset classes. The majority of these REITs have underlying assets that are all located in Singapore. However, some of these REITs have underlying real estate assets that are located offshore.

The 13 REITs are able to yield relatively attractive and stable distribution income to investors on a regular basis. To a large extent, this has contributed to the growth of the REIT market in Singapore. Further, the introduction of various incentives by the Singapore government has also boosted the growth of the REIT market here. Some of these incentives are discussed later on.

2. KEY FEATURES OF A REIT

REITS in Singapore are largely adapted from US REITs and Australian listed property trusts. The general purpose of the REIT structure is to provide an attractive avenue for investors to collectively own quality real estate assets, and from which they can derive a steady source of income on a regular basis.

A REIT is structured as a unit trust and is regulated by the Monetary Authority of Singapore. The REIT is managed by an asset manager and administered by a trustee. Both the asset manager and the trustee are set up as companies limited by shares. As the REITs in Singapore are listed on the Singapore Exchange, their units are freely tradable.

3. TAXATION[1]

3.1. General principles of taxation of a REIT

In general, the income of a REIT derived from or accrued in Singapore is chargeable to income tax in Singapore. In addition, income earned outside Singapore and received or deemed received in Singapore is also chargeable to Singapore income tax, unless the foreign-sourced income is exempted. There is no capital gains tax in Singapore; however gains from the sale of investments, including real estate, are chargeable to tax if such gains are determined to be derived from a trade or business of dealing in investments.

Income tax is imposed on all chargeable income of the REIT after adjusting for allowable expenses incurred by the REIT and tax depreciation claimed on capital assets. This taxable income of the REIT is assessed to tax in the name of the trustee at the prevailing corporate tax rate, currently 20%, except where tax transparency applies.

The net after-tax taxable income of the REIT may be distributed to the beneficiaries of the REIT in the proportion of their share of the REIT income. The beneficiaries are exempt from income tax on the after-tax distributions made by the REIT.

3.2. Taxation of a REIT

3.2.1. Tax transparency

With the exception of REITs with offshore properties, which is discussed in 3.4., REITs with Singapore real properties have been granted tax transparency treatment on their taxable income by the Inland Revenue Authority of Singapore ("IRAS"). The tax transparency treatment is embodied in a tax ruling issued for each of these REITs, and is granted subject to certain terms and conditions.

Under the tax transparency treatment, the trustee of each of these REITs is not assessed to tax on the REIT's taxable income that is distributed to the unitholders. Instead, the trustee will withhold tax from the distributions where applicable (see 3.3 on Taxation of unitholders).

REITs in Singapore generally undertake to distribute at least 90% of their taxable income on a quarterly or half-yearly basis. Undistributed income remains taxable in the name of the trustees. Where such after-tax taxable income are subsequently distributed, the beneficiaries of the REITs would be exempt from income tax on the after-tax distributions received.

3.2.2. Disposal of real property by REIT

So far, the REITs in Singapore have not contemplated any disposal of their real estate properties and are instead investing in new ones. But in the event of such disposal, the question would arise as to whether any gains from the disposal are capital or revenue in nature.

As mentioned above, there is currently no capital gains tax in Singapore; nevertheless, where the gains on disposal of real estate properties are seen to be revenue in nature, the gains would be subject to corporate income tax at the prevailing tax rate. Whether a gain is capital or revenue in nature is a question of fact, and the onus would be on the REIT to convince the IRAS that the gains on disposal of real estate properties are capital in nature.

The tax ruling allowing for tax transparency does not apply to gains from the sale of properties by the REIT which are considered gains or profits from a trade or business, and therefore tax would be assessed on and collected from the trustee on such gains.

Where such after-tax gains are subsequently distributed, the beneficiaries of the REITs would claim a credit for the tax paid by the trustees.

3.3. Taxation of unitholders

Unitholders or investors are in general subject to Singapore income tax on the distributions from the REITs where tax transparency applies. However, in the case of income where tax transparency does not apply, i.e. income that has been taxed in the name of the trustee and subsequently distributed, the unitholders or investors are exempt from tax on the distributions made out of such after-tax income.

Also, various incentives and concessions have been introduced, either by the government or through the tax rulings issued by the IRAS, that make it attractive for certain unitholders or investors. To appreciate the attraction, we need to look at the various categories of unitholders or investors.

3.3.1. Individual unitholders

Individual unitholders who hold the units as investment assets are exempt from income tax on REIT distributions, other than franked dividends, provided the REIT is authorised under the Securities and Futures Act. The tax exemption is applicable to all such individuals regardless of their nationality or tax residence status, except for individuals who hold the units through a Singapore partnership.

3.3.2. "Qualifying" unitholders

Unitholders who are considered "qualifying" unitholders are entitled to receive their distributions from the REIT free of withholding tax. Such "qualifying" unitholders will, in turn, declare the distributions received in their respective tax returns and bring such income to tax at the prevailing corporate tax rate.

"Qualifying" unitholders generally include Singapore-incorporated tax-resident companies, Singapore branches of foreign companies that have obtained approval from the IRAS to receive such distributions free of withholding tax, and bodies of persons registered or constituted in Singapore, for example management corporations, trade unions, registered charities, etc.

3.3.3. Foreign non-individual unitholders

Foreign non-individual investors are entitled to receive distributions from the REIT at a reduced withholding rate of 10% instead of the usual withholding rate, which is the normal corporate tax rate (currently 20%). This reduced rate of 10% is applicable for REIT distributions made between 18 Feb 2005 and 17 Feb 2010.

A foreign non-individual investor is one who is not a tax resident of Singapore and who does not have a permanent establishment in Singapore. Where such an investor has a permanent establishment here, the funds used to invest in the REIT must not be from the permanent establishment.

3.3.4. Other unitholders

All other unitholders or investors receive distributions net of tax withheld at the normal withholding rate, currently 20%.

3.3.5. Stamp duty

To further attract REIT listings in Singapore, stamp duty on instruments of transfer relating to the sale of immovable properties by individuals and companies into REITs that are already listed on the Singapore Exchange, or to be listed within one month from the date of completion of the sale agreement, is remitted for transfers effected between 18 Feb 2005 and 17 Feb 2010.

As stamp duty is usually chargeable at about 3% of the higher of market value or the consideration paid for the immovable property, the proposed remission represents a significant cost savings for REITs.

3.4. Taxation of income from offshore properties

The scheme outlined above is a summary of the tax treatment for the REITs in Singapore that own real estate properties located in Singapore. Let us now look at the case of REITs whose underlying assets, some of which or all of which, are located offshore.

These REITs generally hold special purpose vehicles that own real estate properties located in jurisidictions outside of Singapore. Foreign tax is generally suffered on the income derived from the letting of the real estate properties in the foreign jurisdictions, whether directly or by way of foreign withholding tax. Consequently, the income receivable by such REITs is generally foreign dividends from the special purpose vehicles. In stark contrast to income from Singapore real estate properties which is given tax

transparency treatment, the foreign income of REITs with offshore properties are not given tax transparency treatment. Instead, such REITs get tax exemption on the dividends receivable from the special purpose vehicles. This is on the basis that the dividends, or the income out of which the dividends are paid, are subject to tax in the foreign jurisidictions, and the headline tax rate [2] in the foreign jurisdictions is at least 15%. Also, under the tax rulings obtained by the REITs with offshore properties, the distributions made by the REITs out of such tax-exempt foreign income to its beneficiaries are also tax-exempt in the hands of the beneficiaries.

Where the income of the REITs with offshore properties is subject to tax in Singapore (because the foreign income is not subject to tax in the foreign jurisdictions, or because the income is Singapore-sourced income), tax will be assessed on the income in the name of the trustee. Consequently, distributions made out of such after-tax income will be exempt from tax in the hands of the beneficiaries.

4. CHALLENGES TO DEVELOPMENT OF THE SINGAPORE REIT MARKET

While REITs in Singapore are currently still relatively attractive to investors, over time the supply of local properties that may be put into a REIT is expected to decline. As it is, some REITs are already holding a mixture of local properties and property interests overseas, and the number REITs looking to do so is likely to increase over time. This effectively means there will be added complexity of having to grapple with tax and legal frameworks in overseas jurisdictions, as well as the foreign currency risks that come with cross border investments for investors. This could pose a real challenge to REITs, especially if investors continue to expect stable and attractive yields.

Investors will have to be more "educated" so that they can understand the total risk-return structure of REITs dealing with a mixture of local and overseas properties, rather than continue to invest in REITs based solely on distributions or in the hope of capital appreciation of the REITs' underlying assets.

Also, REITs in Singapore have flourished in the recent low interest rate environment. With interest rates on the increase, REITs may become less attractive as their unit prices will be affected. As interest rates are expected to rise in the current economic climate, locally as well as globally, this could pose an additional challenge to REITs.

5. CONCLUSIONS

The Singapore REIT market should continue to do well in the short to medium term. However, with more countries in the region getting on the bandwagon, notably Malaysia and Hong Kong which are trying to establish their own REIT industries, the REIT market in Singapore could face more competition in the future. At the moment, Singapore's REIT market is the second largest in Asia in terms of market capitalisation, after Japan. With more countries going after the same investment dollars, it remains to be seen how Singapore will cope.

The REIT market in Singapore will no doubt continue to evolve with time, and diverse structures with greater sophistication will emerge. One good example is the stapled structure adopted by the recently launched CDL Hospitality Trusts. Not only is this particular REIT a stapled structure, it also has hotels as its asset class. To continue to be successful, the taxation and legal frameworks in Singapore must keep up with market evolution.

FOOTNOTES

1. **The taxation information of the REITs in Singapore and their unitholders is obtained from their respective prospectuses issued during their initial public offerings. These are public documents and as such, the information contained therein cannot, and are not intended to, be exhaustive. Investors shoud seek professional tax advice on specific transactions to be contemplated.**
2. **The headline tax rate is the highest corporate tax rate of the foreign juridiction, which need not to be actual rate imposed on specific foreign income concerned (in this case dividends).**

Author's Profile

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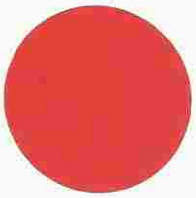
Japan

Development and Taxation of Real Investment Trust*

Ken Takahashi



INTRODUCTION

Since the Law Concerning Investment Trusts and Investment Corporations of Japan ("Investment Corporations Law") enabled the creation of the real estate investment trust and real estate investment corporation in Japan (collectively, "REIT") as from 30 November 2000, and the Tokyo Stock Exchange established the REIT market as from 1 March 2001, the REIT market has evolved dramatically. As at 31 December 2004, 15 REITs were listed on the Tokyo Stock Exchange and total assets held by these REITs exceeded JPY 2 trillion (approximately USD 18 billion). In view of its middle-risk middle-return nature, REITs appear to be popular not only among financial institutions and corporate investors, but also among individual investors.

2. KEY FEATURES OF A REIT

2.1. What is a REIT?

The Investment Corporations Law governs the following vehicles that can be utilized for REITs:

- settlor-directed investment trust (itakusha sashizu-gata toshi shintaku)
- non-settlor-directed investment trust (itakusha hi-sashizu-gata toshi shintaku); and investment corporation (toshi houjin).

2.1.1. Settlor-directed investment trust

A settlor-directed investment trust is a trust established for the purpose of managing investments primarily in securities, real estate or other assets designated under relevant Cabinet Orders ("specified assets"). An eligible fund manager (toushi shintaku itaku gyousha) becomes the settlor of a settlor-directed investment trust who directs its trustee as to how entrusted money should be invested. The beneficial interests of a settlor-directed investment trust is divided into units and sold to multiple investors.[1]

2.1.2. Non-settlor-directed investment trust

A non-settlor-directed investment trust is also a trust established for the purpose of managing investments *primarily in specified assets. A major difference* from the settler-directed investment trust is that its trustee becomes the fund manager. Each of its multiple investors becomes a settler and beneficiary of the trust by concluding essentially identical trust contracts with the trustee, while having no rights with respect to investment decisions.[2]

2.1.3. Investment corporation

An investment corporation is a corporation established for the purpose of managing investments in specified assets.[3] Investors purchase shares (toshi guchi) issued by the investment corporation. As

opposed to a normal company, the investment corporation is allowed to engage in its business only after completing its registration with the Financial Service Agency ("FSA"),[4] and its operation is subject to the supervision of the FSA.[5]

As the investment corporation is designed to be a collective investment vehicle, the Investment Corporations Law requires that the fund management function should be fully assigned or out-sourced to a licensed fund manager,[6] the custodian function to an eligible custodian,[7] and other administrative functions to an outside service provider.[8]

The investment corporation is not allowed to hire any employees:[9] nonetheless, an investment corporation holds shareholders' meetings,[10] and has directors[11] and statutory auditors,[12] like a normal company.

Shareholders' liability is limited by shares.[13] The minimum capital requirement is JPY 100 million[14] and its net asset value must always be maintained at JPY 50 million or more.[15] Its financial statements must be audited by external auditors[16] and be submitted to the FSA within 3 months from each fiscal year-end.[17] The investment corporation can be either closed-end or open-end,[18] as in the case of an investment trust. However, the investment corporation can issue bonds only if it is closed-end[19] and the Tokyo Stock Exchange listing rules require that an eligible REIT must be closed-end.

In practice, all the REITs currently listed on the Tokyo Stock Exchange utilize an investment corporation as their vehicle. Therefore, the rest of this article will focus only on investment corporations.

2.2. Investment restrictions

The Investment Corporations Law does not impose many investment restrictions. Article 193 of the Investment Corporations Law provides that an investment corporation can engage in the following activities in accordance with its articles of incorporation:

- acquisition and disposition of securities; securities lending;
- acquisition and disposition of real estate; real estate leasing;
- assigning (or out-sourcing) property management;
- any other transactions in respect of specified assets, except engaging in real estate development on its own behalf.[20]

Because there are few investment restrictions, the investment corporation is not only used for REITs, but also for exchange-traded funds listed on the Tokyo Stock Exchange.

The Investment Trusts Association of Japan (of which most licensed fund managers are members) defines a REIT as an investment trust or investment corporation whose trust contract or articles of incorporation provide that at least 50% of entrusted assets are invested in real estate, real estate-backed securities or other real estate interests.[21] Incidentally, there is no definition for a REIT in the Investment Corporations Law.

