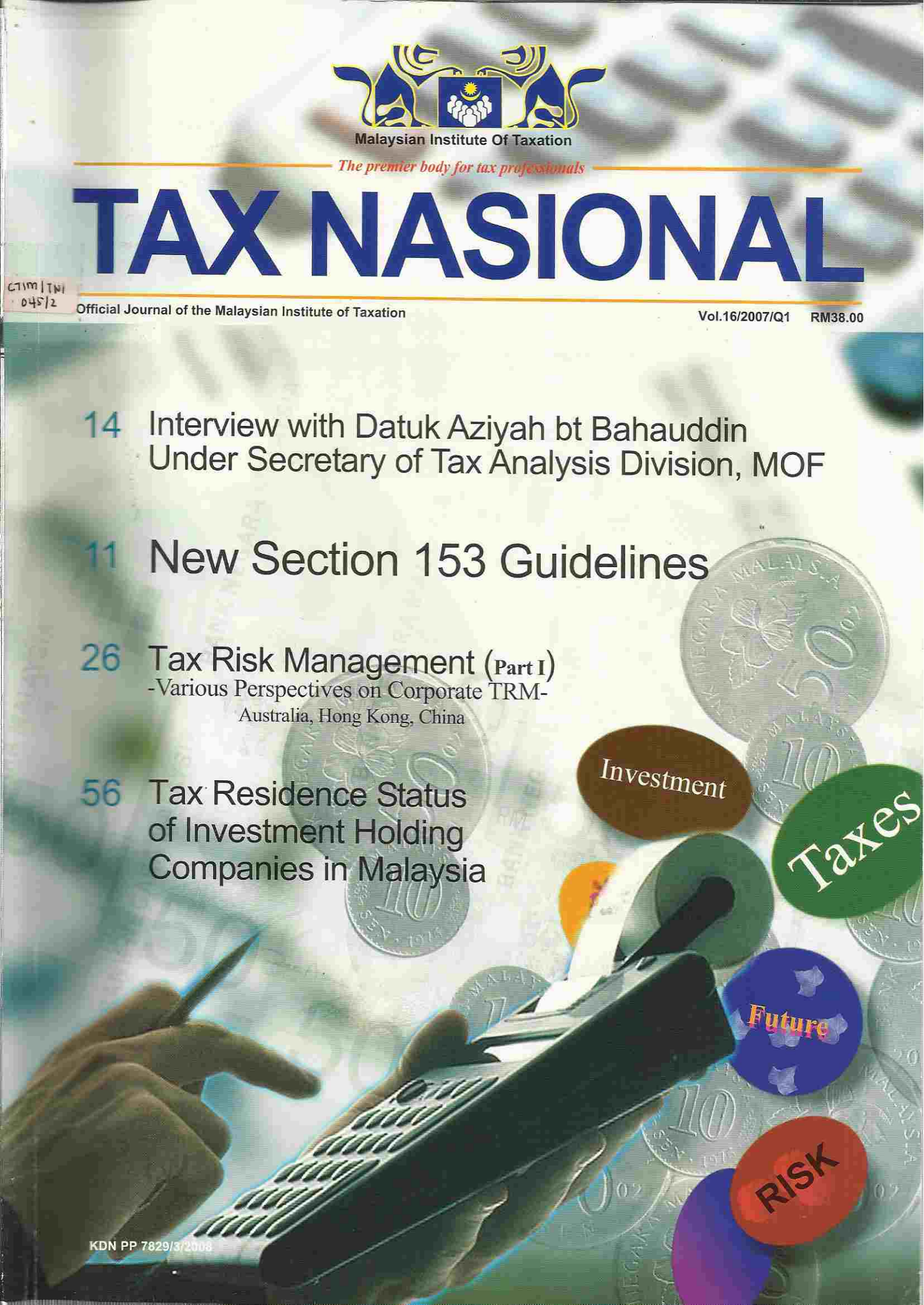
Malaysian Institute Of Taxation

The premier body for tax professionals

TAX NASIONAL

Official Journal of the Malaysian Institute of Taxation

Vol.16/2007/Q1 RM38.00



KDN PP 7829/3/2008

Malaysian Institute Of Taxation

http://www.mit.org.my

The premier body for tax professionals

Continuing Professional Development (CPD)

TRAINING PROGRAMMES 2nd QUARTER 2007

Date	Training Programme	CPD	Venue	Speaker
APRIL 2007				
3 Apr 2007 9.00am - 11.30pm	Workshop: Briefing on E-filing for Form B & Form BE	2.5	Kuala Lumpur	Rep from LHDNM
3 Apr 2007 9.00am - 5.00pm	Workshop: Tax Planning & Exemptions for Malaysian Individuals	8	Johor Bahru	Mr Chow Chee Yen*
5 Apr 2007 9.00am - 5.00pm	Workshop: Tax Planning & Exemptions for Malaysian Individuals	8	Penang	Mr Chow Chee Yen*
6 Apr 2007 9.00am - 5.00pm	Workshop: Critical Tax issues (1st Session)	8	Kuala Lumpur	Mr Harvindar Singh
12 Apr 2007 9.00am - 5.00pm	Workshop: A Critique of Current Case Law and Issues Arising	8	Melaka	Dr NakhaRatnam Somasundaram
13 Apr 2007 9.00am - 5.00pm	Workshop: A Critique of Current Case Law and Issues Arising	8	Ipoh	Dr NakhaRatnam Somasundaram
17 Apr 2007 9.00am - 5.00pm	Workshop: Critical Tax issues (2nd Session)	8	Kuala Lumpur	Mr Harvindar Singh
19 Apr 2007 5.00pm - 7.00pm	An Evening Talk:- Financial Planning from the Tax Perspective	2.5	Kuala Lumpur	1. Mr Joshua Lim, BHLB Trustees 2. Mr Chua Tia Guan, Great Vision
MAY 2007				
3 May 2007 9.00am - 5.00pm	Seminar: Tax Risk Management - A Tax Payer's Guide to Minimising Risk	8	Kuala Lumpur	Various Speakers
9 May 2007 9.00am - 5.00pm	Workshop: Tax Filing for Business & Corporate Entities	8	Johor Bahru	Mr Harvindar Singh*
11 May 2007 9.00am - 5.00pm	Workshop: Tax Filing for Business & Corporate Entities	8	Penang	Mr Harvindar Singh*
11 May 2007 9.00am - 5.00pm	Workshop: A Critique of Current Case Law and Issues Arising	8	Kuantan	Dr NakhaRatnam Somasundaram
18 May 2007 9.00am - 5.00pm	Workshop: Tax Filing for Business & Corporate Entities	8	Ipoh	Mr Harvindar Singh*
24 May 2007 9.00am - 5.00pm	Workshop: Tax Filing for Business & Corporate Entities	8	Kuala Lumpur	Mr Harvindar Singh*
JUNE 2007				
5 June 2007 9.00am - 5.00pm	Workshop: Tax Filing for Business & Corporate Entities	8	Sabah	Mr Harvindar Singh
6 June 2007 9.00am - 5.00pm	Workshop: Tax Filing for Business & Corporate Entities	8	Sarawak	Mr Harvindar Singh
13 June 2007 9.00am - 5.00pm	Workshop: Tax Risk Management - A Tax Payer's Guide to Minimising Risk	8	Johor	Mr Chris Low
15 June 2007 9.00am - 5.00pm	Practitioner's Update	8	Kuala Lumpur	1. Dr Veerinderjeet Singh - Chairman (afternoon only) 2. Ms Teoh Boon Kee
15 June 2007 9.00am - 5.00pm	Workshop: A Critique of Current Case Law and Issues Arising	8	Penang	Dr NakhaRatnam Somasundaram
22 June 2007 5.00pm - 7.00pm	Evening Talk: Islamic Financing & Tax Issues	2.5	Kuala Lumpur	1. Mr Chew Theam Hock 2. to be confirmed

** Representatives from LHDNM are invited.*

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.

ENQUIRIES

Please call **Nur / Latha at 03-2162 8989 ext 106 / 108** or refer to MIT's website at **www.mit.org.my** for more information on the CPD programmes

The President's Note

Dear Members,

The long awaited Sec 153 Guidelines have been issued. Although there are some very minor issues for which we have sought clarification from MOF, by and large I am happy to say that the matter can be put to rest.

Just a note to members, MIT responded immediately when the Sec 153 Guidelines were first issued. We liaised with the other professional bodies to put forward your concerns. I believe that the whole issue was resolved in this satisfactory manner because of their help and also due to the very co-operative LHDNM. Thank you to LHDNM for responding to MIT's call and to the respective Secretariat and Council members who were involved.

On the issue of "return" forms it was ascertained that, tax agents can either file using hard copies or soft. As usual the hard copies are available from the respective IRB Offices. E-filling is available only to tax agents irregardless of whether tax software is used or not. The text format is not mandatory but tax agents are encouraged to use it to help IRB expedite processing. E-filling not available to tax payers filing their own returns.

For the general public the normal e-filing procedures are in place. All hard copy submissions which require acknowledgement must be sent to the Central Processing Unit in Pandan Indah. Hard copies submitted to branches will be accepted without acknowledgement of submission.

The Tax Audit & Investigation Framework have also been issued. LHDNM has conducted a comprehensive roadshow on the matter throughout the country. Members of MIT and those interested can look out for MIT's Practitioners Update in June this year for a rundown of do's and don'ts in preparation for an audit or investigation excercise.

As you all may be aware the National Tax Conference has been postponed to July so keep your dates free and register early for the early bird fee!

We look forward to a good year in tax in both the compliance and operational sectors.

Thank you and good luck!

Tuan Haji Abdul Hamid bin Mohd Hassan
President, MIT

Editors's Note

Dear Readers,

As we approach the end of the 1st Quarter of this year, take a minute to breathe, are we on track to achieve this years targets?

This first quarter issue for 2007 looks to be an interesting issue. Look out in particular for the Article on Tax Risk Management - although it is a re-print from the APTB, it is an emerging area of tax which ought to be addressed by tax practitoners and corporate entities alike. Due to space constraints, this issue features only Part I. Do attend the MIT's seminar on Tax Risk Management in Malaysia on the 3rd of May 2007 for a Malaysian Perspective.

Mr. David Russell has also contributed an excellent article on Managing Tax Disputes while Mr. K Sandra Segaran takes a detailed look at tax status of IHC's. Associate Professors Lee Fook Hong and Faridah Ahmad give us the benefit of their learned views.

Anyway, so long for now. Keep on track and look out for new products and events from MIT – the premier body for tax professionals!

Harpal Singh Dhillon
Editor

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.