The Tokyo Stock Exchange listing rules require that at least 75% of an eligible REIT's total assets must be in real estate or real estate interests, and at least 50% of total assets must be real estate or real estate interests which derive stable real estate rents.

3. TAXATION

3.1. Taxation of an investment corporation

An investment corporation is subject to corporate income tax on its worldwide income at approximately 42%. However, unlike a normal company, the following special provisions apply.

3.1.1. Dividend payment deduction

If the investment corporation satisfies certain requirements, the amount of dividends declared to its shareholders for a qualifying fiscal year becomes deductible in computing its taxable profit (i.e. dividend payment deduction),[22] as a result of which the corporate income tax burden could be mitigated.

To be eligible for the dividend payment deduction, the investment corporation must satisfy all the following requirements:

- the investment corporation must be registered

with the FSA in accordance with Article 187 of the Investment Corporations Law;

- one of the following conditions must be satisfied:
  - ~ the shares are publicly offered at the time of incorporation and the total issue amount at the time is JPY 100 million or more; or
  - ~ as at fiscal year-end, the issued shares are held by 50 or more shareholders, or held solely by qualifying financial institutions;
- the articles of incorporation must stipulate that the shares are offered primarily in Japan; and the fiscal year of the investment corporation must be a period of 1 year or less [23]

A qualifying fiscal year is a fiscal year during which all the following requirements are satisfied: [24]

- the investment corporation does not violate Article 63 of the Investment Corporations Law, which provides that the investment corporation
- must not engage in any other business than investment management;
- the fund management function is assigned to a licensed fund manager as stipulated under Article 198(1) of the Investment Corporations Law;
- the custodian function is assigned to a qualifying custodian as stipulated under Article 208(2) of the Investment Corporations Law;
- as at fiscal year-end, the investment corporation does not qualify as a closely-held corporation [25] as stipulated under Article 2 (10) of the Corporation Tax Law;

  the amount of declared dividends in respect of the fiscal year exceeds 90% of the amount of distributable profits calculated in accordance with relevant enforcement orders;

  the investment corporation does not own 50% or more of shares in other companies; and if the investment corporation borrows money, the loan provider must be a qualifying financial institution [26]

3.1.2. Non-applicability of dividend received deduction

A corporate taxpayer is generally entitled to a dividend received deduction, whereby 100% or 50% of dividends received from a Japanese company can be excluded from the taxable profit of the receiving company. However, an investment corporation is not entitled to this deduction.[27]

3.1.3. Withholding tax exemption for incoming dividends and interest

A corporate taxpayer is generally subject to a 20% withholding tax on dividend or interest income in respect of bonds, investment trusts or stocks. However, an investment corporation is entitled to a withholding tax exemption on incoming dividend or interest from bonds if at least one of the following requirements is met: [28]

- the articles of incorporation stipulate that more than 50% of entrusted assets are invested in securities, securities futures or certain derivative transactions; or
- the shares in the investment corporation are publicly offered at the time of incorporation.

3.1.4. Preferential indirect tax rates

The acquisition of real estate is generally subject to a real estate acquisition tax that is levied by a local government within the territory in which the real estate is situated, and the tax rate is currently reduced from 4% to 3% under temporary legislation.[29] In the case of an acquisition by a qualifying investment corporation on or before 31 March 2007, the tax base is reduced by two-thirds.[30]

The registration of legal ownership of real estate is subject to a 1%[31] registration tax in general. However, a lower rate of 0.6% applies to a qualifying investment corporation on the registration of ownership on or before 31 March 2006.[32]

3.1.5. Other special provisions

The following special provisions apply to an investment corporation:

- the investment corporation is not entitled to

a so-called indirect foreign tax credit [33] (i.e. foreign tax credit for corporate taxes paid by a foreign subsidiary);

entertainment expenses are entirely non-deductible;[34] and

recognition of allowances for bad debts based on a prescribed formula is not applicable to the investment corporation.[35]

3.2. Taxation of investors

3.2.1. Japanese individual investors

The tax treatment of dividends received by a Japanese individual investor from J-REIT shares depends on whether the investor holds more or less than 5% of the total issued shares in the J-REIT. If the investor holds 5% or more, the dividend income is subject to a 20% withholding tax, [36] and should be included in his aggregate taxable base which is subject to progressive income tax rates [37] (up to 50%, including local taxes). If the investor is a portfolio investor who holds less than 5%, a 10% [38] withholding tax applies [39] and the dividend income does not need to be reported in his annual tax return.[40]

Capital gains realized upon the sale of J-REIT shares are currently taxed at a 10% [41] flat rate,[42] regardless of the percentage of shareholding in the J-REIT.

3.2.2. Japanese corporate investors

Dividends received from J-REIT shares are fully taxable for corporate income tax purposes [43] at approximately 42%. A 7% [44] withholding tax on dividends applies, but the tax withheld can in principle be credited against the corporate income tax payable.[45]

Capital gains realized upon the sale of J-REIT shares are also fully taxable for corporate income tax purposes [46] of the Corporation Tax Law. No separate tax rate applies to capital gains which are thus taxable at at the normal corporate income tax rate.

3.2.3. Non-resident individual investors [47]

As with resident individuals, the tax treatment of dividends received by a non-resident individual investor from J-REIT shares depends on whether the investor holds more or less than 5% of the total issued shares in the J-REIT. If the investor holds 5% or more, the dividend income is subject to a 20% withholding tax. [48] If the investor is a portfolio investor who holds less than 5%, a 7% [49] withholding tax applies.[50] The withholding taxes are final if the investor has no permanent establishment in Japan.

The tax treatment of capital gains realized upon the sale of REIT shares also differs depending on whether the investor held more or less than 5% of the total issued shares in the REIT as at the end of the immediately preceding fiscal year. The 5% threshold takes into account shares held by related persons, including those held by a partnership in which the investor is a partner. [51] Where shareholding was more than 5%, the capital gains are taxed [52] at a 15% flat rate, [53] assuming that the investor has no permanent establishment in Japan. If the investor is a portfolio investor who held 5% or less, no income tax should in principle be imposed.

3.2.4. Non-resident corporate investors [54]

Dividends received from REIT shares are subject to a 7% [55] withholding tax. [56] This is a final tax if the investor has no permanent establishment in Japan.

As with non-resident individual investors, the tax [57] treatment of capital gains realized upon the sale of REIT shares depends on whether the investor has held more or less than 5% of the total issued shares in the REIT as at the end of the immediately preceding fiscal year. The 5% threshold takes into account shares held by related persons, including those held by a partnership in which the investor is a partner. Where shareholding was more than 5%, the capital gains are taxed [58] at a 30% flat rate,[59] assuming that the investor has no permanent establishment in Japan. If the investor is a portfolio investor who held 5% or less, no corporate income tax should in principle be imposed.

4. TAX PLANNING ISSUES

The 2005 tax reform introduced capital gains taxation on the transfer of shares (both listed and unlisted) in real estate companies or interests in real estate trusts under Japanese domestic tax. A real estate company is defined, in brief, as a company with 50% or ,ore of total assets consisting of Japanese real estate, shares in other real estate companies or beneficial interests in real estate trusts. A real estate trust is defined in a similar manner. [60]

By definition, a REIT qualifies as a real estate company, and as such the rules applicable to real estate companies also apply to REITs. A non-resident investor is in principle required to report capital gains realized upon the transfer of shares in real estate companies or interests in real estate trusts in his annual tax return. [61] However, exceptions apply for portfolio investors. If a non-resident investor held 5% or less of listed shares, or 2% or less of non-listed shares, in a real estate company as at the end of the previous fiscal year, then the capital gains are tax-exempt, assuming that the investor has no permanent establishment in Japan.[62]

In the case of a non-resident investor who held more than 5% of listed shares, or more than 2% of non-listed shares, in a real estate company as at the end of the previous fiscal year (and thus taxable on capital gains), a question arises as to whether any tax treaty protection is available. In this respect, some tax treaties concluded by Japan (namely, the tax treaties with the US, France, South Korea, Singapore, Mexico, the Philippines and Vietnam) provide that gains derived by a resident of the other country from the alienation of shares that derives at least 50% of its value directly or indirectly from real property situated in Japan may be taxed in Japan.[63] Thus, these tax treaties do not provide any protection.

On the other hand, other tax treaties (including those with the UK, Italy, Germany and Switzerland) have no explicit provision to that effect. If these tax treaties further allocate the taxing right in respect of the capital gains to the other country (i.e. the country in which the taxpayer is resident), then it could be interpreted that Japan has no right to tax the gains; thus, treaty protection is available. The author believes this to be a sound legal interpretation; nevertheless, the possibility that the Japanese tax authorities may challenge this in cases of aggressive tax planning cannot be entirely ignored.

It should be noted that Japan is currently undergoing treaty negotiations with the Netherlands, the UK and India. Many expect the new treaties with these countries to be more or less in line with the new US-Japan tax treaty that came into effect as of 30 March 2004.

5. OTHER ISSUES

Some Japanese tax practitioners express concern with regard to the mechanism of the dividend payment deduction applicable to an investment corporation.

As mentioned in 3.1.1., a deduction is available only if the amount of declared dividends in respect of the fiscal year exceeds 90% of the amount of distributable profits calculated in accordance with relevant enforcement orders. The amount of declared dividends is based on accounting profits, while the amount of distributable profits is the tax profit.

A problem arises when the accounting profit is lower than the tax profit, e.g. when an impairment loss is recognized due to a significant decrease in real estate value for accounting purposes, but is not deductible for tax purposes. It may be extremely difficult, if not impossible, to satisfy the 90% dividend test in such situations. This has become a case for concern especially since the application of impairment accounting in respect of fixed properties became mandatory as from the fiscal year starting on or after 1 April 2005.

It is apparent that legislators did not intend for such anomalous circumstances; however, the author strongly hopes that such situations will be rectified through legislative amendments as soon as possible.

1. Article 2(1) of the Investment Corporations Law.
2. Article 2(2) of the Investment Corporations Law.
3. Article 2(19) of the Investment Corporations Law.
4. Article 187 of the Investment Corporations Law.
5. Article 205(1) of the Investment Corporations Law.
6. Article 198(1) of the Investment Corporations Law.
7. Article 208(1) of the Investment Corporations Law.
8. Article 111 of the Investment Corporations Law.
9. Article 63(2) of the Investment Corporations Law.
10. Articles 89 - 94 of the Investment Corporations Law.
11. Articles 95 - 99 of the Investment Corporations Law.
12. Articles 100 - 104 of the Investment Corporations Law.
13. Article 77(1) of the Investment Corporations Law.
14. Article 68(2) of the Investment Corporations Law.
15. Article 67(6) of the Investment Corporations Law.
16. Article 129(4) of the Investment Corporations Law.
17. Article 212 of the Investment Corporations Law.
18. Article 67(1)(iii) of the Investment Corporations Law.

19. Article 139-2(1) of the Investment Corporations Law.
20. Article 95 of the Investment Corporations Law Enforcement Order.
21. Article 3(1) of the Rules Concerning Real Estate Investment Trusts and Real Estate Corporations (Investment Trusts Association of Japan).
22. Article 67-15(1)(i) of the Special Taxation Measures Law.
23. Article 39-32-3(3) of the Special Taxation Measures Law Enforcement Order.
24. Article 67-15(1)(ii) of the Special Taxation Measures Law.
25. Briefly, a closely-held corporation is defined as a corporation where more than 50% of its shares are held by 3 or less shareholder groups.
26. Article 39-32-3(6) of the Special Taxation Measures Law Enforcement Order.
27. Article 67-15(3) of the Special Taxation Measures Law.
28. Article 9-4 of the Special Taxation Measures Law.
29. Article 11-2(1) of the Supplementary Rules to the Local Tax Law.
30. Article 11(21) of the Supplementary Rules to the Local Tax Law.
31. The rate of 1% applies to the registration of real estate ownership on or before 31 March 2006; thereafter, 2% applies.
32. Article 83-4(3) of the Special Taxation Measures Law.
33. Article 67-15(3) of the Special Taxation Measures Law.
34. Article 67-15(4) of the Special Taxation Measures Law.
35. Article 67-15(4) of the Special Taxation Measures Law.
36. Articles 181 and 182 of the Income Tax Law, and article 9-3(1)(i) of the Special Taxation Measures Law.
37. Article 8-5(1)(ii) of the Special Taxation Measures Law.
38. The rate of 10% applies to dividends received on or before March 2008; thereafter, 20% applies.
39. Articles 9-3(1)(i) and 9-3(2) of the Special Taxation Measures Law.
40. Article 8-5(1)(ii) of the Special Taxation Measures Law.
41. The rate of 10% applies to capital gains realized on or before 31 December 2007; thereafter, 20% applies.
42. Article 37-11 of the Special Taxation Measures Law. The sale should in principle take place via a qualifying stock exchange in order to be eligible for the reduced tax rate.
43. Article 67-15(5) of the Special Taxation Measures Law.
44. The rate of 7% applies to dividends received on or before 31 March 2008; thereafter, 15% applies.
45. Article 68 of the Corporation Tax Law.
46. Article 61-2(1) of the Corporation Tax Law.
47. It is assumed that the investor has no permanent establishment in Japan.
48. Articles 181 and 182 of the Income Tax Law, and article 9-3(1)(i) of the Special Taxation Measures Law.
49. The rate of 7% applies to dividends received on or before 31 March 2008; thereafter, 15% applies.
50. Articles 9-3(1)(i) and 9-3(2) of the Special Taxation Measures Law. The difference in rates compared with a Japanese resident investor is due to the absence of local taxes in the case of a non-resident investor.
51. Article 291(11) of the Income Tax Law Enforcement Order.
52. Article 291(1)(iv) of the Income Tax Law Enforcement Order.
53. Article 37-12(1) of the Special Taxation Measures Law.
54. It is assumed that the investor has no permanent establishment in Japan.
55. The rate of 7% applies to dividends received on or before 31March 2008; thereafter, 15% applies.
56. Articles 9-3(1)(i) and 9-3(2) of the Special Taxation Measures Law.
57. Article 187(11) of the Corporation Tax Law Enforcement Order.
58. Article 187(1)(iv) of the Corporation Tax Law Enforcement Order.
59. If the non-resident corporate investor has no permanent establishment in Japan, no local tax is due. Therefore, only the national corporate tax rate of 30% applies.
60. Article 187(9) of the Corporation Tax Law Enforcement Order and article 291(9) of the Income Tax Law Enforcement Order.
61. Article 187(1) of the Corporation Tax Law Enforcement Order and article 291(1) of the Income Tax Law Enforcement Order.
62. Article 187(10) of the Corporation Tax Law Enforcement Order and article 291(10) of the Income Tax Law Enforcement Order.
63. E.g. article 13(2)(a) of the US-Japan tax treaty.

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Cross Border Employee Share and Option Plans: Distinguishing Employment Income from Investors Gains

Celeste M Black*

ABSTRACT

The tax treatment of benefits obtained under employee share and option plans is more complex than the taxation of many other forms of employee remuneration. There are at least five potential taxing points during the life cycle of the share or option and the gains realised can be characterised as either employment income or investment gains or both. When the benefits are subject to tax in more than one jurisdiction there is also the potential for double taxation or double non-taxation. The amendments enacted by Schedule 4 to the New International Tax Arrangements (Foreign-owned Branches and Other Measures) Act 2005 bring Australia's treatment closer to OCED model which recognises that the right to tax the employment income derived from employee shares and options is more correctly allocated on the basis of the days within the vesting period which are worked in the relevant jurisdiction.

I. INTRODUCTION

Schedule 4 to the New International Tax Arrangements *(Foreign-owned branches and Other Measures) Act 2005* (hereinafter the *"NITA Act 2005"*) introduced various amendments to the taxation treatment of share or rights received under an employee share scheme where the individual / employee works in more than one country or changes residency. The Explanatory Memorandum to the Bill states that these amendments are intended to more closely align Australia's tax measures with the international norms developed by the OECD.[2] In August 2004, the OECD released a report entitled *Cross-border Income Tax Issues Arising from Employee Stock Option Plans* (hereinafter the *OECD Report*).[3] This Report considers the issues of double taxation and double non-taxation of benefits derived from employee share option plans and highlights many of the problems which can arise from the application of differing taxation regimes to this category of employee benefits.

This paper will consider several aspects of Australia's tax treatment of cross border employee share and rights. By way of background, the paper will begin with an overview of the *OECD Report* and its recommendations. The measures enacted by the *NITA Act 2005* will then be considered in some detail and placed in the context of the *OECD Report*. Finally, the impact of these amendments will be considered in the context of other recent Government policies with regard to cross-border movement of labour, in particular the reforms announced in the 2005 Budget which are intended to encourage the movement of skilled labour to Australia. This paper will not considered double tax treaty implications of the *NITA Act 2005* amendments in any detail.

II. THE OECD REPORT

In 2004 the OECD released its final report on the cross-border income tax issues which may arise from employee stock option plans,[4] culminating a process which included a discussion draft issued in March 2002.[5] The *OECD Report* focuses on the taxation of the employee and notes that transfer pricing issues may also be raised by employee stock option plans but are not analysed in the *OECD Report*.[6] It should also be noted that the Report only discusses the treatment of stock *option* plans (in the Australian legislation, rights to acquire shares) and not other forms of equity based remuneration, such as the issue of shares to employees at a discount to market value.[7]

Stock options present particular difficulties as they are often granted subject to vesting requirements and the value in the options may not be realised by an employee until as late as the sale of the underlying shares acquired on exercise of the options. This can given rise at least five potential taxation points: on grant; when vesting conditions are satisfied; on exercise or sale of the option; when restrictions on the sale of the underlying shares are lifted; and on sale of the underlying shares.[8] Given that any particular country may elect to tax the benefit at one or more of these times (or even at other times not specific to options, such as when the employee ceases to be a resident),[9] it is clear that double taxation can arise which is difficult to relieve where the relevant jurisdictions tax at different times.[10]

Additional issues arise from the characterisation of the benefits derived. Some jurisdictions may characterise the benefit as employment income while others consider such benefits to be investment gains, assessable as capital gains.[11] Throughout the life cycle of the option, both characterisations may come into play, as is the case in Australia.[12] The OECD therefore considered that certain standards should be recommended for reducing the potential for double taxation.[13]

The OECD adopts the view that a stock option provided as part of a remuneration package falls within the phrase "salaries, wages, and other similar remuneration" for the purposes of Article 15 of the Model Tax Convention.[14] However, the element of

capital gain for Article 13 purposes must also be preserved. The *OECD Report* therefore sets a dividing line between the employment income and the capital gain.

Based on the fact that a large number of countries tax the benefit up until the exercise of the option as employment income, it was considered that "any benefit accruing in relation to the stock-option up to the time when the option is exercised, sold or otherwise alienated should be treated as income from employment to which Article 15 applies."[15] As a result of characterizing the benefit up until exercise or sale as employment income, the jurisdiction in which the relevant employment was exercised would have the primary taxing right over the benefit. Where the employment is provided in more than one jurisdiction, it was considered that the most logical rule would be to allocate the primary taxing right on the basis of days worked, that is, by determining the number of days within the vesting period worked in the relevant jurisdiction in over total relevant days of the vesting period[16] (relevant days being determined under the terms of the plan).[17] Once the option is exercised, it is considered that any subsequent gain will be derived as an investor (no longer as an employee) thereby triggering the application of Article 13 of the Model Tax Convention.

The calculations required by this approach must be fully appreciated. The *value* of the benefit is measured from the date of grant until the date of *exercise*. However, the allocation of taxing rights is based on the days worked in the period from the date of grant to the date that the option become *fully vested*. This is clearly illustrated in the following example taken from the *OECD Report*:

Employee E is resident and working in State A on 1 January 1998. He is granted an option to purchase shares for a price of 1, conditional on remaining in that employment until at least 1 January 2001. On 31 December 1999 he moves to work in State B, of which he becomes a resident. He exercises the option on 1 July 2001 when the market value of the shares acquired is 8 and sells all the shares so acquired immediately. The benefit from the stock option should be regarded as income from employment covered by Article 15. State A may tax the part of the stock option benefit that was derived from employment carried on there, but only as a proportion of those days that were relevant for the stock option plan. If each working year is 260 days, then the days relevant to the stock option plan total 780 (3 x 260). State A may tax 520 (2 x 260) days of this as deriving from employment carried on there, i.e. 66.7% and State B may tax 260 days as deriving from employment exercised in State B. The remaining 130 days of employment between the date of vesting and exercise were not relevant to the stock option plan and are therefore ignored.[18]

However, the Committee also notes in its report that countries may bilaterally agree to different approaches for determining the relationship between the gain on the stock option and the relevant service.[19]

The *OECD Report* further highlights the difficulties which can arise where the employee changes residence during the vesting period and the two jurisdictions tax the benefit at different points. Based on another example in the *OECD Report*,[20] assume that the employee is resident in State A when the option is granted and resident in State D when the option becomes fully vested and is exercised. Further assume that State A taxes stock options on grant while State D taxes at exercise. On the basis of residence, both State A and State D will be entitled to tax the whole of the benefit, not restricted by Article 15. However, under Article 23 of the A-D convention, each State will be required to provide relief from double taxation, which will be based on the location of the performance of the relevant services (ie State A will provide relief for the proportion of days worked in State D). However, if during the vesting period, services are also provided in another State C the situation becomes

more complex, particularly where the presence in State C is less than 183 days and State C therefore does not tax the benefit. Both State A and State D will seek to tax that part of the benefit which relates to the days of service in State C and none of the relevant treaties will operate to relieve this tax, thereby leading to double taxation on a residence basis of that portion of the gain on the option which relates to services performed in State C.

III. THE NITA ACT 2005

On the stated policy objective that the amendments would bring Australia's regime for taxing employee shares and rights more in line with international norms, the *NITA Act 2005* introduced amendments to Division 13A of the *Income Tax Assessment Act 1936* as well as to the relevant Capital Gains Tax ("CGT") provisions of the *Income Tax Assessment Act 1997*.[21]

Specifically, the amendments in the *NITA Act 2005* extend the application of Division 13A to include in a taxpayer's assessable income the discount received on an employee share or right even if that benefit is granted prior to establishing Australian residency but then excludes back out the discount to the extent to which it relates to foreign service.[22]

The discussion of the provision in the Explanatory Memorandum allows for the adoption of an allocation rule based on the relevant employment days in determining the proportion of an employee share or right benefit which will be taxable in Australia.[23] However, what the *NITA Act 2005* does not do is resolve the potential double taxation problems illustrated in the *OECD Report* where the time of taxation differs across jurisdictions. As noted in the *OECD Report* the majority of jurisdictions seek to tax employee share options when they are exercised whereas under the Australian legislation, the taxing point is generally on grant.[24] The timing of derivation is aligned to exercise only in the case of qualifying rights[25] where no election for up-front taxation is made[26] such that the taxing time is the "cessation time"[27] which may under the circumstances be the time of exercise.[28]

A. INBOUND EMPLOYEES WITH PRE-EXISTING SHARES OR RIGHTS - The Amendments to Divisions 13A

Broadly, the amendments extend the application of the employee share plan rules found in Division 13A to cases where an employee has been granted the share or right and subsequently, but prior to full vesting of the benefit, provides employment services in Australia. The provisions seek to subject to Australian income tax that portion of the employee share benefit (the discount calculated as at grant time) which relates to Australian service by excluding that portion which relates to foreign service.[29] The determination of the relevant portion of the discount to be included in income must be made in the year that the individual becomes an Australian employee[30] but this may require that certain assumptions be made where the vesting period is not yet complete. According to the Explanatory Memorandum to the *NITA Bill 2005*, in making this determination, the most reasonable assumption will often be that the employee will serve out the balance of the vesting period engaged in Australian employment, though this presumption may be rebutted under the facts.[31] To enable Division 13A to apply to these circumstances, the meanings of the terms 'employee' and 'employer' have been extended to also be relevant for foreign service.[32] Under the previous provisions, the meanings of 'employee' and 'employer' were linked back to *ITAA 1936* s 221A and withholding requirements and therefore did not extend to non-Australian employment arrangements. These definitions are now extended to include reference to foreign service, which is defined as "service in a foreign country as the holder of an office or in the capacity of an

employee."[33] Unfortunately, the drafting here is far from simple as this extension does not apply in all circumstances and the more restricted meaning of the term 'employee' is preserved for certain purposes, such as determining if the Division 13A concessions are available.[34] Therefore, one must be cautious in applying the provisions to ensure that the correct meaning of "employee" is used. For the purposes of this paper, the term "Australian employee" will be used to represent an employee under the more narrow (original) definition.

The default trigger point for assessment is the time at which the employee becomes an Australian employee. In light of the basic rule of Division 13A which includes the amount of discount in income in year the share or right is acquired,[35] a new provision applies to a share or right granted prior to Australian employment and includes the discount in the taxpayer's income in the year of income in which the taxpayer first becomes an employee,[36] here using the restricted meaning of employee as "Australian employee".

1. *New International Tax Arrangements (Foreign-owned Branches and Other Measures) Bill* 2005 enacted as Act No 64 of 2005.
2. Explanatory Memorandum to *New International Tax Arrangements (Foreign-owned Branches and Other Measures) Bill* 2005, para 4.1 (hereinafter EM).
3. OECD, *Cross-border Income Tax Issues Arising from Employee Stock Option Plans*, Report approved by the Committee on Fiscal Affairs, 23 August 2004 (hereinafter *OECD Report*).
4. Id.
5. OECD, *Cross-border Income Tax Issues Arising from Employee Stock Option Plans: A Public Discussion Draft*, 1 March 2002.
6. *OECD Report* para 1.
7. *OECD Report* para 2.
8. *OECD Report* para 7.
9. Such as in Australian under the CGT event I1, *Income Tax Assessment Act 1997* (hereinafter *ITAA 1997*) s 104-160.
10 *OECD Report* para 9.
11 *OECD Report* para 16.
12 This is seen in the interaction of *Income Tax Assessment Act 1936* (hereinafter *ITAA 1936*) Division 13A and *ITAA 1997* Subdivision 130-D.
13 *OECD Report* para 17, recommending additions to the Commentary on the Model Tax Convention regarding Articles 15, 23A and 23B.
14 *OECD Report* para 18.
15 *OECD Report* para 23.
16 For these purposes, the concept of vesting of an option is defined in some detail but can be generally understood as having occurred when all the conditions for exercise have been satisfied such that the option may be exercised. Refer *OECD Report* para 5.
17 *OECD Report* para 3 2; see also new para 12.14 to the Commentary on the Model Tax Convention, Article 15.
18 *OECD* Report para 35
19 *OECD* Report para 36 and see the new para 12.15 t the Commentary on Article 15 of the Model Tax Convention.
20 Refer OECD Report paras 41-43.
21 Additional consequential amendments were also made to the Fringe Benefits Tax Assesment Act 1986 and other parts of the ITAA 1936 and the ITAA 1997.
22 New *ITAA 1936 s* 139B (1A).
23 EM para 4.6.
24 *ITAA 1936 s* 139B (2).
25 As defined in *ITAA 1936 s* 139CD.
26 This election being made under *ITAA 1936 s* 139E.
27 *ITAA 1936 s* 139B (3). The term cessation time is defined in *ITAA 1936 s* 139E.
28 *ITAA 1936 s* 139CB (1)(d).
29 *ITAA 1936* s 139CB(1) and new sub-s(1A).
30 New *ITAA 1936* s 139B(2A).
31 EM paras 4.43 and 4.44. In circumstances where these assumption are found later not to have been correct, the assessment may be amended and a new extended period for amendments in provided in new *ITAA 1936* s 139DG.
32 *ITAA 1936* s 139GA.
33 New *ITAA 1936* s 139GBA.
34 Under *ITAA 1936* s 139GA(2), the extension to a person engaged in foreign service does not apply in relation to ss 139B(2A) [when discount is included in income], 139CDA [additional requirement for shares or rights to be qualifying], 139D(3)
35 *ITAA 1936* s 139B(2).
36 New *ITAA 1936* s 139B(2A).

Author's Profile

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Interpretations of DOUBLE TAX AGREEMENTS[1]

Serjit Singh CA

Background

A Double Tax Agreement (DTA) is a bilateral agreement between two countries that governs the way certain transactions are taxed and determines to a certain extent which country has the right to tax in certain instances. It is fair to say that a DTA has three broad roles as defined below: -

- ~ A DTA generally increases the extent to which exporters residing in one Contracting State can engage in trading activity in the other Contracting State without attracting liability in that latter state (subject to certain limitations/conditions);

- ~ When a resident of a Contracting State does engage in sufficient activity in the other Contracting State to incur agreed tax rates the DTA establishes certain guidelines on how that income is to be taxed; and

- ~ A DTA provides a dispute resolution mechanism that the Contracting State may invoke to relieve double taxation in particular instances not dealt with explicitly under the DTA.