COUNCIL MEMBERS

President : **Tuan Haji Abdul Hamid bin Mohd Hassan**
Deputy President : **Mr. Lim Heng How**
Vice Presidents : **En. Nujumudin bin Mydin**
: **Mr. Khoo Chin Guan**
Dr. Ahmad Faisal bin Zakaria
Mr. Arujothi Kanagaretnam
Mr. Chow Kee Kan
Mr. Harpal Singh Dhillon
Prof Dr. Jeyapalan Kasipillai
Dato' Liew Lee Leong @ Raymond Liew
Mr. Lim Kah Fan
Mr. Lim Thiam Kee, Peter
Mr. Neoh Chin Wah
Dr. Veerinderjeet Singh
Mr. Venkiteswaran Sankar
Mr. Yeo Eng Hui, Adrian

Institute Address : The Secretariat
Unit B-13-2, Block B, 13th Floor,
Megan Avenue II,
No. 12 Jalan Yap Kwan Seng,
50450 Kuala Lumpur

Institute Telephone : 03-2162 8989

Institute Facsimile : 03-2162 8990

Institute E-mail : secretariat@mit.org.my
Website : www.mit.org.my

MIT BRANCH OFFICES / CHAIRMAN

East Coast Branch
Chairman : **Mr Wong Seng Chong**
Address : Messrs Lau, Wong & Yeo
1, 2nd Floor, Lorong Pasar Baru 1
25000 Kuantan, Pahang

Malacca Branch
Chairman : **Mr Koh Kay Cham**
Address : KC Koh Tax Accounting & Corporate Services
30 Jalan Melaka Raya 25, Melaka Raya
75000 Melaka

Southern Branch
Chairman : **Dr S Sivamoorthy**
Address : Consultancy Network of Malaysia, CNM Taxlink
No 17-03, Susur Dewata 1, Jalan Dewata
Larkin Perdana Business Park
80350 Johor Bahru

Northern Branch
Chairman : **Mr Ong Eng Choon**
Address : Taxnet Consultants Sdn Bhd
51-21-A Menara BHL Bank
Jalan Sultan Ahmad Shah, 10050 Penang

Perak Branch
Chairman : **Mr Lam Weng Keat**
Address : C-1-03, 1st Floor, No 2 Persiaran Greentown 3
Greentown Business Centre,
30450 Ipoh, Perak

Sarawak Branch
Chairman : **Mr Lau Yaw Joo**
Address : Lau Yaw Joo & Co
No 33, Lot 79, 1st Floor, Chan Bee Kiew Lane
2A Off Padungan Road
93450 Kuching, Sarawak

Sabah Branch
Chairman : **Mr Michael YS Tong**
Address : Horwath TH Liew Tong Chartered Accountants
Damai Plaza 3rd Floor
C11 South Wing, Jalan Damai, PO Box 11003
88811 Kota Kinabalu, Sabah

SECRETARIAT

- Executive Director : **Ms Sunita Nathan** Ext.101
- Technical & Public Practice : Ext.103
- Operations & Public Practice : **Ms Mariah Tasbi bt Abd Wahid** Ext.104
- Publishing : **Ms Ajanta Thinakaran** Ext.111
- Communications : **Ms Mohana Devi Sukalingam** Ext.105
- Events & Conference Management : **Ms Nursalmi Haslina bt Muhd Rusli** Ext.106
- Events & Conference Management : **Ms Karpagalatha KM** Ext.108
- Examinations, Education & Student Affairs : **Ms Aruna Arumugam** Ext.110
- Membership & Services : **Ms Nur Hayati bt Hassan** Ext.114
- Finance & Operations : **Ms Fazilla Rushalina bt Ahmad Nadzri** Ext.109

Tax Nasional

Official Journal of the Malaysian Institute of Taxation

Tax Nasional is the official journal of the Malaysian Institute of Taxation and is distributed to members and students of the MIT as well as subscribers, both corporate and individual. The contents of Tax Nasional do not necessarily reflect the views or opinions of MIT and no liability is accepted in relation thereto. MIT does not accept liability for any views or opinions published herein.

Advertisements appearing within this journal should not be taken to imply any direct support for or sympathy with the views and aims of MIT. Please read the important disclaimer below.

Printer: Libraprint & Advertising Sdn Bhd
No. 2, Jalan Hang Tuah 2, Taman Salak Selatan, 57100 Kuala Lumpur.
Tel: 603 7980 2214 Fax: 603 7981 7840

Malaysian Institute Of Taxation

CONTENTS

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 words (doubled-spaced, typed pages). They should be submitted in hardcopy and softcopy in 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, Kuala Lumpur office

e-mail: publications@mit.org.my

News In Tax is temporarily inactive. We hope to be back in the next issue!

NATIONAL TAX CONFERENCE

Malaysian Institute Of Taxation

The History

The National Tax Conference is jointly organised by the Akademi Percukaian Malaysia, Lembaga Hasil Dalam Negeri Malaysia and Malaysian Institute of Taxation.

A team of experienced speakers and practitioners from both government and private sectors (both locally and internationally) are invited every year to present papers on technical areas of interest in taxation.

We are proud to announce that for the past six years the number of delegates have increased progressively. The NTC 2006 recorded the highest number of delegates todate with over 1300 delegates comprising tax practitioners, tax accountants, financial planners, company directors, academicians, officials from the Lembaga Hasil Dalam Negeri Malaysia and Ministry of Finance and also representatives from other government agencies.

	Date(s)	Venue	Theme
NTC 2001	3 July 2001	Palace of the Golden Horses	Self Assessment: Towards Good Governance
NTC 2002	3 September 2002	Palace of the Golden Horses	Globalised Tax System in a Borderless World
NTC 2003	5 and 6 August 2003	Palace of the Golden Horses	Meeting Future Challenges of Tax Administration
NTC 2004	24 and 25 August 2004	Sunway Lagoon Resort Hotel, Selangor	Gaining A Competitive Edge
NTC 2005	15 and 16 August 2005	Putrajaya International Convention Centre (PICC)	An Effective Tax Regime, A Joint Responsibility
NTC 2006	22 and 23 August 2006	Putra World Trade Centre (PWTC)	Moving Forward, Managing Changes

National Tax Conference 2007

We are proud to announce that this is the seventh consecutive year for the National Tax Conference and this year's theme is *"Progressing with the Nation"*.

The NTC 2007 is scheduled to be held on 17 and 18 July 2007 (Tuesday and Wednesday) at the Kuala Lumpur Convention Centre.

Puan Hasmah bt Abdullah, Director General of Lembaga Hasil Dalam Negeri Malaysia, Tuan Haji Abdul Hamid bin Mohd Hassan, President of MIT and Co-Organising Chairmen, Puan Noor Azian bt Abdul Hamid and Mr Khoo Chin Guan in discussion.

Puan Hasmah and her officials during the discussion of the NTC 2007 programme.

The NTC 2007 promises to be one of the most exciting and important conferences in the area of taxation. This year, we expect to bring together approximately 1000 to 1500 delegates.

The key areas to be discussed during the Conference are:-

- Forum Discussion: Malaysian Taxation System in the Context of the Current Global Economic Environment
- LHDNM: Progressing with the Nation
- Towards an Efficient and Transparent Tax System – the Key to Successful Implementation of Advance Rulings and Audit & Investigation Frameworks
- Legal Issues
- GST: Progress Report/Readiness
- Malaysian Islamic Financial Centre: Tax and Business Issues
- Taxation & Globalisation: Impact on SME's
- Tax Planning for Overseas Investments
- Transfer Pricing: Recent Trends & Developments in Audit

Therefore, the Organisers would like to take this opportunity to invite you to participate in the most exciting and important tax conference in Malaysia.

Contact us NOW to avoid disappointment !

Tel : 03-2162 8989
Fax : 03-2162 8990/03-2162 3567

Registration & Enquiries

Latha : ext 108 **Elaine** : ext 115
Nasrin : ext 113 **Nur** : ext 106

Email : ntc@mit.org.my /
: cpd@mit.org.my

Sponsorship & Exhibition

Mohana Devi : ext 105
email: mohana@mit.org.my

Institute News

Let the pictures speak for themselves.....

MIT visits the DG of Royal Malaysian Customs, January 2007

Tn Hj Abdul Hamid, MIT President and Dato' Sri Haji Abd Rahman bin Abd Hamid, DG of RMC

Dato' Sri Haji Abd Rahman bin Abd Hamid,DG of RMC (seated at the head of the table), En Nujumudin bin Mydin (seated on the right) and Mr Khoo Chin Guan (seated on the left), Vice Presidents of MIT

MIT's Networking Cocktail, January 2007

From the left: Pengarah Jabatan Siasatan En Sabin @ Sapilin Samitah, Mr Lim Heng How Deputy President MIT, Mr Ronnie Lim Managing Director Deloitte KassimChan, Tuan Hj Abdul Hamid President of MIT and En Ahmad Mustapha Ghazali Hon Advisor of MIT

From the left: Pn Mariah Tasbi, Cik Nursalmi bt Mohd Rusli, Ms Eow Siew Lee, MIT Secretariat

Mr Soh Lian Seng Tax Director KPMG and Mr Chris Low Executive Director and Head of Tax Risk Management Unit KPMG

Pn Hasmah bt Abdullah, CEO/DG of LHDNM

Some of the Senior Officers of LHDNM who attended the MIT Networking Cocktail

MIT's Practitioner's Update at Sabah, January 2007

Mr Michael Tong, Sabah Branch Chairman and Puan Noraini binti Ja'afar, Pengarah LHDNM

MIT Workshops in Kuching Sarawak, January 2007

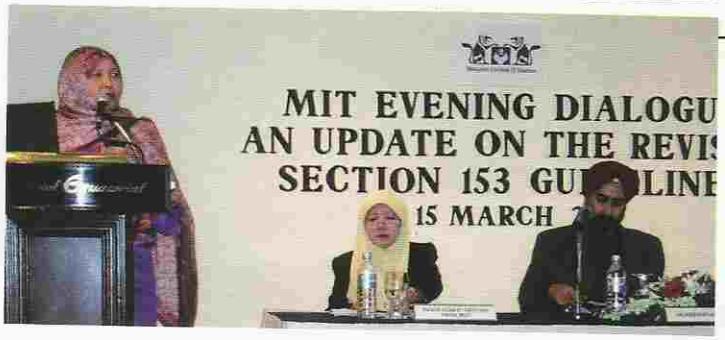
Mr Lau Yaw Joo, Sarawak Branch Chairman, Pn Hj Zaharah bt Hj Mokhtar Pengarah LHDNM and Mr Harvindar Singh, Trainer at Practitioner's Update.

UKM Career Talk, February 2007

Mr Adrian Yeo, MIT Council Member and Chairman of the Public Relations Committee at UKM career talk on 15 February 2007

From Left: Trainers, Mr Sivarajah Arasu and Mr Quah Sin Hor, in action at a workshop on "Tax Investigations (Property Developers & Contractors)"

MIT Evening Dialogue on Section 153, March 2007



From Left: Puan Bidari Ahmad Sapawi (LHDNM), Puan Nor Azian bt Dato Hj Yahya (MOF) and Dr. Veerinderjeet Singh (MIT)

Sec 153 Participants I - Attendees at the evening dialogue in rapt attention

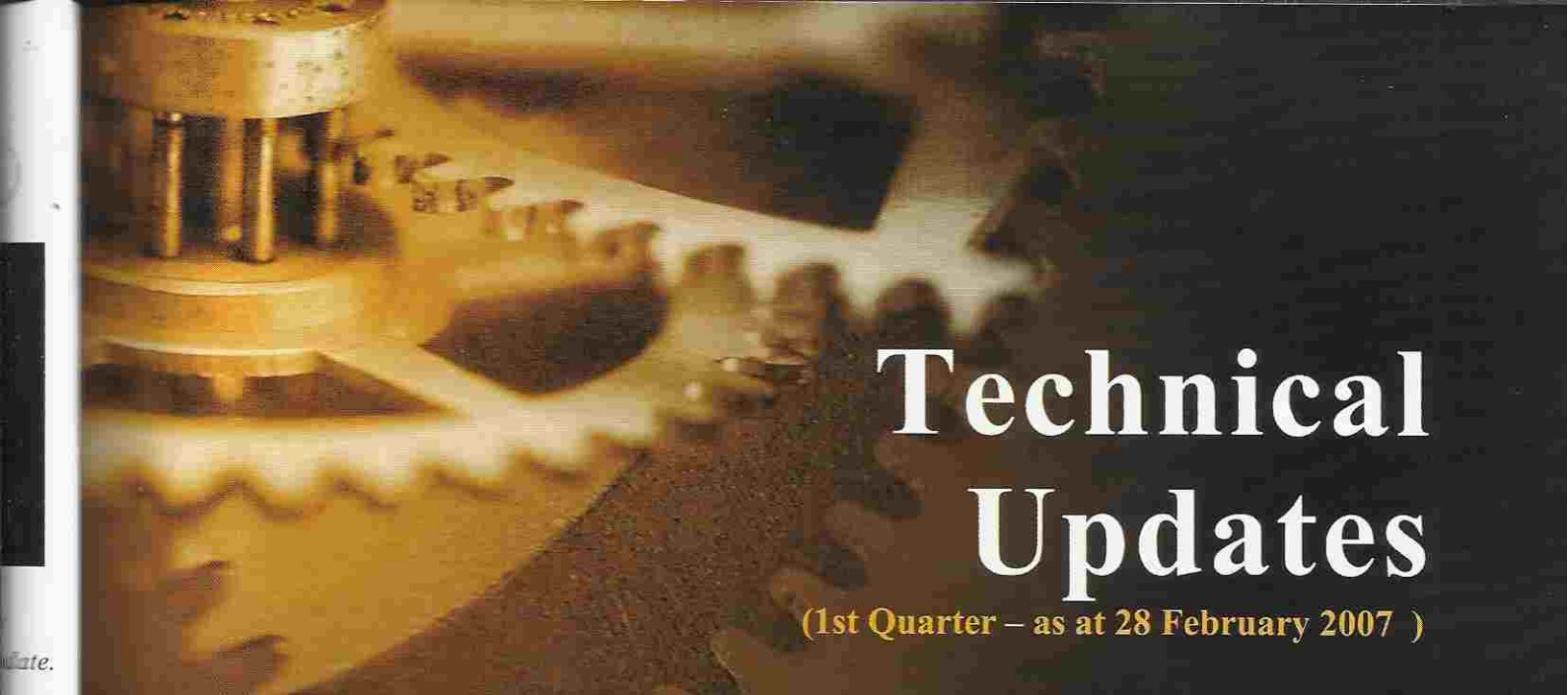
Farewell to MIT's Senior Technical Manager, March 2007

Ms Eow Siew Lee, Senior Manager Technical Department MIT

Siew Lee busy answering HELP Desk queries. Is she going to miss all this???

Well.....perhaps not.

MIT wishes her all the BEST always and in all ways!



Technical Updates

(1st Quarter – as at 28 February 2007)

Legislation

Parliamentary Acts

- The Finance Act 2006 (Act 661) was gazetted on 31 December 2006.
- Service Tax (Amendment) Act 2007 (Act A1281) was gazetted on 8 February 2007
- Customs (Amendment) Act 2007 (Act A1282) was gazetted on 8 February 2007
- Sales Tax (Amendment) Act 2007 (Act A1283) was gazetted on 8 February 2007
- Excise (Amendment) Act 2007 (Act A1284) was gazetted on 8 February 2007

Gazette Orders

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

- ***Income Tax (Exemption)(Amendment)(No.2) Order 2006 [P.U.(A) 420]***
  - this amendment is effective from year of assessment 2007.
  - paragraph 4(a) of the Income Tax Exemption)(No.11) Order 2005 is amended to allow venture capital companies who have invested at least 50% of its invested funds in the form of seed capital in venture companies to qualify for the exemption.
- ***Promotion of Investments (Promoted Areas) (Amendment) Order 2006 [P.U.(A) 430]***
  - with effect from 2 September 2006, the State of Perlis is a promoted area
- ***Sales Tax (Amendment) Regulations 2006 (P.U.(A) 441)***
- ***Service Tax (Amendment) Regulations 2006 [P.U.(A) 442]***
  - with effect from 1 January 2007, the 12 month period in which a debt must be outstanding in order to claim a refund for sales tax/service tax has been reduced to a 6 month period.
  - the refund is also allowed where a debt has been provided for in the accounts as a doubtful debt.
- ***Income Tax (Deduction from Remuneration (Amendment) Rules 2006 [P.U.(A) 451]***
  - with effect from 1 January 2007, Rule 17 (offences) has been amended by substituting the words "exceeding one thousand ringgit" with "less than two hundred ringgit and not more than two thousand ringgit".
- ***Income Tax (Returns by Employers) Order 2007 [P.U.(A) 2]***
  - every employer shall prepare and deliver the Form E to the Director General within thirty days following the date of the publication of this Order which will include the required information.
  - every employer shall prepare and deliver to the employee on or before 30 March 2007, the salary statement in Form CP 8A or 8C containing the required information.
  - the Form E shall be delivered to the Director General at the address specified in the said Form.
  - the Form E may be obtained at any branch of the Inland Revenue Board of Malaysia or by downloading from the website at www.hasil.org.my.
- ***Income Tax (Deduction for Expenditure on Issuance of Islamic Securities) Rules 2007 [P.U.(A) 6]***
  - with effect from year of assessment 2008 until 2010, a deduction will be allowed on the expenditure incurred on the issuance of Islamic securities approved by the Securities Commission pursuant to the principle of mudharabah, musyarakah, ijarah and istisna'.
  - with effect from year of assessment 2007 until 2010, a deduction will be allowed on the expenditure incurred on the issuance of Islamic securities pursuant to any other principle in accordance with the Syariah principle approved by the Minister.
- ***Income Tax (Deduction for Promotion of Exports) Rules 2007 [P.U.(A) 14]***
  - with effect from year of assessment 2006, expenses incurred by a company primarily and principally for the purpose of promoting the exports of goods or agricultural products manufactured, produced, processed, graded or sorted and assembled in Malaysia in respect of registration of patents, trademarks and product licensing overseas would qualify for double deduction.
  - Income Tax (Deduction for Promotion of Exports) (No.2) Rules 2002 (P.U.(A) 116/2002 and Income Tax (Deduction for Promotion of Exports) (No.2) (Amendment) Rules 2002 (P.U.(A) 355/2002) are revoked.

- ***Income Tax (Exemption) Order 2007 [P.U.(A) 58]***
  - with effect from 2 September 2006, a non-resident person in Malaysia is exempted from income tax on income received from a Malaysian shipping company.
  - "Malaysian shipping company" is defined to mean a resident company incorporated under the Companies Act 1965 which owns a Malaysian ship and carrying on a business of transporting passengers or cargo by sea on a ship or letting out a ship.
  - "income received" from a Malaysian shipping company refers to rental of a ship on a voyage or time charter or bare boat basis made under any agreement or arrangement for the use of that ship.

- ***Income Tax (Deduction for Expenditure for Establishment of an Islamic Stock Broking Business) Rules 2007 [P.U.(A) 65]***
  - with effect from 2 September 2006, a deduction will be allowed on the establishment expenditure incurred by a resident Islamic stock broking company.
  - "Islamic stock broking company" is defined to mean a company incorporated under the Companies Act 1965 and is a dealer licensed under the Securities Industry Act 1983 which operates an Islamic stock broking business approved by the Bursa Malaysia.
  - "establishment expenditure" is defined to mean consultancy and legal fees, cost of feasibility study, cost of market research and cost of obtaining license and business approval for the purpose of establishing an Islamic stock broking business.
  - the establishment expenditure shall be deemed to be incurred in the year of assessment in which the business commenced.
  - to qualify for the deduction, the application for approval of the Islamic stock broking business has to be made to the Bursa Malaysia from 2 September 2006 until 31 December 2009 and the business is to commence within 2 years from date of approval.

- ***Income Tax (Exemption)(No. 3) Order 2007 [P.U.(A) 80]***
  - with effect from year of assessment 2007 until 2010, any non-citizen individual will be exempted from income tax in respect of fees received in his capacity as a director of an offshore company.
  - "offshore company" follows the same meaning as in the Labuan Offshore Business Activity Tax Act 1990.

- ***Income Tax (Exemption)(No. 4) Order 2007 [P.U.(A) 81]***
  - with effect from year of assessment 2006 until 2010, any non-citizen individual will be exempted from income tax in respect of 50% of the gross income received from exercising an employment in Labuan in a managerial capacity in a trust company.
  - "trust company" follows the same meaning as in the Labuan Trust Companies Act 1990.

- ***Income Tax (Exemption)(No.5) Order 2007 [P.U.(A) 82]***
  - with effect from year of assessment 2006 until 2010, a citizen individual will be exempted from income tax in respect of 50% of the gross housing and Labuan Territory allowances received from exercising an employment in Labuan with the Federal or State Government, a statutory body or an offshore company.

- ***Income Tax (Exemption)(No.6) Order 2007 [P.U.(A) 83]***
  - with effect from year of assessment 2005 until 2010, any person will be exempted from income tax on 65% of the statutory income from a source consisting of the provision of qualifying professional services rendered in Labuan by that person to an offshore company.
  - "qualifying professional services" is defined to mean legal, accounting, financial or secretarial services and includes services provided by a trust company as defined in the Labuan Trust Companies Act 1990.
  - paragraphs 5 and 6 of Schedule 7A of the Income Tax Act 1967 shall apply if the person mentioned above is a company.

- ***Income Tax (Exemption)(No. 7) Order 2007 [P.U.(A) 84]***
  - with effect from year of assessment 2005 until 2010, a non-citizen individual will be exempted from income tax in respect of 50% of the gross income received from exercising an employment in Labuan in a managerial capacity in an offshore company.

- ***Stamp Duty (Remission)(No. 2) Order 2007 [P.U.(A) 85]***
  - with effect from 2 September 2006 until 31 December 2009, 20% of the stamp duty payable on the principal or primary instrument of financing made according to the principles of Syariah and chargeable pursuant to paragraphs 22(1)(a) or 27(a) of the First Schedule is remitted.
  - the instrument has to be approved by the Syariah Advisory Council of Bank Negara Malaysia or the Securities Commission.

- **Draft Regulations/Rules**

The Lembaga Hasil Dalam Negeri Malaysia LHDNM released the draft Income Tax (Advance Ruling) Rules 2007, draft Income Tax Property Development Regulations 2007 and draft Income Tax Construction Contracts Regulations 2007 on 6 February 2007. Copies of the draft legislation can be downloaded at www.mit.org.my.

Guidelines

Ministry of Finance

The Ministry of Finance (MOF) has released the new guidelines for approved tax agents under Section 153 of the Income Tax Act 1967. The above guidelines detail the new requirements and procedures to be complied with in applying for the tax agent approval as well as its renewal. Copies of the guidelines and the application forms can be downloaded at www.mit.org.my. The Institute is seeking further clarifications on certain aspects of the guidelines from the MOF. Members of the Institute will be updated with any further information/clarification obtained.

Framework

The LHDNM has released the Framework for Tax Audit and Investigation on 6 February 2007. The frameworks are issued to ensure that tax audits and investigations are carried out in a fair, transparent and impartial manner. The frameworks also set out the rights and obligations of both the IRB officers, tax agents and taxpayers. Copies of the frameworks can be downloaded at www.mit.org.my.

Dialogue

A Tax Audit & Investigation Dialogue was held by the LHDNM with the professional bodies on 14 December 2006.

Others

Malaysian Industrial Development Authority (MIDA)

MIDA announced on 2 February 2007 that it has launched its revised forms in relation to applications for Manufacturing Licence, Tax Incentives, Expatriate Posts and Duty Exemption on Machinery and Raw Materials. The existing forms for applications received by 31 March 2007 will still be accepted provided the applicant subsequently furnishes the additional information required according to the format contained in the new forms. To obtain the forms and for further details, please visit **www.mida.gov.my.**

New Section 153 Guidelines

Introduction

The much awaited new Section 153 (3) of the Income Tax Act 1967 Guidelines are out. MIT's Technical Department has compiled it in the form of charts for your easy reading and referencing. These are also available on the MIT's website at www.mit.org.my .

Application Procedures for Tax Agent's License (Under Subsection 153(3), Income Tax Act 1967)

COMPARISON: PROCEDURES FOR NEW APPLICATION

No.	Description	2006	2007
1	Attendance at Budget Seminar	All applicants applying for their tax agent license are required to attend the latest Budget Seminar organised by LHDN.	All applicants applying for their tax agent license are required to attend the latest Budget Seminar organised by LHDN/MIT/MATA.
2	Copies of certificates to be attached with application form	A copy of certificate(s) of attendance in budget seminar organised by LHDNM certified as a true copy by a Commissioner of Oath	Attestation by Commissioner for Oath of Statutory Declaration by applicant on the true copies of the original documents and certificate.
3	Period	A certificate will be issued to the successful candidate for the period of **two years.**	A certificate will be issued to the successful candidate for the period of **three years.**
4	Interview appeal procedures	Applicants who failed the interview may re-apply by providing the completed form, six months from the date of rejection letter.	Applicants who failed the first interview may appeal to MOF for the second interview conducted jointly by MOF and LHDNM. If applicants is rejected/fails in the second interview, he may re-apply by providing the completed form, six months from the date of rejection letter.
5	Method of Payment	Either by cheque or money order	Either by postal order or money order or bank draft.

COMPARISON: PROCEDURES FOR RENEWAL APPLICATION

No.	Description	2006	2007
1	Attendance at Budget Seminar	All applicants applying for their tax agent license are required to attend the latest Budget Seminar organised by LHDN.	All applicants applying for their tax agent license are required to attend the latest Budget Seminar organised by LHDN/MIT/MATA.
2	CPD/CPE hours to be collected	80 CPD hour within 2 years.	90 CPD hour within 3 years.
3	Procedures	Fill in Form EC(1) in 3 copies	Fill in Form EC(1) in 2 copies
4	Interview process	All applicants will go through an interview process	Not available
5	Method of Payment	Either by cheque or money order	Either by postal order or money order or bank draft.