Additonally, DTAs provide an element of economic and fiscal certainty for international investment. For example, a Malaysian company investing into Australia and receiving dividends on the investment from Australia, will be taxed at the appropriate withholding tax rate of 10% (or such appropriate rate determined from time to time), as stipulated in the DTA between Malaysia and Australia.

The fundamental role of a DTA thus can be summarised to act as a prevention of double taxation and consequently the elimination of fiscal evasion and avoidance.

As a matter of interest, DTAs (also known as bilateral tax treaties) were spearheaded by two well known international fiscal associations, i.e. the Organisation for Economic Co-operation and Development (OECD) and the United Nations (UN). These two organisations have created templates from where the DTAs which we have today originated from. For the avoidance of doubt, the OECD Model Treaties are the most popular templates, and most if not all DTAs are based on the OECD model. Very briefly, the main differences between the two treaties is that the UN model places more emphasis on source taxation[2] and it also recommends not fixing a maximum amount on withholding tax on dividends and interest. Instead it advocates negotiation between the two parties in establishing a mutually acceptable rate. A detailed analysis of the genesis of differences between the 2 models is beyond the scope of this article. Suffice to say that for the purposes of this article, a background has been set on the ideology and origin of DTAs. What I would like to explore is its application and more importantly, its interpretation.[3]

Welcome to DTA Interpretation 101

Philip Baker QC (renowned specialist on Double Taxation Conventions and a tax academic in International Law and Taxation) states that DTAs have a dual nature. On the one hand, they are international agreements entered into between contracting states pursuant to which those contracting states agree to limit the exercise of their fiscal jurisdiction. On the other hand they become part of the domestic tax law of each contracting state, whether automatically or by incorporation through enactment into domestic tax law.[4]

As domestic tax legislation, some countries adopt a strict and literal construction approach. However as an international treaty, a DTA should be subject to the same rules of interpretation as other treaties, that is following a purposive approach.[5] Therefore should DTAs be interpreted as domestic tax legislation or as treaties?

> "The rapporteurs of Germany, Luxembourg, and Switzerland particularly stress the fact that double taxation agreements are bilateral conventions and thus belong to the law of nations, but when they have been ratified and are put into effect by the contracting States, they also belong to the domestic law of such States. An agreement is thus simultaneously subject to the rules of interpretation applicable to international and domestic public law, the rules of public international law taking precedence in cases of dispute." [6]

A clear majority of Courts in a number of countries have now accepted that DTAs are to be interpreted in accordance with the rules of public international law applicable to the interpretation of treaties, and not by application of the rules applicable to domestic tax legislation.[7]

Aids to Interpretation

1. The Vienna Convention

As mentioned above DTAs are international agreements entered into between contracting states. Also as mentioned above the interpretation of DTAs are governed by public international law, specifically by the Vienna Convention on the Law of Treaties of May 23, 1969 (the VC). [8] *Klaus Vogel* states that the VC brought clarity and a measure of uniformity to treaty interpretation.[9]

Pursuant to Article 31(1) of the VC, the starting point for the interpretation of a DTA is therefore to consider a particular term s ordinary meaning, in the context of the DTA, and in light of the object and purpose of the DTA. The text of the DTA is therefore of primary importance.

The ordinary meaning of a term is the meaning ascribed to it in everyday usage and may be obtained from a dictionary. However, the ordinary meaning of a term is not necessarily only that of everyday usage. Vogel states that to the extent that an internationally uniform legal usage or a legal usage consistent between contracting states has developed, or to the extent that a specific technical language has developed in certain specialised areas, such as tax law, these can then be viewed as the ordinary meaning pursuant to Article 31(1) of the VC.[10]

Vogel states that **"object and purpose"** is one integral expression. He goes on to state that the phrase is used in international case law and that there is no reasonable interpretation of object being separate from purpose.[11]

Articles 31, 32, and 33, of the VC have been referred to in a growing number of decisions around the world involving the interpretation of DTAs.[12] Even some states that have not ratified the VC follow these Articles in the interpretation of DTAs.[13]

2. OECD Model Treaty, Commentary, Observations and Reservations

i. Basis and nature of relevance

Vogel prefers the view that the terms of the Model Convention constitute the *"ordinary meaning"* if the contracting states based their DTA on the Model Convention [VC Article 31(1)], or at the least a *"special meaning"* [VC Article 31(4)] and consequently binding on the parties.[14] As such the Model Convention and its commentaries would be a direct tool of interpretation and not merely a supplementary means of interpretation.[15] The New Zealand Court of Appeal accepts it as a direct tool of interpretation by stating that the DTA is *"part of a network of international agreements using* ***international language****...the OECD Convention rules have an international currency...and accordingly the language of the rules should be construed on* ***broad principles of general acceptation*** *and having appropriate regard to the commentary..."* [16]

Member states of the OECD may also be legally bound to follow the Model Convention unless they entered a reservation or unless domestic law prevents a member country from adopting a provision. Vogel claims a presumption that a state intends to incorporate the meaning attributed by the Model Convention if the DTA follows its wording.[17] Certainly a member state s taxation authority and taxpayers are implored by the introduction to the OECD Model Convention to interpret and apply DTAs in accordance with the Commentaries.

The OECD Model Convention is both a primary source of interpretation (Article 31) and a secondary source (Article 32). As members to the OECD states are bound to follow its objective and thus it s content. This is a rule of International Law of the member states and as such falls under Article 31(4) of the Vienna Convention. It also forms part of the wider meaning of context.

The existence of the Model Conventions and Commentary, and the member states obligations in respect thereof are known to the authors of a DTA. The need to bring the DTA within the OECD framework is therefore certainly a *"circumstance of its conclusion"* and relevant as secondary means of interpretation in terms of Article 32 of the Vienna Convention.

ii. Static or ambulatory

Should the version of the Model Treaty and Convention valid at the time of conclusion of the DTA be relevant to interpretation (static) or should the version valid at the time of application of the provisions of the DTA (ambulatory) be relevant.

The current Model Convention favours an ambulatory approach.[18]

Some authors [19] and courts [20] have favoured the static approach arguing convincingly that if the Commentary is relevant to interpretation as conveying the ordinary meaning of the treaty under Article 31(1) of the Vienna Convention or a special meaning under 31(4) then it is because the Commentary was available to the Parties at the conclusion of the DTA and the Parties concluded the DTA with the ascribed meanings in mind. Abandoning the old Commentary for the new [21] would have the implication that the parties intention would change which is clearly an untenable situation.

Other courts have accepted commentaries issued subsequent to the conclusion of the DTA as relevant. [22]

3. Travaux Preparatoires

Travaux preparatoires are the working papers that are prepared prior to the conclusion of a DTA.[23] Several Courts have sanctioned the use of *travaux preparatoires* as an aid to the interpretation of DTAs.

The real question is, however, will Courts use *travaux preparatoires* as a matter of course, or only where a particular term is ambiguous or obscure, or the meaning given to a particular term is absurd or unreasonable?

The International Court of Justice has been reluctant to have recourse to *travaux preparatoires* where the text of the DTA is clear and leads to no absurdity.[24] The UK House of Lords has adopted a similar attitude.[25]

4. Unilateral Material

Baker defines unilateral material as *"material prepared by one contracting state and reflecting that party's understanding of the meaning of the treaty."*

The New Zealand Court of Appeal has applied unilateral material in interpreting DTAs on the basis that it assists in establishing a uniform interpretation between the contracting states.[26]

Unilateral material should however be an aid and not of binding force.

5. Foreign language texts/Parallel treaties

Parallel treaties are sometimes used to assist interpretation.[27] *Baker* however doubts their value.[28]

DTAs are often concluded in more than one language in which case the treaty may state that one or both of the versions are authoritative.[29] If both languages are agreed as being authoritative the Vienna Convention determines that an interpretation that best reconciles a conflicting text should be followed.[30]

Where the other language text is not declared to be authoritative the English courts accept the value of foreign language texts *"to look for assistance, **if assistance is needed**"* in cases including but also other than where there is ambiguity.[31] The portion emphasised does however indicate that foreign language texts would not be relevant should the meaning ascribed by the language of promulgation be unequivocal when interpreted in terms of the provisions of the Vienna Convention.

6. Expert evidence

In a few cases, Courts have also accepted expert evidence to assist in the interpretation of DTAs.[32]

In *Xerox* [33] the US Court of Claims received evidence from members of the US negotiating team for the US-UK DTA as well as evidence of the two English Ministers who had been involved in Parliamentary proceedings relating to the Convention. It should be noted that the Federal Circuit Court of Appeals reversed the decision at first instance however, stating that the statements of legislators are usually not accorded much weight, but that such evidence could be admitted when it reinforced the plain and ordinary meaning of a text.

Jones argues that even where the evidence of negotiators or Ministers is in accordance with the plain and ordinary meaning of the text, that such evidence should be given little weight, if accepted at all. [34]

However, expert evidence from international law experts and language experts are generally accepted as aids in the interpretation of DTAs.

In *Commonwealth Development Corp v CIR* [35] affirmed on appeal (Civil Appeal No.14 of 1992, 14 June 1994)., the High Court of Fiji took evidence from a leading expert on international tax

law as to the meaning of the treaty between Fiji and the UK. An argument was presented that the meaning of the treaty was a question of Fijian law. The High Court held, however, that expert evidence is admissible as to foreign law and the effect of foreign law, and accepted the evidence on that basis.

Similarly, in *Lamesa*[36] the Federal Court of Australia has accepted the evidence of a leading expert on Dutch international tax law in connection with the interpretation of the Netherlands-Australia DTA. Baker states that there is no reason why foreign decisions and rulings should not be proved in this way.

7. Reference to domestic law

Currently the applicability of domestic law on DTAs is as follows:-

Firstly the express definitions within the text of the treaty or the treaty rules of interpretation will be applied.[37]

Should there be no definition in the text of the DTA the definition of the term in the domestic law of the state applying the DTA is sought. If the tax law definition differs from the definition ascribed to the term in other spheres of law the former has precedence.

Vogel is of the opinion that the general rules of interpretation should be followed in the absence of a definition in the state s tax laws.[38] Save for giving preference to the tax law definition the treaty does not require the definitions of domestic tax laws to be treated any differently from other domestic law definitions.[39] The *"context"* still reigns supreme over both. Vogel s statement that *"interpretation by recourse to domestic law in cases not covered by Art. 3 (2) is permissible only if the context does not provide any basis for interpretation at all"* cannot be accepted.

Thereafter the domestic law definitions (there may be numerous definitions) must be considered in the context of the treaty. This requirement incorporates the rules of the Vienna Convention, the guidance of the commentaries and other sources of interpretation into the realm of definition seeking. Context is also determined by the intention of the parties at the time of the conclusion of the treaty and the meaning given to terms by domestic laws.[40] Should the domestic definition be contrary to the Commentaries or be against the object and purpose of the Treaty it should be rejected or tempered as required by the context.[41] These sources would tend to attribute a meaning that serves the object and purpose of the treaty, including the avoidance of double taxation and consistency. To attribute a meaning that would cause double taxation or be contrary to the import of the DTA would be contrary to the context and would require a different interpretation.[42]

A balance is must be achieved between the need to secure the permanency of commitments and to avoid states negating their obligations by promulgating subsequent legislation; and the need for treaties to remain topical, current and practical and avoid the need to refer to outdated definitions leading to unsuitable results.[43]

It is important to note that domestic law may only be utilised in relation to the definition of specific individual words. Domestic law may not be utilised to interpret the DTA in general.[44]

Conclusion

This article has attempted to shed some light on some tried and proven methods in the interpretation of DTAs. As one can appreciate, the subject of interpretation of statutes, laws and the like are taught over a period of time at universities and other institutions of higher learning. An attempt to summarise these tools within this article will only prove to be futile.

However, it is my intention that this article provides some useful aids in the interpretation of DTAs from a practical standpoint. Tax practitioners and academics alike, when faced with an interpretation of DTAs situation can rely on these tools with some degree of certainty and confidence.

As can be seen, and perhaps as should be expected, given the nature of DTAs, their interpretation is by no means a straightforward task.

As with all treaty interpretation, the primary goal in the interpretation of DTAs is to give the correct effect to their object and purpose . As illustrated above, this means more than merely determining the intention of the contracting states at the conclusion of a DTA.