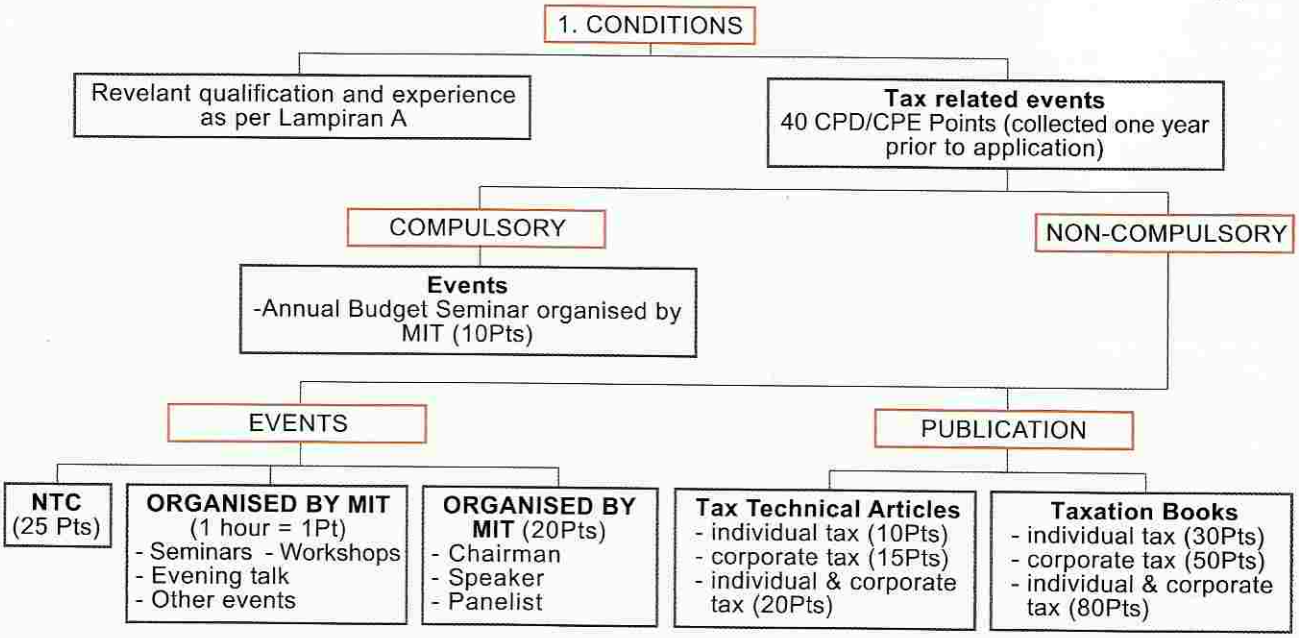
COMPARISON: APPLICATION FORM FOR NEW APPLICANTS

No.	Description	2006	2007
1	List of clients	There is no restriction to the number of clients to be disclosed in the EC form.	Applicants must provide a list of at least 20 clients, audited and non-audited.

COMPARISON: APPLICATION FORM FOR RENEWAL OF LICENSE

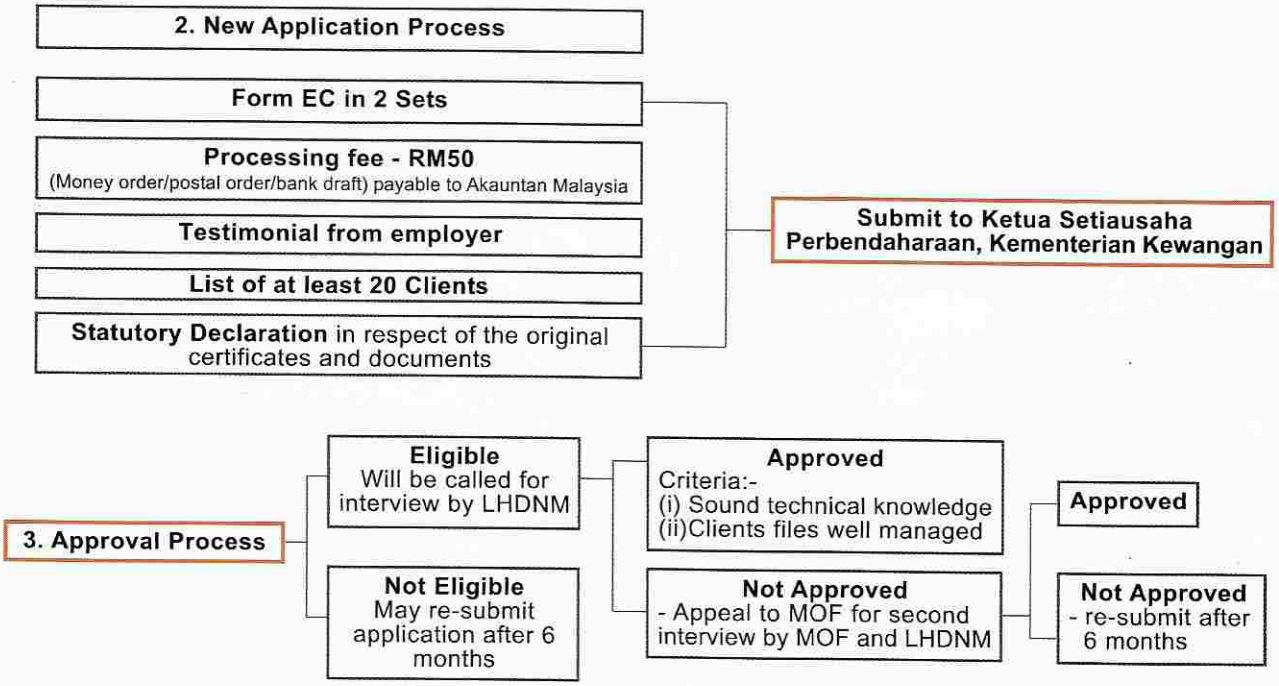
No.	Description	2006	2007
1	Particulars of tax agent firm	Applicants are required to provide the name and address of their firms.	Applicants are not required to provide the name and address of their firms.
2	List of clients	There is no limitation to the number of clients to be disclosed in the form.	Applicants must provide a list of at least 30 clients, audited and non-audited.

A. Tax Agent Licensing (New Application) (Income Tax Act 1967 Subsection 153(3)



Note: Practitioners can also attend other tax related events to collect CPD/CPE points. Please refer to the guideline for further details.

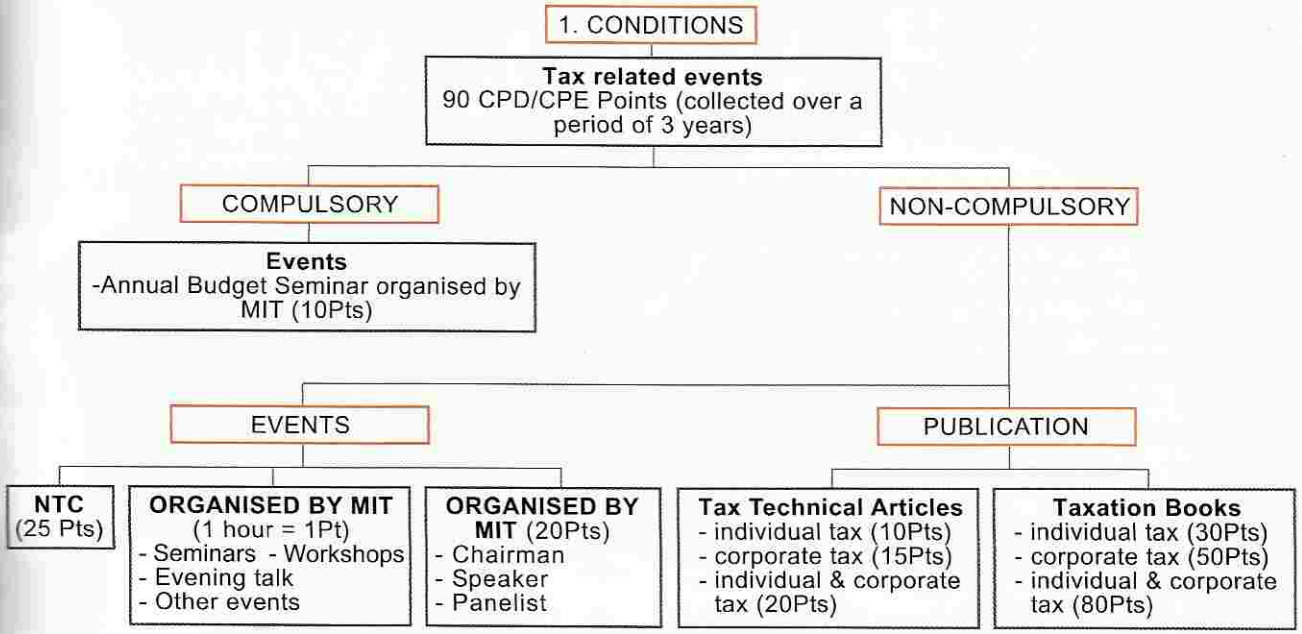
A. Tax Agent Licensing (New Application) (Income Tax Act 1967 Subsection 153(3)



Note:

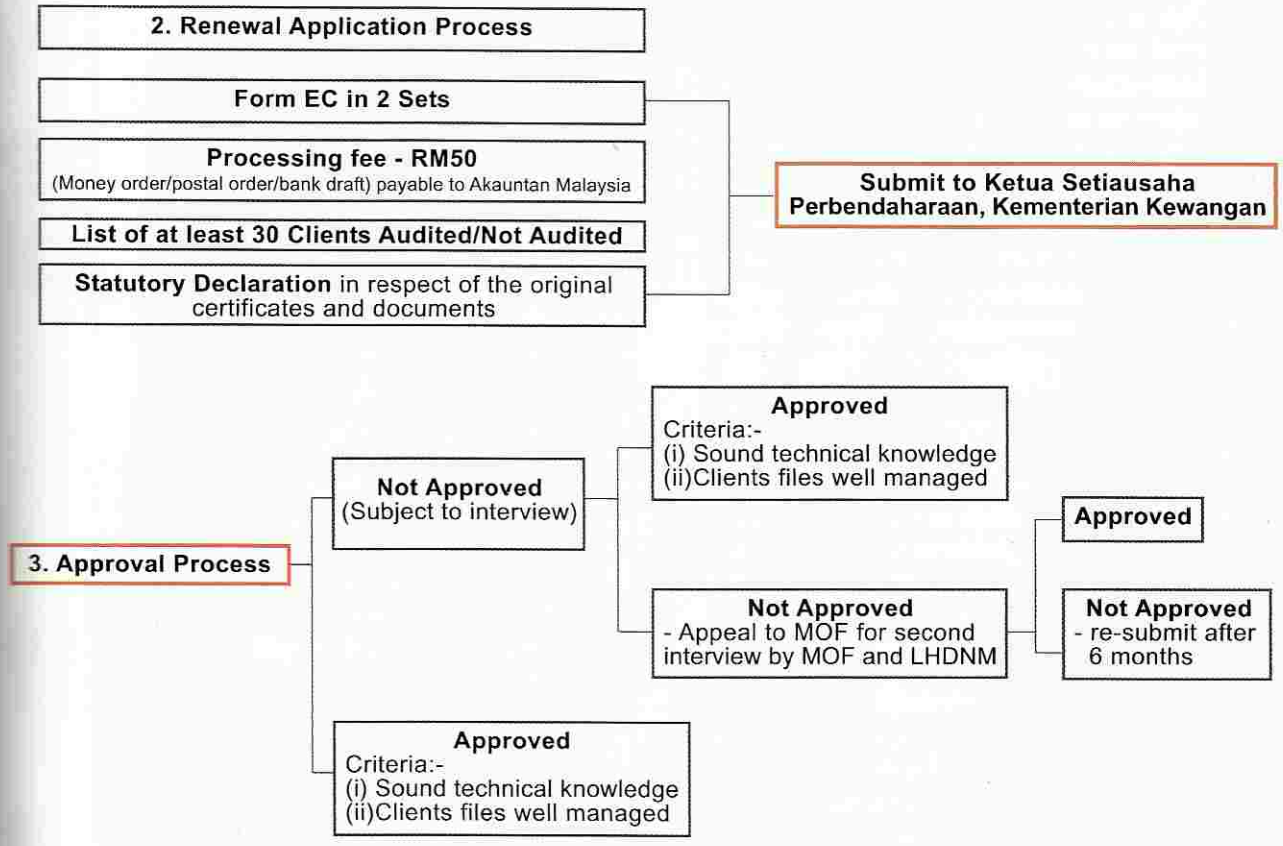
Applicants must ensure that they have submitted their own tax returns to the LHDNM and settled their income tax liabilities on a timely basis so as to avoid any delays in their approval as tax agents.

B. Tax Agent Licensing (Renewal Application) (Income Tax Act 1967 Subsection 153(3)



Note: Practitioners can also attend other tax related events to collect CPD/CPE points. Please refer to the guideline for further details.

B. Tax Agent Licensing (Renewal Application) (Income Tax Act 1967 Subsection 153(3)



Note:

1. Submissions must be done at least 4 months prior to the expiry date of the current approved license.
2. Applicants must ensure that they have submitted their own tax returns to the LHDNM and settled their income tax liabilities on a timely basis so as to avoid any delays in the renewal of their tax licence.

Interview with Datuk Aziyah

on 13 February 2007

MIT was fortunate to be granted an exclusive interview with Datuk Aziyah bt Bahauddin, Under Secretary Tax Analysis Division, Ministry of Finance. Also present were the Editor of Tax Nasional Mr. Harpal Singh Dhillon, MIT's Senior Tax Manager Ms. Eow Siew Lee and MIT's Publishing Manager Ms. Ajanta Thinakaran.

What a marvelous person she is, warm, humble, simple, well informed and direct. MIT thanks Datuk Aziyah again for making the time to be interviewed by Tax Nasional, specially and exclusively for you dear members of MIT and subscribers of Tax Nasional!!!

Part 1- About yourself

(1) Our readers would love to know a bit about your family and education background. Could you please tell us a bit?

Well, I am married with two children, a girl and a boy. My husband is a retired officer from Inland Revenue Department (before it was corporatised). He is a very understanding husband and has always been supportive in the development of my career.

In so far as my education is concerned, I studied in Sekolah Kebangsaan Bukit Kuda, Klang until primary three. Then I join the Klang Methodist Girls' School for my Special Malay Class up to Form Five. I did my Form Six in Sekolah Tun Fatimah Johor Bahru. I then went to University Malaya and graduated in 1974 with a Bachelor (Hons) in Arts majoring in Economics.

Somehow fate had its way that although I was offered to do my Masters' (MSc in Taxation) it never materialized. Even then I don't think I have done too badly….

(2) Could you please give us a brief history of your career till you were appointed as Head of the Tax Analysis Division, Ministry of Finance?

I have been a part of Treasury all my working life. I started out in Tax Division in 1974, transferred to Contracts or Procurement Division for 5 years and then back to Tax in 1984 until today. Actually, I retired in October 2006 and am currently on contract till October 2007.

Part II – Your plans and vision for the tax environment in Malaysia

(3) The "Self-Assessment" policy has been implemented since 2001 for companies and 2004 for individuals. How successful do you think it has been? Has it been more effective in increasing the collection of taxes in the corporate sector and also from individuals?

"Self-Assessment" is one of the tax policies introduced by Datuk Dr. Syed Muhamad when he was the head of the Tax Division. A man of vision and change, he pressed for the implementation of "Self-Assessment". As a result, there is a perceptible shift towatds taxpayers becoming more honest and conscious of how they declare their income taxes.

(4) There must be a co-relation between Revenue growth and growth in GDP. What is the ideal balance?

In general, the relationship between GDP and tax revenue is expressed in terms of tax buoyancy. Ideally, a one percent increase in GDP should result in at least a one percent increase in tax revenue. Not surprising then, given the tax leakages in the form of generous tax incentives, exemptions and deductions, the tax buoyancy is only 0.88%.

(5) How will the present reduction in global crude petroleum prices benefit the man in the street?

In a free market economy, the reduction in global crude oil prices should translate into lower petrol or diesel prices for the man on the street. However since, in Malaysia, petrol and diesel prices are controlled through an automatic pricing mechanism, where the government uses taxes and even cash subsidies to stabilise the retail prices of petroleum products, the public does not see a reduction in the prices at the pump as the reduction of crude oil has not stabilised. Crude oil prices came down between September to November but went up in December, came down again in January and February but is now on an upward trend. As you know, when the Government guaranteed that retail prices would not be increased until the end of 2006, the Government had been subsidizing retail consumers as the price of crude oil after March 2006 had increased substantially to more than USD70 especially from May to August 2006.

(6) The corporate tax rate was reduced in the 2007 Budget as an incentive. How will this affect the revenue?

The assumption is that the reduced rate will induce companies to reinvest, resulting in more economic activities and ultimately result in a higher tax collection.

(7) What are major revamps/changes you intend to bring in the next 2 years?

Well you know my one-year contract ends in October 2007. I do not envisage any major changes to the tax system as the review of the tax treatment for specific industries and addressing anomalies in the tax legislations are being undertaken by the Tax Review Panel. Thus I will focus on-

a. *improving delivery system of this Division within the expectations of the public;*
b. *reviewing the existing array of tax incentives in terms of their effectiveness and tax expenditures;*

c. *designing new measures towards achieving the objectives of the 9th Plan and the IMP3;*
d. *working closely with industries including tax consultants to improve the framing and administration of tax policies; and*
e. *building up the capacities of my officers.*

Although the Tax Review Panel is doing the studies, this Division is always invited to join the discussions with the industry arranged by the Panel. The officers in my Division need to understand the issues and the Panel's proposals as whatever issues arising from the agreed measures will be handled by the Division after the measures are implemented. Y. Bhg. Dato' Kamariah and myself usually discuss issues together to avoid duplications.

(8) Do you think that the Tax Review Panel should be a permanent feature?

If I say yes, it may be construed that I am lobbying to be a part of the Panel after October. Frankly, I find that the establishment of the Panel is very appropriate as the Panel can really expend the time to do in-depth studies as it is not responsible for the day-to-day functions of the Division.

(9) What do you think is an effective way for taxpayers to address their grievances on administrative matters to the authorities and the way for the authorities to respond?

I still feel that complainants should first approach the LHDN as information on the status or treatment of their tax is with them. I was made to understand that all LHDN branches now have a public relations officer to entertain public complaints. However when taxpayers are still not satisfied with the customer service at the LHDN, there is the Public Complains Bureau. As in the Ministry, there is no specific point. Taxpayers will write to the Minister or the Division generally. On the suggestion that the Division should post a hotline, it is not a good idea as the Division will be distracted from its core functions.

(10) In your opinion, what is the role of MIT in the tax profession? How could MIT play a more proactive role to assist the Tax Analysis Division?

MIT is an association unlike MIA which is a statutory body that regulates the accounting profession. Nevertheless MIT has done quite well within its limited scope. The Division welcomes MIT's positive contributions through comments on the present tax policies and also proposals for future tax policy directions.

Part III – Personal Tit- Bits

(11) Describe the most memorable incident during your career in this division?

Well, I don't know whether it is the most memorable or the least memorable but it is certainly one I remember to this day! It was 12.30 pm after the usual special cabinet meeting on the Budget Day. On that day the cabinet made substantial changes that warranted the speech and the appendixes to the speech to be amended. As Tax Division is responsible for the printing and distribution of the Budget speech to Parliament we were in a real panic to get the job done. Just imagine the speeches and the appendixes, more than a thousand copies, at that time were all stapled. To unstaple them, take out pages and insert new ones was really time consuming. As most of our officers and staff were already exhausted due to staying late the night before and at the same time most of the Muslim officers needed to go for their Friday prayers, we resorted to calling all the lady officers and staff of the Administration Division to help out. Up to now I always keep my fingers crossed until the Cabinet meeting is over. In fact, the Budget speech and the appendixes are now never stapled until the special cabinet meeting is over!

(12) What is your favourite past time and what do you do away from office to relieve stress?

I am always so busy that I find no time for a favourite pastime! I guess I watch some TV programmes. I like heavy dramas. I like reading Qur'an and find that prayer is the best form of relieving stress.

(13) Whom do you consider as your role model or idol?

I don't really have an idol or a role model. Having been in employment for a very long time and having served under many bosses, what I do is to avoid repeating the unfavourable behaviour which I have experienced and observed. In other words, I like to emulate all the best behaviours of my bosses in the civil service. I am trying my best. Although I may not be able to achieve all of them.

(14) How do you divide your busy schedule between career and family? How does your family respond to your busy schedule?

Actually I think I have not and still am not doing justice to my family. I spend more time in the office or doing office work than others. But my husband is not ordinary. He doesn't mind me working extra hours in the office or home. In fact, after his retirement, I do not even have to cook or do house chores at home. He prepares breakfast before I leave for office and normally packs my lunch with either fruits or bread as well as makes sure that there is food for dinner when I come home. My children too have been a source of support in accepting and understanding my extremely long working hours every day.

(15) In your career, who do you consider to be the person who has been supportive and the driving force behind your success?

My husband.

Managing TAX Disputes

- An Australian Perspective-

Mr David Russell QC

(Part I)

Outline and Scope

Attendees at a paper on the topic of "Managing Tax Disputes" could be forgiven for thinking that this paper will be free of the issues of definition and scope that normally arise in tax discussion groups. Unfortunately, that is not the case.

In particular, the question arises as to what comprises a tax dispute or, perhaps more precisely, when that dispute commences. In my experience, the view is often taken that the dispute arises, at the earliest, when an unfavourable assessment issues or perhaps even later when the decision to disallow the objection against it is notified.

In the sense that the latter of those two points is the first time at which lawyers need to be involved (and then only if a decision is taken to appeal against the objection decision to the Federal Court),[1] the view can be adopted that a tax dispute starts then. So to view the matter is to adopt an approach analogous to commercial litigation, when the problems only start once a commercial relationship has broken down.

In the world of taxation, particularly where what is involved is the taking of a position in an Income Tax Return ("return") or Business Activity Statement ("BAS") which it is understood may be contested by the ATO, that may be an unwise approach. The outcome of a tax dispute, and in particular the level of penalties if a taxpayer is unsuccessful in an objection, can easily be influenced by the manner in which issues such as requests for information are handled. Moreover, the obligation of those dealing with the ATO to be accurate in statements made to it means that an imprecise approach to the provision of information can have significantly adverse consequences.

For this reason, it seems to me appropriate to consider the management of a tax dispute as encompassing all aspects of dealing with the ATO and its legal representatives from the time it is apprehended that there may be a contest as to the appropriate taxation treatment of a particular transaction. In some cases at least that may be even before lodgment of the relevant return or BAS.

For that reason I propose to deal with the topic under four subheadings, namely:

- Pre-litigation Strategies and Obligations
- The Litigation Choice – Declaratory Proceedings or Part IVC
- Part IVC proceedings – section 14ZZO, *Rio Tinto* and the Model Litigant
- Post-Assessment *Corporations Act* responsibilities

Pre-litigation Strategies and Obligations

Recent cases like ***R v Pearce***,[2] and in other jurisdictions ***R v Charlton***[3] and the prosecution of Arthur Anderson in the United States, have emphasised the very different atmosphere in which tax disputes can nowadays be conducted.

Tax professionals have been used to a litigious world in which, for the most part, there is little dispute about what actually occurred. What has more likely been in dispute is how the law applies to the underlying facts -- either the general law, upon which the taxation law operates, or the taxation law itself. Rarely, in such a context, in former days was the evidence of the tax professional or the taxpayer the subject of serious challenge as to what actually occurred. Where there is such a challenge, it was usually associated with the issue of whether or not a tax motivation existed for particular conduct where the case for the taxpayer concerns deductibility under s 8-1 and/or anti-avoidance rules.

Increasingly, factual issues are contested in tax cases. That is particularly so if criminal law is involved.