Practically, it should also be remembered that DTAs have an international purpose which overflows into domestic usage and law. A whole league of revenue authorities, taxpayers, and politicians rely on the correct interpretation of DTAs. As McHugh J stated in *Applicant A and Another v Minister for Immigration and Ethnic Affairs and Another :* [45]

> **"Fourthly, international treaties often fail to exhibit the precision of domestic legislation. This is the sometimes necessary price paid for multinational political comity..."** [46]

The rules of interpretation and the aids to interpretation are therefore there to try to ensure that the correct interpretations of DTAs are made, uniformly, and keeping pace with the relevant changes over time. It is worth remembering the following comment made at the 48th International Fiscal Association Congress in Toronto in 1994:

> **"All treaties in their very nature demand and leave room for interpretation...lawyers have a tendency to assume, erroneously, that treaty texts are inflexible and carved in stone. They are not. They are resilient texts designed to be moulded and to adjust to unforeseen problems arising in the relationship between the states parties."** [47]

FOOTNOTES

1. The work of my esteemed colleague Dwerryhouse C, in his Master of Taxation Studies research paper on the *"Interpretation of DTAs"* is noted in the formulation of this article.
2. For further details please refer to Jeffrey Owens *"The Main Difference between the OECD and the United Nation's Model Conventions"* in Richard Vann (ed) *"Tax Treaties: Linkages between OECD Member Countries and Dynamic Non Member-Economies"* (OECD, Paris, 1996) p49.
3. For further consideration and interest on this topic, please refer to Philip Baker *"Double Taxation Conventions: A Manual on the OECD Model Tax Convention on Income and on Capital" (3rd ed. Sweet & Maxwell, London, 2003) A1-A7.*
4. P Baker, *"Double Taxation Conventions"*, September 2004, University of London at pB-8
5. Supra n3 at pE-1
6. The International Fiscal Association s 1960 *"Report on the Interpretation of Double Taxation Conventions"* (1960) 42 Cahiers DFI at p294.
7. Supra n3 at pE-2.
8. Ibid.
9. K Vogel, *"Double Taxation Conventions"*, 2nd Edn, Munich 1991, Kluwer Law and Taxation Publishers, at p13.
10. Articles 31, 32, and 33 of the Vienna Convention on the Law of Treaties 1969, p29
11. Ibid at p30.
12. These include: New Zealand: *CIR v JFP Energy Inc.* (1990) 14 TRNZ 617. Australia: *Ngee Hin Chong v CoT* (2000) 2 ITLR 707. UK: *Sportsman v IRC* [1998] STC (SCD) 289. Canada: *Coblentz v R* (1996) 96 DTC 6,531. Fiji: *Commonwealth Development Corp. v CIR* Civil Appeal No.14 of 1992 (High Court of Fiji, Appellate Jurisdiction). Belgium: *Verast & Folens* (1998) 1 ITLR 435 denying reference to the Vienna Convention on the grounds that the provision in question was unambiguous. Norway: Supreme Court decision of November 9, 1992.
13. *Thiel v FCT* (1990) 90 ATC 4,717 at 4727 where the High Court of Australia referred to the Vienna Convention even though the other contracting State, Switzerland, was not a party to that Convention, on the grounds that the rules of interpretation contained there were no more than an endorsement of existing practice .
14. *Vogel* refer note 9, p. 44, par. 80
15. *Thiel's* case seems to utilise the Model Convention as supplementary means as noted by *Vogel* ibid
16. *CIR v. JFP Energy Inc.* (1990) 14 T.R.N.Z. 617 (C.A.) at p. 621
17. *Vogel* refer note 9, p. 45, par. 80 and 80a

FOOTNOTES

18. Introduction to the OECD Model Tax Convention, 2003, p. 16, par. 33
19. *Vogel* refer note 9 p. 46, par. 82a written before the 1997 amendments
20. British High Court of Justice (Chancery Division) in *Sun Life Assurance v. Pearson* STC 461ff. (1984) at 513 similarly decided before the 1997 amendments.21.Please note that the OECD Model Convention and Commentaries have been through considerable changes over the years. The first published version was released in 1963, revised in 1967 and published in its revised form in 1977. There were revisions thereafter as a result of which a new model was published in 1992, again to be revised in 1994, 1995, 1997 and 2000.
22. See the cases referred to by *Baker*, p. E-16 and 17, e.g. Viscount *Dilhorne* in *J. Buchanan & Co. Ltd. v. Babco Forwarding and Shipping Co. Ltd.* (1978) A.C.141 at 157; quoted with approval in *Thiel v .F.C. of C.* 89 A.T.C. 4015 at 4021
23. G A Harris, *"New Zealand's International Taxation"*, December 1989, Oxford, at p76.
24. *European Commission of the Danube* [1927] PCIJ Series B, No.14, at p31.
25. See case *Fothergill v Monarch Airlines Limited* [1980] 3 WLR 209
26. *C.I.R. v. J.F.P. Energy Inc.* (1990) N.Z.T.C. 7,176 at 623-624
27. *The Queen v. Crown Forest Industries Ltd. and the Government of the United States of America (Intervener) 95 D.T.C. 5389 (Supreme Court of Canada)* (refer Dominion Tax Cases online copy as printed p. 11)
28. *Baker* refer note 4 p. E-32
29. *Baker* refer note 4, p. E-32, par. E.33
30. Article 33(4)
31. *J. Buchanan & Co. Ltd v. Babco Forwarding and Shipping (U.K.) Ltd.*1978 A.C. 141 (H.L.(E.)) at 152E; *Fothergill* supra at 272C-H
32. *Baker* refer note 4 pE-33.
33. (1988) 88-1 USTC 83,776 (US Court of Claims), reversed by the Federal Circuit Court of Appeals, (1994) 94-2 USTC 86,344.
34. The practice of bringing Affidavits from Ministers has been criticised by John Avery Jones — see [1995] BTR 425.
35. Case No.1 of 1991, affirmed on appeal (Civil Appeal No.14 of 1992, 14 June 1994).
36. *FC of T v Lamesa Holdings BV* 97 ATC 4752
37. *Vogel* refer note 9 p. 215, par. 74
38. Ibid p. 216, par 74
39. *Baker* refer note 4, p. E-23, par. E.22
40. Ibid p. 3-6, par. 3C.12
38. Ibid p. 216, par 74
39. *Baker* refer note 4, p. E-23, par. E.22
40. Ibid p. 3-6, par. 3C.12
41. Ibid
42. *Vogel* refer note 9, p. 215, par. 73; see also the first finding and reasoning in *R. v. Melford Developments Inc.* (1982) 82 D.T. C. 6, 281 (CCH Online Collection/ Canadian Tax Cases/ Full Court of Appeal/ 1981/ The Queen v Melford Developments Inc at par. 16 to 23)
43. *Baker* refer note 4, p. 3-6, par. 3C.13
44. Ibid p. 209, par. 62
45. (1996-1997) 142 ALR 331.
46. Ibid at p351.
47. 48th IFA Congress, Toronto, 1994, Vol.19c: *How Domestic Anti-Avoidance Rules Affect Double Taxation Conventions* (Kluwer Law International, 1995) at p6.

Author's Profile

The author is currently pursuing a Master in Taxation Studies at the University of Auckland, New Zealand. His current research interest includes the study of international tax structures and arbitrage, particularly the use of offshore jurisdictions and trusts as a tax planning tool. The author is a Manager attached to one of the Big Four accounting practices in Auckland. The views expressed by the author are his personal views.

CUSTOMS REQUIREMENTS FOR THE IMPORT AND EXPORT OF TIMBER AND WOOD PRODUCTS

Thomas Selva Doss

INTRODUCTION

Wood is a unique raw material that is eco-friendly and can be harvested and replanted in managed forest areas. This product is largely classified on the basis of growing regions (tropical and temperate) and other attributes (coniferous and non-coniferous). It is traded in a variety of forms, including, but not limited to, round logs, sawn timber, plywood, veneers and fibreboards. The world trade of round logs and sawn timber itself is in excess of 120 million cubic meters and is valued at over US $25 billion.

Forestry is one of Malaysia s most rapidly growing economic sectors. Malaysia is one of the largest exporters of tropical wood in the world accounting for about 70% of the world s supply of raw logs. Sabah and Sarawak occupy some of the oldest and most diverse rain forests in the world. These forests provide most of Malaysia s exports of tropical logs. The increase in large scale exploitation of these rainforests is largely due to the increase in world demand for tropical timber. In fact logging has hit Sabah and Sarawak so rapidly and with such drastic consequences that many environmentalists consider it to be an urgent problem. Many countries in South-East Asia such as Indonesia and Thailand have reacted to the excessive world demand by enacting legislative restrictions. Malaysia has also been cautious and has imposed certain restrictions on logging with a view to and emphasizing the curbing of illegal logging. Establishing the Malaysian Timber Council and the Malaysian Timber Industry Board (MTIB) has enabled the Malaysian Government to introduce controls on the timber trade.

The MTIB is the main body responsible for the wood industry as stipulated under the Malaysian Timber Industry Board (Incorporation) (Revised) Act 1990. One of its main functions is to regulate and control the distribution and marketing of wood with the purpose of upholding the quality and the name of Malaysian wood.

The recent controversy surrounding the importation of sawn timber at the Kuala Linggi Port in Melaka has raised many questions as to what are the requirements and prohibitions imposed by the Customs Department on the import and export of logs, sawn timber, veneer, mouldings and so on.

The Customs (Prohibition of Imports) and (Prohibition of Exports) Order 1988 has listed certain wood and wood products which are subject to Import Licences and Export Licences. Effective 1 January 1988, logs, large scantling and squares (timber that has been converted with a saw or split by wedges or having a cross section of not less than 60 square inches or 375 sq cm and whose thickness equals or exceeds half of its width) can only be imported into Malaysia with a valid Import Licence issued by the MTIB. The export of logs, sawn timber, moulding, plywood, veneer, chip or particle board, fibre boards, wood chips and ground wood require an Export Licence. Exporters are also required to be registered with the MTIB.

The Harmonised Commodity Description and Coding System has carefully classified wood and articles of wood under Chapter 44. Starting with fuel wood, it progresses to cover wood in the rough, hoopwood, railway sleepers, sawn wood, veneer sheets, specially shaped wood, particle board, fibre board, plywood and densified wood ending with various types of wood products. Chapter 44 is specifically designed to cover various types of un-manufactured wood, semi-finished products of wood and in general articles of wood. In this chapter, the classification of wood is not affected by the treatment necessary for its preservation, nor is it affected by it being painted or varnished as long as it retains its original nature.

IMPORTATION

Most of the logs originating from Sabah and Sarawak are either immediately processed into sawn timber or transported to Peninsular Malaysia for further processing. These are mainly to be used in the furniture industry and looks to be a very promising area of the economy. However the supply of wood in Malaysia is gradually decreasing and our neighbouring countries of Thailand and Indonesia are able to offer more competitive prices for more or less the same type of wood as is found in Malaysia. As a result of this price discrepancy, much of the Thai and Indonesian timber find their way, legally and illegally into our country.

The illegal importation of logs from Kalimantan, Indonesia to Sabah and Sarawak has been a long standing problem. The long border with Indonesian Kalimantan and the existence of numerous *'lorong tikus'* or logging tracks deep in the jungle make it difficult for Malaysian enforcement officers to keep track of these illegal shipments, which are expertly monitored by syndicates. Once this timber makes it way into Sabah or Sarawak it is quite impossible for the authorities to ascertain whether they were illegally brought in or obtained from our own forests.

Effective 25 June 2002, the Malaysian Government has taken action to ban the importation of logs from Indonesia. The importation of logs from other countries is still permitted. The decision to ban the Indonesian timber is in response to the move by the Indonesian Government to ban the export of their logs, so as to overcome the problem of illegal logging which has reached a serious stage. There has been no issuance of import licences for logs from Indonesia since the announcement of the ban. Despite the ban and the enforcement efforts taken so far, we are still confronted with the problem of Indonesian logs entering Malaysia. Customs officers have made a number of seizures involving boats carrying Indonesian logs but falsely declared as coming from other sources such as the Solomon Islands. Malaysia is serious in totally curbing the entry of Indonesian logs into Malaysia and is taking measures to strengthen our enforcement efforts and remove any loophole that exists in implementing the ban. Apart from banning the importation of round logs, the ban on the importation of squared logs i.e. timber measuring more than 60 square inches in size from Indonesia was effected from 1 June 2003. This decision was made in an attempt to erase the negative perception against our timber industry by international timber buyers that timber and timber products from Malaysia are from illegal and unsustainable sources.

IMPORT PROCEDURES

To import logs, importers must obtain permission from the Ministry of Primary Industries. The following details must be furnished:

i. species / main types and quantity of logs (in cubic meters) to be imported;

ii. point of entry;

iii. reasons for importing (commercial or personal);

iv. for import of logs to Sabah only — name and the factory s licence number, where the logs are to be processed;

In addition to this, an Import Licence must be obtained from the MTIB with the following documents:

i. approval letter from the Ministry of Primary Industries;

ii. 4 copies of Customs No. 1 Form;

iii. Import Licence form (JK 69);

iv. 2 copies of log tally;

In the event that the logs imported are of

various kinds/species, a complete list of the type and species need to be attached with the application. This complete list must also be forwarded to the Directors of the respective State Forestry Departments for the purpose of physical examination. The Import Licence is only valid for 60 days from the date of issuance.

For the physical examination, the importers need to stockpile the logs at the respective landing points and notify the State s Forestry Department officers. The logs need to be marked at both ends by using the property hammer mark. The importers property hammer mark needs to be registered with the respective State Forestry Department and may not be used by other importers.

Importers also need to contact the Forestry Department for a Transfer Permit before transferring logs from the landing point. Each of the lorry s load will be inspected at the Forestry Department inspection point to ensure the permitted load-weight.

To import mangrove wood/bakau wood, wood roughly squared, half squared logs, sawn timber and other wood products, approval from the Ministry of Primary Industries is not needed but an Import Licence from the MTIB is required. All wood products need to be imported at designated ports or landing points such as Port Klang, Penang Port, Johor Port, Miri Port, Bintulu Port, Sandakan Port and so on. Customs regulations also require the importer to fill in the necessary customs forms such as the Customs No.1 to be submitted to the proper officer of customs at the port. Import duty for goods classified under chapter 44 of the Harmonised System ranges form NIL to 40% and sales tax is from NIL to 10%. Most of the raw wood does not attract sales tax.

EXPORT PROCEDURES

Export of Logs

To export logs, the exporters must be registered with the MTIB and also obtain permission from the Ministry of Primary Industries. These exporters must also be in possession of valid licences from the respective State Forestry Departments. Application must be made to the MTIB Headquarters with the following documents:

i. a copy of the letter of credit;

ii. a copy of the contract between the exporter and the overseas buyer;

iii. Exchange Control Forms (KPWX) if the value of the export exceeds RM20,000.00;

iv. Approval letter from the Ministry of Primary Industries;

Applications will be considered, provided these following conditions are fulfilled:

i. the diameter of logs are 30cm (12in) or less;

ii. the logs to be exported are other than those listed below:-

- Balau
- Bintangor
- Chengal
- Damar Minyak
- Durian
- Jelutong
- Kapur
- Kasar
- Kelat
- Keledang
- Kempas
- Keruing
- Kulim
- Kungkur
- Machang
- Melunak
- Mengkulang
- Meranti Merah
- Meranti Puteh
- Merbau
- Merpauh
- Mersawa
- Nyatoh
- Sepetir
- Sesendok
- Simpoh
- Terentang

EXPORT OF LOGS THROUGH TAMBAK JOHOR

In addition to the Export Licence, exporters also need to attach these following documents:

i. Customs Declaration Form No.2 (6 copies);

ii. Transfer pass issued by the respective State s Forestry Department; and

iii. a copy of letter of approval to export logs from the MTIB;

The Export Licence is valid for 60 days from the date of issuance.

EXPORT OF LOGS THROUGH PASIR GUDANG

In addition to the Export Licence, exporters also need to attach these following documents:

i. Customs Declaration Form No.2 (8 copies);

ii. A list of log tally, validated by the Quality Control Inspector;

iii. Transfer pass issued by the respective State s Forestry Department; and

iv. a copy of letter of approval to export logs from the MTIB;

The Export Licence is valid for 60 days from the date of issuance.