The criminal law is essentially concerned with facts. The majority of criminal cases are not concerned about what the law really means, but

rather whether or not the accused has in fact committed the act in question, or, if that be not in dispute, whether the act was committed with the intention necessary to make it criminal. Criminal lawyers (particularly prosecutors) are trained not to argue nice points of law (although they do from time to time arise), but rather to establish, by way of evidence, that the version of events being given by the accused should not be accepted by the jury.

Legislatures all over the world have acted, as they see it, to protect their respective jurisdictions' tax bases from inappropriate techniques of tax reduction. The most familiar of these are General Anti-Avoidance Rules, but in addition there are various attribution rules so that taxpayers can be made liable to tax in respect of income that they do not beneficially own (as, for example, controlled foreign corporation provisions in those jurisdictions which maintain the whole of the world as the territorial base) and, increasingly, prescriptive rules which require transactions of various types to be dealt with in ways which may be inconsistent with Generally Accepted Accounting Practice.

The result, particularly in Europe, the United States and Australia, is the bewildering maze of legislation which well merits the criticism of it by Learned Hand J:[4]

In my own case the words of such an act as the Income Tax, for example, merely dance before my eyes in a meaningless procession: cross-reference to cross-reference, exception upon exception—couched in abstract terms that offer no handle to seize hold of—leave in my mind only a confused sense of some vitally important, but successfully concealed, purport, which it is my duty to extract, but which is within my power, if at all, only after the most inordinate expenditure of time. I know that these monsters are the result of fabulous industry and ingenuity, plugging up this hole and casting out that net, against all possible evasion; yet at times I cannot help recalling a saying of William James about certain passages of Hegel: that they were no doubt written with a certain passion of rationality; but that one cannot help wondering whether to the reader they have any significance save that the words are strung together with syntactical correctness. Much of the law is now as difficult to fathom, and more and more of it is likely to be so: for there is little doubt that we are entering a period of increasingly detailed regulation and it will be the duty of judges to thread the path—for path there is—through these fantastic labyrinths.

Given that these observations were made in 1947, one might wonder whether perhaps the final conclusion reached was overly optimistic in the light of subsequent developments. Be that as it may, it is the daily task of the tax adviser to meet clients' needs against a background of some complexity.

The other significant change has been the move in many countries towards a system where the responsibility for determining tax liability falls in the first instance not on the relevant Revenue Authority, but on the individual taxpayer. Gone are the days when a taxpayer can make a full disclosure of the transactions entered into, leave it to the Revenue Authority to adopt a view of the liability, and escape any suggestion of inappropriate conduct. Whilst in most jurisdictions the counterpart of abolition of the assessment process has been the adoption of binding ruling systems, these bring their own problems.

In that environment, there will from time to time be pressure on tax professionals to come to see their role as Professor Graetz has asserted it to have become:[5]

The tax bar, the accounting profession, and other tax-return preparers no longer hold the view—if they ever did—that filing a tax return should represent each taxpayer's best efforts at determining the actual tax due. Instead, they treat tax returns as an 'opening bid,' where every issue is resolved in favor of paying less taxes on the assumption that the taxpayer will not be audited or that, if audited, the IRS agent will either overlook or compromise on the issue.

This characterisation is perhaps a little unfair, given that in circumstances of genuine doubt, a taxpayer who does not claim a particular tax position will never have the opportunity to have the matter resolved in his or her favour. There may well be proper cases in which in circumstances of genuine doubt, or even an "on balance" view that an amount should be treated in a particular way for tax purposes, the possibility that the revenue or, on appeal, the Courts may adopt a different position warrants non-application of one's own view of the law. Indeed, the legislative structure in the context of self-assessment systems, involving as it does concepts such as (limited) safe harbour for reasonably arguable positions, and increasing levels of penalty for error depending upon whether what is involved is lack of reasonable care, recklessness or intentional disregard for the law, necessarily recognises that positions of this type may be taken and identifies with clarity the levels of risk involved.

Nonetheless, it remains the position that a taxpayer in a self-assessment system has the responsibility to assess his or her liability to taxation. The United States Supreme Court in United States v Arthur Young & Company[6] observed that:

Our complex and comprehensive system of federal taxation, relying as it does on self-assessment and reporting, demands that all taxpayers be forthright in the disclosure of relevant information to the taxing authorities.

The jurat at the foot of the Australian individual tax return reflects the requirements of sections 284-10, 284-75(1), 388-50(1)(b), 388-60, 388-65, 388-70,and 388-75 of the Taxation Administration Act 1953. It says (taking the 2000/1 return as a model):

I declare that:

- *all the information I have given in this tax return, including any attachments, is true and correct*
- *I have shown all my income—including net capital gains—for tax purposes for 2000-01*

IMPORTANT

The tax law imposes heavy penalties for giving false or misleading information.

Likewise, the jurat at the foot of the Company Tax Return says:

I declare that the information in this tax return is true and correct.

As Tony Molloy QC has noted,[7] *the words are "Is" true: not "disputably, possibly, by some stretch of the imagination, may be arguably" true.*

By subsection 8J(11) of the Taxation Administration Act 1953:

"Where a person omits from a return ... of income derived by the person ... during a period, any assessable income derived by the person ... during the period, the person shall... be taken to have made a statement in the return to the effect that the person ... did not derive the assessable income during the period."

Failure to respect these obligations not only may be an offence in itself, but may constitute evidence of a dishonest intent which might support a charge of conspiracy to defraud the Revenue. The prosecution case against one of the accused, Cunningham, in the case of *R. v. Charlton* mentioned above included evidence that he had not believed the answers that one of the taxpayers had prepared in response to the Revenue's questions. Yet Cunningham proceeded to submit the answers to the Revenue, and then followed up with letters that were "aggressive" and that claimed that the Revenue was attempting to browbeat the client. The Court of Appeal could find no fault with the trial judge's directions that it was open to the jury to find that Cunningham had acted to conceal the truth from the Revenue.

In a similar vein in *R v Pearce*,[8] Malcolm CJ noted:[9]

On 2 September, Pearce sent a copy of a fax he intended to send to the ATO to Wharton for his approval. It contained, to the knowledge of both Pearce and Wharton, a number of inaccurate and false statements. In particular, the assertion that "the lender has advised us that actual funds were physically passed to the Franchiser by virtue of the direction to pay and that the loan funds remain under the control of the franchiser". It was further asserted that no round-robin of cheques occurred and that the lender and indemnifier were non-associated third parties. On 3 September, Wharton approved the letter to the ATO with some minor modifications. Pearce sent the letter dated 3 September 1998 to the ATO.

Malcolm CJ concluded in these terms:[10]

In the present case, it was clear from the material provided to prospective franchisees that it was intended to represent to them that the $39,500 would be received by the franchisor and that of that amount, $38,000 would be expended in the provision of the services to be provided in the period of 13 months after the expenditure had been incurred. It was also clear that the representations made were both false and intended to cause the franchisees to claim the $38,000 as deductible expenditure against their income in the year ended 30 June 1998. As a matter of fact, to the knowledge of the appellants, while the loan agreements themselves were not shams, there was not to be any genuine transfer of funds, but only a "round-robin" calculated only to provide an artificial basis for the participants to claim a deduction in the amount of $38,000. This was intended by the appellants to enable each franchisee to fund the amount invested from the taxation refund which was obtained from the ATO. (emphasis added)

Further, in my opinion, the Crown case and the evidence was such that the only inference which could properly be drawn in the light of all the evidence was that each of the elements of the charge of conspiracy had been proved beyond reasonable doubt. It follows from this conclusion that, had the true facts been known to the ATO or the Commissioner of Taxation, the deductibility of the claimed deductions would have been questioned or challenged by the Commissioner with the result that the deductibility of the relevant expenditure would also have been challenged.

If sloppy, inexact or inaccurate answers in dealings with the revenue authorities can provide a basis for criminal charges, it is hardly a matter for surprise that they also have the capacity either to diminish the credibility of the factual case put by a taxpayer, or to support a conclusion of lack of reasonable care, recklessness or intentional disregard of the law.[11] It is unfortunate in this context that the Australian Taxation Office ("ATO") encourages "informal" discussion of issues with taxpayers and their accounting advisers in which answers may be given without the precision which would

be employed by a lawyer, and subsequently relies upon any clarification or change of position based on more comprehensive analysis of the position as evidence of dishonesty or professional misconduct.[12] Its apparent practice of refusing to supply transcripts or copies of recorded conversations in this context, even when requested under Freedom of Information legislation, is also hardly reassuring.

Hence my earlier comments that these processes should be regarded as forming part of the dispute and attended to with the same level of care and precision as the later parts of it. Put another way, the starting point in a tax dispute is the filing position taken by a taxpayer.

The Litigation Choice – Declaratory Proceedings or Part IVC

Recent cases highlight the availability (and on some views at least the utility) of resolving disputed indirect tax issues by proceedings in State Supreme Courts[13] or the Federal Court[14] for declarations about tax liabilities. The ATO has recognized the utility of such proceedings in an indirect tax context in *Sales Tax Ruling* ST 2454:

10. The question arises, however, as to how section 67 of Assessment Act (No.1) interacts with the declaratory jurisdiction of the Supreme Courts of the States and Territories and of the Federal Court. As sales tax imposition can strike at the heart of a taxpayer's business, there is often a need for disputes about sales tax liability to be resolved promptly. Sales tax assessments are still the exception rather than the rule and as the new special assessment procedure in section 25AA is optional and can be time-consuming, declaratory relief is seen in some circumstances as a prompt remedy available to persons in addition to the statutory procedures set out in Assessment Act (No.1). Reliance on section 67 in declaratory proceedings to conclusively prove the matters set out in any document referred to in that section could frustrate the effective conduct of such proceedings. Accordingly, such action should not be taken in these types of declaratory actions.

Disputes in General

11. Notwithstanding the availability of declaratory relief, it is clear that Parliament intended that the new objection and appeal procedure should be the main remedy available to dispute sales tax liability. The question then arises as to what should be the Commissioner's policy when declaratory proceedings have been commenced and at the same time a decision on an objection has been referred to either the Tribunal or the Federal Court under section 42C of Assessment Act (No.1), both proceedings seeking to resolve the same issues. The guiding objective is that any action should seek the quickest resolution of the issues in dispute, by whatever means. In some circumstances, this may be achieved by seeking to join both proceedings in one forum. In other circumstances, it may be achieved by accelerating one proceeding and seeking, as a matter of discretion, to have the other proceeding stayed or dismissed. In determining which action should be taken, care should be exercised to ensure that all issues in dispute will be dealt with in the *litigation.*

12. The following examples provide guidance on suggested courses of action:

a) If declaratory proceedings are commenced in the High Court, an application could be made to the Court under sub-section 44(1) of the Judiciary Act 1903 to remit the matter to the Federal Court. Then, if the objection decision is before the Federal Court, an application could be made to that Court to have both proceedings heard together. A similar joinder could be achieved where declaratory proceedings have been remitted to the Federal Court and the objection decision is before the Tribunal for review. An application could be made to the Tribunal under sub-section 45(1) of the Tribunal Act to refer questions of law (being those questions to be resolved in the declaratory proceedings) tothe Federal Court.

b) Where declaratory proceedings are commenced in the Supreme Court of a State or Territory, use could be made of the national cross-vesting of jurisdiction scheme. (The cross-vesting scheme became operative as from 1 July 1988.) Depending on which of the declaratory proceedings or cross-vesting scheme became operative as from 1 July 1988.) Depending on which of the declaratory proceedings the objection proceedings in the Federal Court is more advanced, an application could be made to transfer the less advanced proceedings to the other Court so that they can be heard together. Under section 4 of the Jurisdiction of Courts (Cross-Vesting) Act 1987 (Cth), and equivalent provisions in each State and the Northern Territory, so far as sales tax matters are concerned, Supreme Courts are vested with the jurisdiction of the Federal Court, and the Federal Court (by sub-section 4(3) of the Cth Act) is given the same jurisdiction as the Supreme Courts have, once a matter is transferred under section 5 of the Cth Act to the Federal Court. Section 5 permits a Court to transfer proceedings to another Court in which related proceedings are pending if it considers that it is more appropriate for the proceedings to be determined by the other Court. It is acknowledged

that transfer of sales tax matters will not be achieved in all cases. The ability of the Commissioner and taxpayers to make effective use of the scheme in this regard partly depends on the approach Courts take on what is more appropriate in particular circumstances. It is noted that no appeal lies from any decision about whether to transfer (section 13) and that section 11 deems any steps taken in the transferor Court to be steps taken in the transferee Court.

c) If one of the proceedings is far more advanced than the other, and provided that all the issues in dispute are covered by those proceedings, then an application could be made to the Court hearing the other proceeding for a stay or a dismissal on the basis that the first action will determine the issues in dispute more expeditiously. However, in the light of recent High Court authority, the Commissioner would need to show, in seeking a stay, that continuation of the other proceedings would be oppressive, vexatious or otherwise an abuse of process and that a stay would not cause injustice to the applicant. It may be difficult to satisfy this burden save in exceptional circumstances.

d) Where the declaratory proceedings and objection proceedings cover different issues, though may be in relation to the same facts, both proceedings should be allowed to run their normal course. Adjustments may have to be made to the running of the less advanced proceedings when the decision in the more advanced proceedings is handed down.