EXPORT TO SINGAPORE BY TRAIN

In addition to the Export Licence, exporters also need to attach these following documents:

i. Customs Declaration Forms No.2 (8 copies);

ii. Transfer pass issued by the respective State s Forestry Department;

iii. Validation from the MTIB Quality Control Inspector, inspecting the logs; and

iv. A copy of letter of approval from the MTIB;

The Export Licence is valid for 60 days from the date of issuance;

EXPORT THROUGH EXITS OTHER THAN TAMBAK JOHOR AND PASIR GUDANG

In addition to the Export Licence, exporters registered with the MTIB also need to attach these documents:

i. Customs Declaration Form No.2 (5 copies);

ii. A list of log tally certified by the MTIB Quality Control Inspector;

iii. Transfer pass issued by the respective State s Forestry Department; and

iv. A letter of approval to export logs by the MTIB;

The Export Licence is valid for 60 days from the date of issuance.

EXPORT OF SAWN TIMBER TO SINGAPORE BY TRAIN

In addition to the Export Licence the following documents are required:

i. Customs Declaration Form No.2 in 8 copies;

ii. 2 copies of Grading Summary issued by the Timber Grader;

iii. Standard contract between the supplier and importer; and

iv. Validation from the MTIB Quality Control Inspector;

The Export Licence is valid for 60 days from the date of issuance.

There are numerous procedures for the export of railway or tramway sleepers of wood, and large scantlings and squares (H.S. code 44.03 and 44.06), veneer, plywood, blockwood, chip or particleboard, fibreboard, fuel wood, ground wood and mouldings. The exporters need to

classify each type of wood product accurately. The export duty for goods classified under Chapter 44 of the Harmonized System ranges from NIL to 15%. There is no sales tax.

EXPORT REQUIREMENTS FOR SOLID WOOD PACKAGING MATERIALS (SWPM)

Malaysian exporters using wood packaging and dunnage should be aware that their solid wood packing materials (SWPM) will need to comply with ISPM15 (the international standard for the trade in wood packaging material including dunnage). SWPM is defined as wood packing materials other than loose wood packing materials, used with cargo to prevent damage, including but not limited to dunnage, crating, pallets, packing blocks, drums, cases and skids.

This requirement is necessary to ensure that pests are not transmitted from the exporting country. Inspections at ports showed an increase in pests associated with wood packaging material which pose a serious threat to the agriculture, cultivated and natural forest of a country.

To obtain a permit to enter countries which have implemented the ruling, the SWPM must have been:

i. heat treated to achieve a minimum wood core temperature of 56°C for a minimum of 30 minutes. Such treatment may employ kiln-drying, chemical pressure impregnation, or other treatments that achieve this specification through the use of steam, hot water, or dry heat;or

ii. Fumigated with methyl bromide in an enclosed area for at least 16 hours of the stipulated dosage, stated in terms of grams of methyl bromide per m3;

iii. Following fumigation, fumigated products must be aerated to reduce the concentration of fumigant below hazardous levels (normally 24 hours in Malaysia);

MOVEMENT OF SAWN TIMBER BETWEEN SABAH OR SARAWAK AND PENINSULAR MALAYSIA

Sawn timber brought into Peninsular Malaysia from Sabah or Sawarak is not regarded as an import. However the relevant customs form No.3 must be filled in for the inspection of Customs Officers.

Movement of sawn timber, veneer and certain wood products from Peninsular Malaysia to Sabah and Sarawak is also not considered as an export as long as they are moved by companies registered with the MTIB as an exporter. The Customs No.3 form must also be filled in.

The import and export of logs, sawn timber and wood products come under the jurisdiction of the Customs Department. Customs officers at the point of entry encounter various types of goods moving in and out of the country. Certain types of goods require specific procedures to be followed. The standard operating procedures are often stringently enforced by these officers to prevent illegal goods from entering or leaving Malaysia. In the case of timber, Customs Officers and the Marine Police are vigilant for tongkangs and other crafts plying the Straits of Malacca trying to land illegal timber especially from Indonesia. Most of the timber is unloaded at remote jetties along the West Coast of Peninsular Malaysia. Few are detected due to the crafty methods used by the smugglers who are well-versed with the numerous landing points dotting the mangrove coastline of the West Coast.

Author's Profile

Thomas Selva Doss served as Senior Officer of Customs in Royal Malaysian Customs Department for 13 years. He is trained in Customs Audits and Investigations at the Malaysian Customs Academy. Currently, Thomas runs his own firm, Dossnett Consulting Sdn Bhd., providing Customs advisory services to clients in Malaysia and Singapore. He can be contacted at 012-230 9417 or email customs@stremyx.com.

Practical Education

Joint and Separate Assesment of Income Tax for Married Women

QUESTIONS and ANSWERS

Q1. Explain what is the meaning of separate assessment, and who can be assessed separately?

A1. A separate assessment means the income of the wife is not assessed jointly / together with the husband s income. Under self assessment, a separate Form B or BE is issued to both husband and wife respectively. Self assessment is given automatically to the wife unless she elects to be assessed jointly with the husband. A joint assessment must be elected for in writing i.e. by filling in Part A page 1 of Form B or BE, column A7 and A8. The option of electing for either a joint or combined assessment is on a year to year basis and is governed by section 45(2) of ITA 1967.

Q2. What are the advantages of electing for a separate assessment?

A2. When a wife is assessed separately from the husband, among the advantages that she may gain are as follows:

(1) She is entitled to her own self relief of RM8,000 (granted automatically) — sec 46(1)(a).

(2) If she is disabled person, she is entitled to claim an additional disability relief of RM6,000 — sec 46(1)(e).

(3) She is entitled to claim relief for medical expenses for her parents up to a maximum of RM5,000. These include medical care and treatment provided by nursing homes. Endorsement(s) from the doctor certifying the treatment and the original receipts should be obtained — sec 46(1)(c).

(4) She is also entitled to claim relief, up to a maximum of RM5,000, for the purchase of basic medical support equipment like wheelchairs, dialysis machines, etc. in aid of a limited class of persons namely herself, her spouse, her children and /or her parents. — sec 46(1)(d).

(5) She is also entitled to claim up to a maximum RM6,000 as relief for any life insurance policies paid by her or contribution made by her to an approved provident or pension fund such as EPF (employees provident fund) — sec 49(1)(a), 49(1)(b), 49(1)(c), subsection 49(1A).

(6) The wife is entitled to claim as relief up to a maximum of RM3,000 for any payments for insurance premiums paid by her for medical benefits or education benefits for her children — sec 49(1)(B).

(7) In certain circumstances, the wife is also entitled to claim child relief for the maintenance of her unmarried children.

a. if her children below 18 years old — RM1,000 per child — sec 48(1)(a).

b. if her children are above 18 years old attending fulltime education at college or university, local or overseas — RM4,000 per child— sec 48(1)(b).

c. if her children are handicapped and below 18 years old — RM5,000 per child — sec 48(1)(d).

d. if her children are handicapped and above 18 years old and pursuing tertiary education — RM9,000 each (ie. RM5,000 + RM4,000) per child — sec 48 (3)(a).

(8) The wife is entitled to claim up to a maximum of RM5,000 on fees expended by her for any course of study up to tertiary level of education in any institution or professional body in Malaysia which is duly recognized by the government. The courses undertaken are for the purpose of acquiring technical vocational, industrial, accountancy or legal skills — sec 46(1)(f).

(9) The wife is also entitled to claim up to a maximum of RM5,000 in respect of medical expenses expended by her for herself, her spouse or children who are suffering from any serious diseases. Serious diseases include Acquired Immune Deficiency Syndrome (AIDS), Parkinson s disease, cancer, renal failure, leukemia and other similar diseases — sec 46(1)(g).

(10) The wife can claim up to a maximum of RM500 in respect of complete medical examination expenses expended by her. This amount shall be part of the amount limited to a maximum of RM5,000 in paragraph (9) — sec 46(1)(h).

(11) The wife is also entitled to claim a maximum of RM700 (increased to RM1,000, as proposed under the 2007 Budget Proposal w.e.f. year of assessment 2007) in respect of expenses incurred

for the purchase of books, journals, magazines and other similar publications for the purpose of enhancing knowledge for herself, her spouse or her children, original receipts must be obtained — sec 46(1)(i).

(12) The wife can claim a tax relief up to RM3,000 for purchase of computers. This relief is given every 3 years and must be evidenced by receipt(s) (as proposed under the 2007 Budget Proposal w.e.f. year of assessment 2007).

Q3. ***What is the primary objective of having separate assessment?***

A3. Basically the rationale for separate assessment is to reduce the overall tax liability of the family. This is because the more income one has the higher the rate of tax. Thus, by being assessed individually, both husband and wife will show lower individual incomes, thus attracting lower rates of tax.

Q4. ***The following information is given by Mr. and Mrs.A for year of assessment 2006. Explain the income tax liability of Mr. and Mrs. A in both scenarios i.e. under a joint assessment and under a separate assessment.***

Mr. A:
- ~ Employment income RM 62,300 (after EPF of 11%)
- ~ Dividend (net) RM 7,200 from Pepco Sdn Bhd.
- ~ Medical expenses spent on his parents RM 5,700.
- ~ Life insurance premium policy taken on his life RM 210 per month.
- ~ Expenses incurred on books and journals for his usage RM 520.

Mrs. A:
- ~ Employment income RM 35,600 (after 11% EPF deduction)
- ~ Rental income from property in Klang RM 24,000 (before deducting quit rent and assessment rates of RM 220 and RM 280 respectively)
- ~ Alimony received from ex-husband RM 2,000 per month.
- ~ Medical and education insurance premium policy on children RM 3,400.
- ~ Life insurance premium policy taken on her life RM 180 per month.
- ~ Expenses spent on female magazines for her RM 120.
- ~ She spent RM 2,100 on children school books.

Note:
(a) They have 3 unmarried children, between 20 and 11 years old. The youngest child is mentally disabled. The eldest is studying accountancy in Auckland, New Zealand. The amount spent by the family is RM 7,000 per month. The second child 17 years old is studying A level at HELP Institute, Kuala Lumpur. Amount spent on her is RM 600 per month.

(b) Mr. A donated RM 350 cash to an approved old folks home.

(c) Mrs. A donated goods worth RM 720 to an approved charitable organization.

A4. (i) Tax liability of Mr. A and Mrs. A under Separate Assessment for Year of Assessment 2006

Mr A

				RM
Sec 4(b)	: Employment income (62,300 x 100/89)		=	70,000.00
Sec 4(c)	: Dividend (7,200 x 100/72)		=	10,000.00
	Aggregate Income			80,000.00
Less	: Approved donation – cash – sec 44(6)			(350.00)
	Total Income			79,650.00
Less	: Personal Relief :			
	Self relief	8,000		
	Medical expenses (mx)	5,000		
	EPF + Life insurance (mx) (7,700 + 2,520)	6,000		
	Books + journals	520		
	Children (20)	4,000		
	(17)	1,000		
	(11)	5,000		(29,520.00)
	Chargeable Income			50,130.00
	Tax on the1st RM50,000		=	3,475.00
	Tax on the balance 130 @19%		=	24.70
				3,499.70
	Less:Tax credit (28% x 10,000)			(2,800.00)
	Tax Payable			699.70

Mrs A

				RM
Sec 4(b)	: Employment income (35,600 x 100/89)			40,000.00
Sec 4(d)	: Rental – gross	24,000		
	(-) quit rent	(220)		
	(-) Assessment rate	(280)		
	Adjusted rental income			23,500.00
Sec 4(e)	: Alimony (2,000 x 12)			24,000.00
	Aggregate Income			87,500.00
Less	: Donation – in kind (not qualified)			NIL
	Total Income			87,500.00
Less	: Personal Relief:			
	Self relief	8,000		
	EPF + Life insurance (mx)(4,400 + 2,160)	6,000		
	Books + magazines (mx)(120 + 2,100)	700		
	Medical + education (mx)	3,000		(17,700.00)
	Chargeable Income			69,800.00
	Tax on the 1st RM50,000		=	3,475.00
	Tax on the balance 19,800 @19%		=	3,762.00
	Tax Payable			7,237.00

(ii) Tax Liability of Mr. A and Mrs. A under Joint Assessment for Year of Assessment 2006

				RM
Total Income- Mr. A				79,650.00
- Mrs. A				87,500.00
Total Income of Family				167,150.00
Less: Personal Relief				
Self relief		8,000		
Wife relief		3,000		
Medical expenses (mx)		5,000		
EPF and Life insurance (mx)(7,700 + 2,520)		6,000		
Book + journal + magazines(520 + 120 + 2,100) (mx)		700		
Medical + education (mx)		3,000		
Children (20)		4,000		
(17)		1,000		
(11)		5,000		(35,700.00)
Chargeable Income				131,450.00
Tax on the 1st RM100,000			=	14,475.00
Tax on the balance 31,450 @ 27%			=	8,491.50
				22,966.50
(-) Tax Credit (28% x 10,000)				(2,800.00)
Tax Payable				20,166.50

Note: EPF and Life Insurance Premium paid by Mrs. A cannot be claimed since it is a joint assessment, and the main tax payer is the husband.

Conclusion:

1. Under separate assessment, the total tax liability of the family is RM7,936.70 (ie. 699.70 + 7,237)
2. Under joint (combined) assessment, the total tax liability of the family is RM20,166.50
3. Thus, the family can save RM12,229.80 if the wife is separately assessed on her own name as a taxpayer.

Q5. Other than her income, which can be assessed separately, are there any other items or claims for which Mrs. A can have under separate assessment?

A5. If Mrs. A is under a Separate Assessment , she is entitled to claim child relief. However once child relief is allowed for Mrs. A then her husband, Mr.A, is not entitled to claim on the same relief. The claim for relief be in writing i.e. by filling up the boxes on page 4 of Form B and BE.

Q6. What will be Mr. A and Mrs. A's tax liability if Mrs. A is separately assessed and she opts to claim child relief instead of her husband in year of assessment 2006 ?

A6.

Mrs. A's Tax Liability – YA 2006		RM
Total Income (as per A 4)		87,500.00
(-) Personal Relief: Self relief	8,000	
EPF and life insurance (mx)	6,000	
Books and magazines (mx)	700	
Medical and education(mx)	3,000	
Child relief (20)	4,000	
(17)	1,000	
(11)	5,000	(27,700.00)
Chargeable Income		**59,800.00**
Tax on the 1st RM50,000	=	3,475.00
Tax on the balance 9,800 @19%	=	1,862.00
Tax Payable		5,337.00

Mr. A's Tax Liability – YA 2006		RM
Total Income		79,650.00
(-) Personal Relief:		
Self relief	8,000	
Medical Expenses(mx)	5,000	
EPF and Life insurance(mx)	6,000	
Books and magazines	520	(19,520.00)
Chargeable Income		60,130.00
Tax on the 1st RM50,000	=	3,475.00
Tax on the balance 10,130 @19%	=	1,924.70
		5,399.70
(-) Tax Credit (28% x 10,000)		(2,800.00)
Tax Payable		2,599.70

In this situation, there will be no difference in the total amount of tax liability paid by the family to the LHDNM (IRB) if Mrs. A were to make an election claiming relief for children. This is because both Mr. A and Mrs. A have only a minimum difference in their total income ie. Mr. A (RM79,650) and Mrs. A (RM87,500), and both of them are claiming more or less the same amount of personal relief. Tax savings will only be substantial when the wife earns a higher income than her husband. Thus if claiming of relief for children is given to the wife, that will help to reduce her chargeable income thereby reducing her income tax liability.

Q7. Is Mr. A allowed to claim relief on his step children and vice versa?

A7. Both husband and wife are allowed to claim relief for their step children provided they contribute to the maintenance of, whether wholly or partly, of the unmarried child below the age of 18 years old. If the stepchild is above 18 years of age, the child must be studying fulltime (either in Malaysia or outside Malaysia) and not receiving any income of his own.

Author's Profile

A academician of repute, Faridah Ahmad is an Associate Professor at the Faculty of Accountancy, UiTM specialising in Malaysian Taxation. She has also taught the various levels of professional courses of ACCA, MICPA and ICSA.

She is a Fellow Member of the Chartered Certified Accountants (FCCA, UK), a Fellow of the Malaysian Institute of Taxation (FTII) and a Chartered Accountant of the Malaysian Institute of Accountants (CA). She also holds a diploma in Accountancy (DIA) from the University Teknologi MARA (UiTM). Besides teaching, she is involved in providing consulting services for taxation and cash flow management to small and medium enterprises (SME) and has also conducted various workshops and seminars organized jointly by ACCA Malaysia, SMEDEC, JELITA and FELDA.

Entertainment Tax

How do you know you've met a good tax accountant?
He has a loophole named after him.

A fine is a tax for doing something wrong.
A tax is a fine for doing something right.

A visitor from Holland was chatting with his American friend and was jokingly explaining about the red, white and blue in the Netherlands flag.
"Our flag symbolizes our taxes," he said. "We get red when we talk about them, white when we get our tax bill, and blue after we pay them."

That's the same with us," the American said," only we see stars, too."

RECENT CASE SUMMARIES

Editor's Note:

This is a new segment starting from this issue of the Tax Nasional. We gratefully acknowledge Thomson*Sweet & Maxwell, Asia for their gracious contribution in providing us with these updates from their All Malaysia Law Reports. The cases stated herein are from January 2006 till June 2006. Please note that we have shortened the facts/details due to space constraints. Please refer to the full case as cited for a detailed and accurate reading of the case(s).

Index of Cases

Summary of Cases

Steruda Sdn Bhd -v- Ketua Pengarah Hasil Dalam Negeri (2006) 1 AMR 87, HC

Revenue Law -

Does a contractual payment of a percentage of a company's net profit to an employee constitute a bonus and thereby be rendered liable to a restriction under Section 39 (1) (h) of the Income Tax Act 1967?

Held: allowing the appeal with costs

1. A contractual payment may, depending on the circumstances be a bonus payment. However, it did not follow that every contractual payment that was not derived of a fixed lump sum was a bonus.

2. On the facts of this case it was held that the said payment was merely a method of calculating the rest of the employees salary, the payment of which was deferred until the profits were ascertained. The payment of the sum representing the percentage of nett profits was not discretionary, not subject to review and not applicable on any other employee of the company. Therefore it was not a bonus and was not caught under Section 39 (1) (h) Income Tax Act 1967.

Suasana Indah Sdn Bhd -v- Ketua Pengarah Hasil Dalam Negeri (2006) 1 AMR 302, CA

Revenue Law -

i. Whether the definition of the word "Partnership" in Section 2 of the Income Tax Act 1967 (hereafter referred to as the "ITA") is applicable in determining if an arrangement between parties is indeed a partnership.

ii. Whether a payment made upon termination of a joint venture agreement is taxable.

Held, dismissing the appeal with costs

1. The definition of partnership in s 2 of the ITA is not applicable for determining at large whether an

arrangement between parties is a partnership, but is intended only for the interpretation of that word where it is used in the ITA.

2. **(a)** A party's contention that a sum of money (in this case, RM6,400,00) was capital withdrawn upon the dissolution of a partnership and therefore not chargeable to tax, does not provide occasion or justification for calling in aid the definition of the word "partnership" in the ITA. The said definition cannot be used to determine whether a Joint Venture Agreement (JVA) constituted or created a partnership between the aparties. On the facts of the case, Article 11.7 of the JVA must therefore prevail and be given effect to. Consequently there was no dissolution of a partnership as such and the sum of RM6,400,000 was therefore not capital withdrawn upon any such dissolution of partnership. In any event, there could not have been withdrawal capital when there was never injection of such capital in this instance.

(b) In order to determine if the sum of RM6,400,000 was capital, the **vital test** to be satisfied is as laid down in *Van den Berghs* i.e. whether the JVA was one that was "related to the whole structure of the party's (in this case, the appellant's) profit making apparatus". The said test is one which looks to the nature of the agreement in relation to the profit making apparatus of the company, and which agreement can be said to be related to the whole structure of the profit making apparatus of the company. It certainly does not look primarily to the consequences on the profit making apparatus as a result of the cancellation or termination of the agreement.

(c) On the facts of this case, the appellant was not incorporated for the purpose of implementing the JVA nor did the JVA regulate its activities. Based on what the appellant was required to do under the JVA, the JVA was merely an ordinary commercial contract for the provision of services, made in the course of the carrying on of the appellant's business. There was no evidence that the JVA was related to the whole structure of the profit making apparatus of the appellant. In the absence of such evidence to that effect, the appellant therefore failed to prove that the RM6,400,000 was neither capital withdrawn from a partnership nor compensation for loss of all rights under the JVA.

(d) On the facts of this case, the JVA constituted or represented the interest of the appellant and SPSSB and the services rendered by the appellant were, whilst the joint venture lasted, a contribution to their common interest and had benefited SPSSB in that it increased the value of SPSSB's lands. Upon termination of the JVA, the said lands remained with SPSSB and the services rendered by the appellant, which had increased the value of the said lands, were as good as having been rendered to SPSSB.

(e) On the facts of this case, whether or not the appellant was an independent contractor in the sense intended, and whether or not the JVA was in the circumstances, an agency agreement, the fact remains that pursuant to the JVA, the appellant had contracted with SPSSB to perform services, and did in fact perform such services.

Mount Pleasure Corporation Sdn Bhd -v- Ketua Pengarah Hasil Dalam Negeri (2006) 1 AMR 563, CA

Revenue Law -

Whether the concurrent findings of the Special Commissioners of Income Tax and that of the High Court were correct as to the nature of the property acquired by the appellant. i.e. whether landed property bought by a company purportedly for investment purposes was indeed so or as assessed by the LHDNM that the property constituted trading stock.

Held, dismissing the appeal with costs

1. There was no evidence to support the appellant's contention that the property was bought for investment purposes. There was also no admissible oral evidence to establish that the property was acquired as an investment. From the facts proved, the said property was not the only property that the appellant dealt with at the material time, where it had dealings with 5 other properties. The special commissioners were therefore right to conclude that its frequent dealings raised a prima facie inference that it was carrying on the business of land dealing, either as a developer or as a real estate merchant, which inference the appellant failed to rebut.

2. The presumption against the appellant was further strengthened by the fact that its memorandum and articles of association did not authorise the purchase land for investment purposes except if there were surplus funds, which it did not have. In fact, the evidence showed that the purchase of the said property was financed by family funds.

3. The special commissioners further found that although the appellant claimed that the property was classified as stock-in trade in 1978, it remained a fixed asset in its accounts until 1982, with no explanation offered for the discrepancy.

4. The appellant failed to discharge the onus of proving that the assessments raised against it were erroneous.

Comment: This case appears to be decided very much on its peculiar facts. Whether a principle of law has been created here remains to be seen. Basically though this case provides some guidelines on how to purchase a property for investment purposes, in particular where the purchaser is a company.

Ketua Pengarah Hasil Dalam Negeri -v- Malaysian Bar (2006) 1 AMR 510, HC

Revenue Law -

1. Whether by reason of Section 142 of the Legal Profession Act 1976 (hereafter referred to as the LPA), the statutory body corporate established under the said Act was liable to tax.

2. Whether Section 53 of the Income Tax Act 1967 (hereafter referred to as the ITA) is applicable to the respondent.

3. Whether income derived from the body corporate's Compensation Fund is chargeable to tax in the light of Section 80 (13) of the Legal Profession Act 1976.

4. Whether the body corporate is entitled to capital allowances deductions.

i.e. A body corporate established under the LPA , whose primary source of income was through subscription of members, contributions and donations was assessed by LHDNM under Sec 53 (treating the body corporate as a "trade association") and assessments were raised on the interest income derived from the body corporate's compensation fund although no assessment was raised in respect of contributions to the building and compensation funds.

Held, dismissing the appeal with costs

1. On the facts, there was no justification to reverse the determination of the Special Commissioners of Income Tax (hereafter referred to as " SCIT") on this issue. In essence:

(a) Section 142(1) and 142(2) of the LPA is to be read separately;

(b) It was correct for the SCIT to have gone through the historical basis;

(c) There was clearly a drafting error due the oversight of the drafter of the legal profession bill and any ambiguity if at all, in the said bill, must be construed in favour of the taxpayer;

(d) A purposive approach should be taken in the interpretation of the ITA and the LPA instead of a literal approach so as to ensure there is no surplusage and absurdity.

2. In the context of income tax legislation, for an organization to be deemed a "trade association", the following conditions must be satisfied i.e.:

(a) it must be formed by two or more persons for a common cause;

(b) the members must have voluntarily gotten together to form the association;

(c) the object of the association is to produce income, profits or gains.

The organisation cannot be recognised as an "association of persons" for tax purposes if any of the above conditions are not satisfied. In the instant case none of the above conditions befits on the respondent and as such the respondent cannot be deemed to be a trade association. The objects of the respondent as set out in s 42(1) of the LPA, clearly, is not to produce income, profit or gain, but rather, to uphold the cause of justice and to improve the standards of conduct of the legal profession, etc. Nowhere is it stated therein that the "safeguarding or promoting the business of its members", is its main object. Undoubtedly therefore s 53 of the ITA is not applicable to the respondent.

3. Section 80(13) of the LPA clearly stipulates that the respondent is exempted from tax on the compensation fund and it is evident that the said provision is constituted under Article 96 of the Federal Constitution which provides that "No tax or rate shall be levied by or for the purposes of the Federation except by or under the authority of federal law". The LPA is obviously a specific legislation whilst the ITA is a general legislation and therefore where there is a conflict between the LPA and the ITA, it is the LPA which prevails.

4. The respondent, being a statutory body, is entitled to claim deductions for capital allowances in accordance with s 78 of the LPA.

Multipurpose Holdings Berhad -v- Ketua Pengarah Hasil Dalam Negeri (2006) 2 AMR 733, CA

Revenue Law -

Whether a disposal of shares was assessable to income tax pursuant to the Proviso to Section 5 of the Share (Land Based Company) Transfer Tax Act (1984) (hereafter referred to as the "Act")

i.e. Conditional agreement to transfer shares (hereafter

referred to as the "Agreement") between a company and its 2 subsidiaries. The shares that formed the subject matter of the Agreement were companies that owned land. The Agreement was entered into before the enactment of theAct. The required approval from the Foreign Investment Committee (FIC) was granted before the enactment of the Act. The final approval by the authorities (Bank Negara) was given after the enactment of the Act and the transaction was completed after the enactment of the Act.

Held, allowing the appeal

1. The proviso does not assist the respondent (Ketua Pengarah Hasil Dalam Negeri) because the proviso does not make it clear whether it refers to a requirement imposed by law or a requirement of the term of the agreement of disposal. It was therefore ambiguous and had to be construed in favour of the appellant taxpayer. Adopting the approach in *Mangin v Inland Revenue Commissioner [1971] AC 739,* the requirement for which the proviso provides refers to a requirement imposed by law. Therefore, it was incumbent on the respondent to point to a written law which requires an agreement such as in the instance case to have the approval of government or an authority or committee appointed by the government.

2. On the facts of this case, if the respondent was correct in saying that the Act applied to the appellant, this would mean that that the appellant would have had to comply with several provisions of the Act. The consequences were unjust since the Act was not passed by Parliament until December 31, 1984. Applying the principle in *Marathaei v Syarikat JG Containers (M) Sdn Bhd [2003]* 2 AMR 660 to this case, Parliament could not have intended such an unjust result.

3. The Act must be read harmoniously with the first limb of Article 7(1) of the Federal Constitution (the Constitution) which strikes at retrospective penal laws. This approach is in keeping with the presumption that Parliament does not intend its Acts to violate the Constitution. Thus, a statute must be read harmoniously with the Constitution to avoid any conflict between them that will result in the statute becoming void. Adopting this approach, the Act must be read prospectively to prevent the appellant from becoming retrospectively criminally liable. An excessively retrospective taxing statute may be struck down as violative of a citizen's fundamental rights. Whether a particular taxing statute is excessively retrospective depends on the facts and circumstances of each case.

4. The appellant's contention that FIC approval was not conditional approval was correct. An approval that is conditional is an approval that is subject to conditions. On the facts of this case, the FIC did not subject their approval to a condition, which the failure to observe would render the approval inherently ineffective. The FIC perceived that in the scheme of government administration, the approval of BNM was required, and by those words they told the appellant so. They were not words of condition. Therefore the words added to the proviso did not apply and the disposal of the shares remained as having taken place on the date of the FIC letter, that is before the chargeability date, and did not attract the share transfer tax.