13. Where declaratory proceedings have been commenced and the assessment and review procedure has not yet reached either the Tribunal or the Federal Court, the objective still remains to ensure a quick resolution of the issues in dispute. Accordingly, while the Commissioner does not wish to see any delay in the reference of requests made under section 41 of Assessment Act (No.1) or in the determination of any objections, there is an obvious benefit in concentrating resources on the litigation of the declaratory proceedings. Where assessment action is contemplated when declaratory proceedings have commenced, such action should be put on hold unless a taxpayer has specifically requested the issue of an assessment under section 25AA.

And, more recently, in the annexure to GSTD 2004/1 such procedures appear to have been regarded by the ATO as the equivalent of Part IVC proceedings:

4.The circumstances are that all the following requirements are satisfied:

(a)(i) under Part IVC of the Taxation Administration Act 1953 you have applied to the Tribunal for review of an objection decision or appealed against an objection decision to a Court, and in making the objection decision the Commissioner decided that you have not made a creditable acquisition, and the grounds of the objection include that you have made a creditable acquisition and are entitled to an input tax credit; or

(ii) you have sought declaratory orders from a Court that you have made a creditable acquisition and are entitled to an input tax credit; or

(iii)you or the Commissioner has appealed against a decision of the Tribunal or Court that resulted from a proceeding covered by clause 4(a)(i) or appealed against a decision of the Court that resulted from a proceeding covered by clause 4(a)(ii); and

(b) the Court or Tribunal has found that you have made a creditable acquisition and are entitled to an input tax credit. (emphasis added)

In considering the utility of proceedings for declaratory relief in a GST context it is useful to consider how, otherwise, a dispute may be resolved. For most taxpayers other than ultimate consumers, payment of GST on inputs presents few problems so long as the corresponding input tax credits can be accessed. And collection of the tax from the ultimately consumer presents few difficulties for them.

GST is a multilevel value-added tax intended to be paid by ultimate consumers, not by enterprises. It is critical to the economic integrity of the tax that inter-enterprise transactions do not generate net tax liabilities – the tax paid by the supplier is balanced by the input tax credit payable by the revenue,[15] subject only to timing differences arising due to different tax periods for the taxpayers concerned or different bases of tax (one taxpayer being on a cash basis and the other on an accruals basis).

For this reason there is a duality about every transaction on which GST is payable – except where the ultimate recipient of the taxable supply is not an enterprise which is registered or required to be registered, the taxable supply by the supplier is a creditable acquisition by the acquirer.[16] Indeed, subsequent dealings by one of the parties can change the tax consequence for the other, as with bad debt writeoffs.[17] In the GST context, therefore, the commercial realities that led the Full Court of Victoria to hold[18] that an end lessee (a person other than a taxpayer) had standing to challenge legal views of the Commissioner as to the classification of goods which led to sales tax assessments which were as a matter of reality passed on the end lessee become legal realities for the third party. They are not merely subsidiary matters forming part of the process of making an assessment.

The absence of symmetrical treatment of taxpayers involved in the same transaction which is a feature of income tax jurisprudence[19] has no application in a GST context. It is both relevant and necessary to examine the tax treatment of all aspects of the transaction – both how it affects the parties to each component (external symmetry) and how it affects the enterprise in all its ramifications (internal symmetry) - to reach the correct conclusion as to the way in which it is treated for the purposes of GST.

In countries with a more developed Value Added Tax jurisprudence than Australia, the term encompassing both these concepts is "neutrality". It was explained thus by Ward LJ in the Court of Appeal in *Commissioners of Customs & Excise v Plantiflor Ltd*[20]

The result contended for by the Commissioners before us would be equally surprising and wrong. One tests it in this way. As set out in Article 2 of First Directive, VAT is a tax on consumption exactly proportional to the price of goods and services. The tax is paid by the ultimate consumer. As *Elida Gibbs Limited -v- The Customs and Excise Commissioners* [1996] STC 1387 confirms in paragraph 31, the position of taxable persons must be neutral the principle of neutrality is offended if:-

"The tax authorities would receive by VAT a sum greater than actually paid by the final consumer, at the expense of the taxable person."

These observations reflect the decision of the European Court of Justice in *Elida Gibbs Limited -v- The Customs and Excise Commissioners:*[21]

General considerations

18 Before replying to these questions, it is appropriate to describe briefly the basic principle of the VAT system and how it operates.

19 The basic principle of the VAT system is that it is intended to tax only the final consumer. Consequently, the taxable amount serving as a basis for the VAT to be collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him.

20 Thus, in Case 89/81 Staatssecretaris van Financiën v Hong Kong Trade [1982] ECR 1277, paragraph 6, the Court held that it was apparent from the First Directive (Council Directive 67/227/EEC of 11 April 1967 on the harmonization of the legislation of the Member States concerning turnover tax (OJ, English Special Edition 1967, p. 16) that one of the principles on which the VAT system was based was neutrality, in the sense that within each country similar goods should bear the same tax burden whatever the length of the production and distribution chain.

21 That basic principle clarifies the role and obligations of taxable persons within the machinery established for the collection of VAT.

22 It is not, in fact, the taxable persons who themselves bear the burden of VAT. The sole requirement imposed on them, when they take part in the production and distribution process prior to the stage of final taxation, regardless of the number of transactions involved, is that, at each stage of the process, they collect the tax on behalf of the tax authorities and account for it to them.

23 In order to guarantee complete neutrality of the machinery as far as taxable persons are concerned, the Sixth Directive provides, in Title XI, for a system of deductions designed to ensure that the taxable person is not improperly charged VAT. As the Court held in its judgment in Case 15/81 Schul v Inspecteur der Invoerrechten en Accijnzen [1982] ECR 1409, paragraph 10, a basic feature of the VAT system is that VAT is chargeable on each transaction only after deduction of the amount of VAT borne directly by the cost of the various price components of the goods and services. The procedure for deduction is so arranged that only taxable persons are authorized to deduct from the VAT for which they are liable the VAT which the goods and services have already borne.

24 It follows that, having regard in each case to the machinery of the VAT system, its operation and the role of the intermediaries, the tax authorities may not in any circumstances charge an amount exceeding the tax paid by the final consumer.

These observations apply equally to the design of the Australian GST as appears from the Explanatory Memorandum Executive Summary. The opportunity to resolve a dispute as to liability in a way which binds all interested parties would seem to make declaratory relief a particularly appropriate procedure where the issue is the application of the GST to complicated transactions.

Notwithstanding the eminently sensible observations in the Ruling set out above and the foregoing considerations, as the litigation in *Platypus Leasing Pty Ltd v. Federal Commissioner of Taxation (No 3)*[22] demonstrates, the ATO's co-operation in facilitating declaratory proceedings will not always be forthcoming and the conclusion of Gzell J[23] that Supreme Courts[24] lack jurisdiction to make a declaration once an assessment issues and is tendered provides the ATO with a ready means available to it to frustrate the exercise of such jurisdiction.

If the ATO is not inclined to frustration, declaratory relief will usually be the simpler method of resolving the dispute. But if the ATO's co-operation cannot be taken for granted, the question remains whether an application for declaratory relief will serve a useful purpose.

The ATO may take considerable time in carrying out an investigation, while increasing the pressure on the various parties. It may have made its intended position quite clear, although without precision as to the reasoning relied upon. It may have shown enthusiasm for obtaining the taxpayer's legal opinions if it can. It may also suggest that the Commissioner's Accountant's Concession will not be applied in the hope, presumably, that there will be some correspondence that gives it more insight.

Eventually, but potentially after a long interval, the ATO may issue assessments to most, if not all, the entities involved in an arrangement, which will take inconsistent positions: in a GST context, denying the various input tax credits but leaving GST payable on all taxable supplies, or, in an income tax context including the same income in the assessable incomes of more than one person. Inconsistent alternative assessments, if *bona fide,* are allowed at law. The ATO's modus operandi is often also to impose penalties at the greatest level possible, with a view to placing pressure on taxpayers to settle. For example, it attempted, in *Prebble v FCT*,[25] to support an assessment to penalties at 75% of the tax assessed on the basis that the taxpayer, who had sought legal advice, had intentionally disregarded the law. That contention was rejected summarily by the Court.

More recently, the ATO has asserted that a taxpayer, who seeks legal advice as to its tax position which suggests that, despite the (favourable) advice there is always a risk that the ATO will disagree, is reckless and subject to 50% penalties if it does not disclose its circumstances to the ATO. This approach should also be rejected by the courts but, until it is, the ATO can be expected to assess on such a basis. Also, in the minds of some practitioners there is a suspicion that the ATO has never accepted in an assessment that any view of the law other than its own is "reasonably arguable". So it does not apply the provisions that reduce, or eliminate, penalties on that basis.

The taxpayers may well intend to object to these assessments. Although the grounds of objection must be comprehensive, and reasons for the objections detailed, the taxpayers need not disclose their legal advice to the ATO. The ATO can be expected to ask for the legal advice, purportedly to assist it in deciding the objections, but the taxpayers are not obliged to provide it or to set out their opinion on how the tax law operates; that is the ATO's function. The ATO's deliberations cannot go on indefinitely, because the taxpayers have the power after 60 days to require the ATO to make a decision after a further 60 days.[26] The ATO can also issue further notices requiring provision of information in order to assist it in deciding the objections.[27]

Ultimately the ATO's unfavourable objection decisions should proceed to the Federal Court. The ATO is obliged to state its contentions in detail within a short time of the proceedings being instituted.[28] The taxpayer will usually also be required do so. The taxpayers must give their evidence by affidavit, which will be provided to the ATO prior to the hearing.

Seeking a declaration involves a somewhat different process if the facts in the case are largely uncontroversial (apart from anti-avoidance issues which could not be the subject of the declaration). The parties would settle questions upon which the court is asked to declare the law, which declarations will bind the taxpayers and the ATO. The taxpayers would have to provide evidence, which would be to prove how and when the transactions occurred. In this regard the various documents often speak for themselves. Although occasionally the parties agree a statement of relevant facts for the court in such matters, and the ATO is under an obligation as a model litigant not to dispute uncontroversial matters, it is open to the ATO to refuse to agree anything. It is open to the taxpayers to lodge a notice requiring facts to be admitted. If the ATO refuses, and the facts are proved, then the ATO might be ordered to pay the taxpayers' costs of proving those facts. Contentions by the ATO that it stands in a different position to other litigants in this regard have not been accepted by the Courts.

might be ordered to pay the taxpayers' costs of proving those facts.[29] Contentions by the ATO that it stands in a different position to other litigants in this regard have not been accepted by the Courts.[30]

Seeking a declaration may have a number of advantages in appropriate circumstances:

- It gets the taxpayer on the front foot, rather than sitting by and waiting for the ATO to proceed with the matter at its own pace;
- There would be a much earlier resolution of the issues, a matter of some significance in the context of a corporate taxpayer for the reasons discussed below; and
- It precludes the ATO relying upon delay as a tactic.