5. The requirement intended by Parliament in the proviso was not a requirement self-imposed by parties in their agreement, the requirement intended must be a requirement in law or of something having the force of law. Thus, for the purpose of the proviso to s 5, the disposal did not require approval by "the Government or an authority or committee appointed by the Government".

Kerajaan Malaysia -v- Yong Siew Choon (2006) 2 AMR 93, FC

Probate & Administration Revenue Law - Whether in view of the provisions of the Income Tax Act 1967 (hereafter referred to Revenue Law as the "ITA"), Order 15 r 6A of the Rules of the High Court 1980 (hereinafter referred to as the "RHC 1980") was applicable to an action raised under Section 160 ITA in relation to an assessment in the name of an executor as defined in the ITA.

Held, allowing the appeal with cost here and below

1. There was no dispute that the judgment of the Court of Appeal was an excellent exegesis on Order 15 r 6A of the RHC. However, there had been no analysis of its inapplicability to proceedings for the recovery of tax in the light of relevant provisions in the Act itself. The object of Order 15 r 6A of the RHC was to provide a remedy where there is no person in law who can be sued. It was therefore superfluous to state that even where no grant of probate or administration has been made to the estate of a deceased person, Order 15 r 6A will have no application if there is, in law, a person who can be sued. An executor de son tort is such a person.

2. (a) In matters relating to the assessment and chargeability to tax of an estate, the specific provisions to make the executors liable are ss 64(1) and 74(1) of the Act. It was therefore clear that the person assessable and chargeable to tax in the case of the estate of a deceased person is his executor. In its legal sense the

word "executor" is a reference to a person who has obtained the grant of probate or of letters of administration of a deceased person. Such a person has the capacity to sue or to be sued.

(b) The definition of "executor" and "administrator" in s 2 of the Act, which refers to persons who are legally appointed only means that the "person administering or managing the estate of a deceased person" is not one who is appointed. The Act has given an extended meaning to the word "executor" by including in its definition a person administering or managing the estate of the deceased. The High Court's finding that the respondent was the person administering the estate of the deceased was therefore correct in law.

Teruntum Theatre Sdn Bhd -v- Ketua Pengarah Hasil Dalam Negeri (2006) 3 AMR 758, CA

Revenue Law -

1. Whether after having assessed the appellant for capital gains tax and upon payment thereof being made and a certificate of clearance being issued, the LHDNM may vacate the same and reassess the appellant for income tax under the ITA.

2. Whether the sale by the appellant company of the properties amounted to a trading in land constituting an adventure in the nature of trade and not a realisation of capital assets.

Held, dismissing the appeal

1. (a) The estoppel relied on by the company (here-after referred to as the "appellant") in this instance is that of estoppel in pais, i.e. estoppel by words or conduct. Estoppel cannot be invoked against the Director General of Income Tax when he is put to notice that an incorrect assessment has been made under the RPGT. The special commissioners thus were not wrong to have rejected the suggestion that the assessment by the LHDNM (hereafter referred to as the "respondent") of a taxpayer under the RPGT is an irrevocable act.

(b) There is no rule of law precluding the respondent from discharging the assessment under the RPGT and proceeding with an assessment under the ITA. Where the facts and circumstances warrant it, the respondent is free to revise and discharge the assessment under the RPGT and to raise an assessment under the ITA instead. On the facts, the appellant had not been subjected to double taxation and had been informed that the tax paid under the RPGT would be transferred to its account. In the circumstances, the special commissioners' and the High Court's decision on this issue is affirmed.

2. (a) The word "intention" connotes a state of affairs which the party "intending" does more than merely contemplate. It connotes a state of affairs which so far as in him lies to bring about, and which, in point of possibility, he has a reasonable prospect of being able to bring about by his own act of volition. In this case the appellant cannot be said to "intend" to build the cinema or to "intend" its occurrence as the building of the same was subject to the approval of DBKL and dependent on so many other influences or circumstances. However if it was achieved, the appellant's volition would have been no more than a minor agency collaborating with the factors which predominately determine its occurrence. On the facts, the term "intention" to build the cinema was unsatisfied as the appellant had too many hurdles to overcome or too little control of the events. [see p 769 line 39 - p 770 line 10]

(b) The factors that were taken into consideration by the special commissioners when determining this issue in favour of the respondent, were indeed relevant and material and it was open to them to arrive at the conclusions that they did. The special commissioners were right to have rejected the appellant's contention that the sale of the properties were forced sales upon DBKL's rejection of the plan to build the cinema as no evidence was led to show why the appellant could not have proceeded with the development of the subject properties which had already been approved by DBKL for limited commercial use. In the circumstances, it could not be said that the said properties were of no use to the appellant. [see p 770 lines 15-42]

(c) The High Court accordingly, was right to have upheld the special commissioners' findings and in affirming the decision that the transactions entered into by the appellant amounted to an adventure in the nature of trade and gains from the sale of the properties, and which was taxable under s 4(a) of the ITA. [see p 771 lines 2-6]

Comment: This is a peculiar case which appears to have far reaching ramifications. A case to note as when and if it comes on appeal to the Federal Court.

Malaysian Institute Of Taxation

TAX CASES and LEGISLATION

What tax practitioners need to appreciate

BY DR. NAKHA RATNAM SOMASUNDARAM

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Tax Cases
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- ~ Contentious points in tax cases
- ~ Legislations and tax cases – issues and defense
- ~ Tax cases in tax advisory and tax appeals

Tax Appeals
- ~ Right to Appeal to the Tax Assessment Branch
- ~ Review of Assessment Under Appeal
- ~ Finalisation of Appeal
- ~ The Special Commissioners of Income Tax
- ~ Further appeals

A review of recent tax cases

Speaker:

Dr. Nakha Ratnam Somasundaram holds a PhD in Taxation from the University of Newcastle, and is a member of the Malaysian Institute of Taxation. Dr. Nakha was a former lecturer in taxation at the UiTM, The Malaysian Institute of Certified Public Accountants and the University of Malaya. Dr. Nakha served the IRB for 30 years, retiring in 2001 as the Kelantan State Director. He is currently a tax consultant to Chua & Chu, Chartered Accountants of Kota Bahru.

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Letters to the Editor:

***Editor's Note*:**

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Budget 2007 on TV3 Program (Wanita Hari Ini)

4 September 2006 is a day to remember for me! On that day I was invited to appear on TV3 representing the Malaysian Institute of Taxation (MIT) to talk about the goodies given or offered by the Government through the 2007 Budget Proposal which had been presented by YAB Dato' Seri Abdullah Ahmad Badawi, Prime Minister and Finance Minister of Malaysia.

Although this was not the first time I had appeared live on the Wanita Hari Ini (WHI) programme, but 4 September 2006 was really different. Two important events made the difference.

Firstly and on the programme itself, I was featured with Deputy Minister of Finance YB Dato' Dr Ng Yen Yen. I felt honored to be with someone who is so important to the government and Malaysia as a whole. Dato' is such a nice lady, jovial, willing to discuss with a sincere heart and such a down to earth person. There was no barrier between us. I felt so proud to be able to present my views about the budget, especially the points that affect women and their families as a whole. We were discussing the waiver of examination fees related to UPSR, PMR, SPM and STPM. The incentive(s) to women relating to mammograms done at private hospitals, monthly cash (grant) allowances given to poor students which have been increased, the set up of child care centres by government departments (and the private sector is also encouraged to follow suit!) and other issues pertaining to women and families as a whole.

Secondly and equally if not more excitingly, I was honored and humbled when suddenly His Majesty, the Yang diPertuan Agong and Raja Permaisuri Agong paid a visit to TV3. I just couldn't put into words how thrilled and nervous and excited I was (and I think the whole crew of WHI was too) when we got to know that their Royal Majesties decided to drop by and watch the show that was being aired live. That was my first time ever meeting their Royal Highnesses. They are such a loving, dignified and yet approachable couple, smiling all the way through and I may describe them as the "King and Queen berjiwa rakyat". Perhaps that was my first and last time being in such a situation.

A million thanks to MIT who had invited me and trusted me to represent the institute to appear on the program. I am proud to be a member of this professional body and able to give my small contribution to MIT and the society as a whole.

Faridah Ahmad.
10 September 2006

BOOK REVIEW by

Kalisewaran Sinniah
LLB (Hons) University of Wolverhampton, CLP

Title of Book : **Malaysian Tax Workbook, 2nd Edition**
Author : **Faridah Ahmad**
Publisher : **CCH - a Walter Kluwer business**
Date of Publishing : **2006**

The Malaysian Tax Workbook is a superb guide for the Malaysian student of tax. It is based on the Malaysian Income Tax Act and framework. The law is as at 31st December 2005.

Essentially keeping to the tradition of its first edition, it follows a similiar format. This familiarity is useful for for both students and lectures. It stands proud, targeting both students and lecturers alike. Physically a larger than average book, the clear font and sequence in each chapter makes it easy reading especially during examtime!

Beginning with Assessment and going on to Income and continuing therefrom in an orderly manner, each chapter begins with a definition of terminology, scope and nature of the topic. This is followed by facts, laws and examples. Each chapter ends with a set of Revision Questions testing the understanding of the student in applying what has been learnt in a practical scenario.

The Table of Cases, Section Finding list and Index together provide a fairly good guide for the easy use of this book/data.

Last but not least the Suggested Solutions (for the earlier mentioned revision questions) help make the life of both teacher and student simpler!!

An academician of repute, Faridah Ahmad is an Associate Professor at the Faculty of Accountancy, UiTM specialising in teaching Malaysian Taxation. She has also taught the diploma, undergraduate and various professional courses of ACCA, MICPA and the ICSA. A prolific writer, she has authored articles and booklets in various publications, including but not limited to "Fundamentals of Malaysian Taxation".

This book is a must read for all students and in particular the ACCA students as the Revision Questions are sourced from them.

Disclaimer: The views and opinions expressed in this review are those of the reviewer personally made in good faith. They are not necessarily views endorsed or expressed by MIT or its Council.

News In Tax - An chrononical update of the Tax news you may have missed!

(Disclaimer: Please note that these news items are on a piecemeal basis and MIT is not responsible for any news previously printed in any newspaper article but which is not mentioned here. MIT is also not responsible for any error/omission/inaccuracies contained herein. Please take note that the news stated herein is only a brief outline. For detailed news please refer to the revelant edition of the particular newspaper.)

Date	Newspaper / Pages	News
30/06/2006	the STAR online	South Korea's Ministry of Finance & Economy's decision to designate Labuan as a tax haven means that firms headquatering in Labuan must pay witholding taxes on their proceeds from investment in South Korea
14/07/2006	The Sun - "Business News" Page 27	Malaysian Japan Free Trade (MJFTA) Agreement - take effect on 13/07/06. More than 6,600 Malaysian goods to enjoy duty free treatment in Japan. Among others, the MJFTA will enable Japan to enjoy market access to Malaysia in areas such as professional services, IT related services, educational, hospital, etc
27/07/2006	the STAR online	RM4.8bil in tax refunds- Income tax refunds totaling RM4.8 billion ringgit for the year 2004 had been settled by 30 June 2006 this year. In order to help LHDNM expedite refunds, taxpayers must attach complete documents including their tax return statements for previous years to ensure that there were no tax arrears, so that the overpaid amount could be refunded.
14/08/2006	the STAR oneline	Defaulters rise by 10 times - The use of technology has assisted LHDNM to track down more defaulters resulting in a 10 times increase in the number of tax defaulters within 2 years.The offences included failure to submit returns, declaring false entries, not providing information or bank statements and the retention of monies collected by employers from their workers purportedly to pay their tax.This information has facilitated the IRB to target thousands of potential taxpayers who had failed to file tax returns or dodged paying taxes.

BOOK REVIEW by

Jude Alexander
LLB (Hons) University of London, CLP

Title of Book : **Thornton's Malaysian Tax Commentaries**
Author : **Richard Thornton**
Publisher : **Thomson * Sweet & Maxwell Asia**
Date of Publishing : **2006**

Malaysian Tax Commentaries is an excellently authored piece of work. It is one of the few, if not the only, book(s) in Malaysia which provides the full text of the law and relevant subsidiary legislation with regard to taxation in Malaysia.

Richard Thornton is no new face in the area of Malaysian tax practitioners. He has extensive practical experience in Malaysian taxation being an approved tax agent under the Income Tax Act 1967 and provides tax consultancy services under the umbrella of Total Approach Sdn Bhd . He is also a member of the panel of examiners for the Association of Chartered Certified Accountants as well as an examiner for various other taxation papers/bodies.

He is an experienced author of numerous publications on taxation among which are the popular "100 Ways to Save Tax in Malaysia" series and "Q & A on Personal Taxation in Malaysia: Satisfying Karen's Curiosity".

As a second edition, this book generally keeps to the layout and style of the first edition. Why tamper with a good thing? Along with the substance of the law, Mr. Thornton provides us with his insightful and incisive section by section annotations and commentary. Additionally there is a comprehensive index, cross references to definitions and amendments.

The ambit and scope of Malaysian Tax is substantially simpler and keeps to a somewhat standard format compared to many other countries. This is largely due to the fact that in Malaysia the relevant Acts/ primary legislation maintain the same section numbers. For example, generally anti-avoidance provisions are always associated with Section 140 regardless of the year of issue of any Income Tax Act.

Nevertheless the recent trend of the authorities in amending the Acts have been by way of Gazette Orders [P.U. Orders].This further complicates the life of the tax practitioner by increasing the sheer bulk of legislation.

Both the author and the publisher have endeavoured to ensure that with this book, the reader is well equipped to face the daunting challenge of wading through the labyrinth of tax! In addition to the book itself, there is a CD Rom supplied free of charge in which all of the subsidiary legislation as well as the Promotion of Investments Act1986 and the Labuan Offshore Business Activity Tax Act 1990 are incorporated for easy reference.

All direct tax areas are comprehensively covered with the exception of the petroleum income tax which is usually not of interest or relevance to the general tax practitioner.

The law is as stated at 31/12/2005. We hope that an update to this book, be it in written or CD Rom format will be out soon.

Disclaimer: The views and opinions expressed in this review are those of the reviewer personally made in good faith. They are not necessarily views endorsed or expressed by MIT or its Council.

Malaysian Institute Of Taxation

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8. Any person who is an approved Tax Agent under Section 153 of the Income Tax Act, 1967.
9. Any officer or ex-officer from the Royal Customs Department.

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