Should the ATO seek to pre-empt such proceedings, it can issue assessments and/or (in a GST context) Division 165 declarations for the relevant periods against the taxpayers. The ATO will then rely on section 177 of the *Income Tax Assessment* Act 1936 or, in a GST context, section 59 of the *Taxation Administration Act* 1953.

Whilst it may be possible for the ATO to stall the declaratory proceedings by issuing assessments and/or declarations promptly, and the advantages of such proceedings would not arise in such a case, at least the taxpayer will have assessments and/or declarations that can be attacked under Part IVC. This is itself an advantage, if one concern of the taxpayer is the delay in resolving the matter with the ATO.

There are a number of potential disadvantages that have to be considered.

First, the institution of, and preparation for, declaratory proceedings will give rise to additional costs to the taxpayer (compared with proceeding with Part IVC proceedings alone). Even though much the same preparation will be involved, these additional costs would not be insignificant. Of course they would be reduced to some extent if the taxpayer is successful, but likewise increased if unsuccessful.

Second, assuming the declaratory proceedings occur, the ATO may have an opportunity to cross-examine the taxpayer's witnesses. This evidence could then be used by it in the later Part IVC proceedings.

Third, the taxpayers will be subject to the usual disclosure rules, which would include, if requested by the ATO, disclosing documents which may otherwise be the subject of the Accountant's Concession claim. This disadvantage is probably illusory, for the ATO will probably indicate that it thinks there are "extraordinary circumstances" warranting a lifting of the self-imposed sanction on accounting advice. So, at any time, the ATO can determine that it wants access to those documents.

The decision will often be finely balanced.

As mentioned above, in *Platypus Leasing Pty Ltd v. Federal Commissioner of Taxation (No 3)* the ATO argued that there was no jurisdiction both before the assessment issued, and after. It succeeded on the latter proposition. In relation to the former, it argued in a strikeout application that the somewhat stringent requirements for striking out the plaintiff's claim were met on the basis that

(a) the Plaintiffs' summons and consequent proceedings disclosed no reasonable cause of action in that:
(i) they were premature and hypothetical;
(ii) they may not involve a federal matter under the Constitution;
(iii) they were frivolous or vexatious;
(iv) there was no reasonable prospect that the Court would make the declarations sought in the Summons on discretionary grounds; and

(b) the Plaintiffs' summons and consequent proceedings constituted an abuse of processof the Court as being instituted for an ulterior purpose, namely the inhibition of the exercise by the Defendant of his statutory responsibilities.

In relation to these issues, Gzell J observed:

The fate of the matter argument

55 In light of the tender of the signed copies of the notices of assessment and declaration, for the reasons expressed below, it is unnecessary for me to express an opinion on the Commissioner's argument that the proceedings raised no matter.

56 It was not contended by the Commissioner that proceedings in a State court seeking declaratory relief with respect to liability under A New Tax System (Good and Services Tax) Act 1999 (Cth) will never raise a matter. On the contrary, he submitted that such proceedings are appropriate in some instances.

57 There is a long history of declaratory proceedings against the Commissioner in disputes arising under the former sales tax legislation. Indeed, the Commissioner issued Sales Tax Ruling ST 2454 expressing his approval of such proceedings in appropriate cases. Their utility in resolving disputes with the Commissioner prior to the issue of a notice of assessment is demonstrated by Oil Basins Ltd v The Commonwealth (1993) 178 CLR 643 in which Dawson J held that the fact that the Commissioner had not made up his mind whether or not to

issue an assessment did not deprive the court of jurisdiction for want of a proper contradictor.

58 In his final submissions, counsel for the Commissioner submitted that it was "theoretically possible" that a case with a factual controversy could be the subject of declaratory relief by a State court. It was submitted that appropriate cases for this form of relief were those where not factual controversy existed. I doubt that is a valid distinction or that the grant of jurisdiction under the Judiciary Act 1903 (Cth), s 39(2) is so circumscribed. However, that is a matter for another day.

Utility of the declaratory proceedings

59 International Lease Finance and its associated companies pointed to the utility and the convenience of proceeding to a hearing on the merits in this court. There is obvious force in those arguments in light of the material that has already been filed in these proceedings, the allotment of a hearing date and the delay that will inevitably be occasioned by the procedures in the Taxation Administration Act 1953 (Cth), Pt IVC.

60 Nevertheless, signed notices of assessment and a declaration have now been tendered in this court and the effect of that tender must be analysed.

Gzell J did not need to deal with the abuse of process issue, as the taxpayers made it clear that they did not seek to obtain any forensic advantage flowing from limitations which might otherwise arise on the use by the ATO of its compulsive powers[31] and, to make that clear, consented to an order authorizing completion of the audit he was conducting. In a similar vein, an adjournment of the Plaintiffs' summons was granted so that the ATO could, with reasonable expedition, complete the audit. The prospect of such proceedings being used to interfere inappropriately with the due conduct by the ATO of its statutory functions is accordingly remote.

On appeal, the only member of the Court (Handley JA) to consider the matter in any detail made it clear that in his view the challenge to jurisdiction in a pre-assessment context was bound to fail.

N.B. Part IVC proceedings – section 14ZZO, Rio Tinto and the Model Litigant & Post-Assessment Corporations Act responsibilities will be continued in the next issue as Part II of this article.

1. That is because a corporate taxpayer must be represented by a lawyer unless the court grants leave otherwise.
2. [2005] WASCA 74 (Malcolm CJ, Murray and Steytler JJ, 15 April 2005)
3. [1996] STC 1417, 1433
4. **Thomas Walter Swan**, 57 Yale LJ (1947) 167, 169:
5. **The US Income Tax: What it is, How it Got That Way, and Where We Go From Here** (1999) page 51
6. 465 US 805, 815-816 (1984)
7. A P Molloy QC: **Restrictions on the Role of International Tax Advisers** (2004) World Tax Conference papers
8. [2005] WASCA 74 (Malcolm CJ, Murray and Steytler JJ, 15 April 2005)
9. at para [50]
10. at paras [153] and [163]
11. see, e.g., *Harts Australia Ltd v. Federal Commissioner of Taxation* 2001 ATC 4,572, *Weyers v. Federal Commissioner of Taxation* (2006) Federal Court (Dowsett J) [2006] FCA 818
12. see, e.g., the transcript of cross-examination of the Applicant's witnesses in *Di Lorenzo Ceramics Pty Ltd v. Federal Commissioner of Taxation* (2006) Federal Court (Lindgren J) (decision reserved)
13. e.g. *TAB Limited v. Federal Commissioner of Taxation* 2005 ATC 4,512
14. e.g. *Marana Holdings Pty Ltd v. Federal Commissioner of Taxation* 2004 ATC 4,256, 5,068
15. Explanatory Memorandum Chapter 1 – Executive Summary
16. GST Act, paragraph 11-5(b). A less common example is the unavailability of the margin scheme method of accounting for real estate transaction where the acquisition resulted in a taxable supply by the vendor who was not himself using the margin scheme (GST Act subsection 75-5(2))
17. GST Act subsection 21-15(c)
18. *Federal Commissioner of Taxation v. Biga Nominees Pty Ltd* [1988] 1,006 at pp1,015-6
19. *G P International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124 at p. 136; *Federal Commissioner of Taxation v. Rowe* (1997) 187 CLR 266 at pp 279-280 (Brennan CJ, Dawson, Toohey and McHugh JJ) and pp 291-2 (Gaudron, Gummow and Kirby JJ)
20. [2000] EWCA Civ 26 (3 February 2000). The actual decision was reversed on other grounds by the House of Lords [2002] UKHL 33
21. *Elida Gibbs Ltd v Commissioners of Customs and Excise*. [1996] EUECJ C-317/94 (24 October 1996)
22. [2005] NSWSC 388 (17 May 2005)
23. upheld on appeal at [2005] NSWCA 399. See also the decision of the House of Lords in comparable circumstances in *Autologic Holdings plc v Inland Revenue Commissioners* [2005] 3 WLR 339
24. and, seemingly, by parity of reasoning, the Federal Court
25. [2002] FCA 1434.
26. *Taxation Administration Act* 1953 section 14ZYA
27. **ibid**. para 14ZYA(1)(b)
28. *Federal Court Rules* O.52B r.5(a)(v)
29. *Federal Court Rules* O.18 r.2 and O.62 r.25 and 25 and corresponding provisions in the Rules of the State and Territory Supreme Courts
30. see, e.g., *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation* [2004] FCA 1299
31. see, in the context of section 155 of the *Trade Practices Act* 1974, *Brambles Holdings Ltd v. Trade Practices Commission* (1980) ATPR 40-179

Author's Profile

Mr David Rusell QC *was called to the Bar in 1977, having been admitted as a solicitor in 1974. Admitted to practice in New South Wales, Queensland, Victoria, the Northern Territory, the Australian Capital Territory and Papua New Guinea, David took silk in 1986 and holds that office in all the above jurisdictions except Papua New Guinea.*

Tax Risk Management

- Various Perspectives on Corporate TRM -

(Part I) Australia, Hong Kong, China

Look out for (Part II) India, Malaysia, New Zealand in Q2/07

Australia

Mr Gary Christie

1. Introduction

Tax Risk Management (TRM) has gained prominence in recent years as a number of global and local factors such as corporate governance requirements resulting from Sarbanes-Oxley legislation in the US, Corporate Law Economic Reform Package (CLERP 9) and an increased compliance focus by the revenue authorities have compelled companies to take TRM seriously.

One way a company can demonstrate to revenue authorities as well as to investors and shareholders that they are managing their tax risks appropriately is to adopt a TRM approach.

There has been quite a lot written globally on TRM in recent years, particularly on what is TRM and the processes used to identify and manage tax risks.[1]

While this article will discuss the concept of TRM and some of the processes used to identify and manage tax risks, the focus of this article is on TRM from an Australian perspective. With this in mind, the article will look to examine what the Australian Taxation Office (ATO) is currently doing about TRM and what an Australian company can do to minimise its tax risk exposure.

2. The Current Environment in Australia

Pressures for improved corporate governance have come from a number of high profile investor crises. The agenda for improved corporate governance is aimed at empowering boards to achieve high levels of financial disclosure and protection of shareholder interests. Regulators are demanding greater transparency in taxation matters. As a consequence, organisations are being required to disclose much more information to the government and shareholders than ever before. Some important examples in the development of this trend are:

- Sarbanes-Oxley – The Sarbanes-Oxley Act 2002 has focused corporate attention on risk management including the management of tax risk associated with the financial reporting process. As a consequence, corporations have been required to develop appropriate TRM policies and controls to manage their tax risks and the reporting of such risks
- Corporate Law Economic Reform Package (CLERP 9) which effectively requires that a board of a listed entity be confident that financial reports present a true and fair view in all material respects of the organisations taxation responsibilities and that it has established policies on TRM
- Australian Stock Exchange (ASX) principles of good corporate governance - The ASX principles describe ten principles of good corporate governance, each of which is supported by best practice recommendations;[2] and

- increased and more sophisticated tax enforcement processes as the Australian Taxation Office (the ATO) improves its approach to identifying and understanding tax risks.

It is particularly important therefore, that in the current environment of increasing regulatory reporting and disclosure, an organisation has implemented appropriate processes around tax compliance, transparency and corporate governance and that corporate boards and directors are not only aware of these processes, but oversee such processes in order to minimise its risk exposure.

3. What is TRM?

TRM is designed to assist an organisation in the development of a framework around risk identification and risk management that:

- assists in identifying existing and potential tax risks across an organisation
- prioritises those risks so that appropriate attention and resources are focused on the most critical areas
- determines a treatment strategy or appropriate response for each priority risk area
- communicates the TRM process to key stakeholders within the organisation including senior management, the audit committee and the board of directors; and
- establishes procedures for evaluating future tax planning opportunities, based on the risk tolerance of the organisation.

Essentially therefore, TRM is about understanding where the tax risks arise and making a decision around how they are to be addressed. It is considered broadly, that the concept should address the following specific types of risks or uncertainties:

- Transactional risk – this relates to the risks and exposures associated with the application of tax laws, regulations and decisions to specific transactions undertaken by an organisation. An organisation needs to ensure that the particular transaction complies with appropriate tax laws and regulations
- Administrative/Procedural and Compliance risk – risks associated with meeting an organisations tax compliance obligations, for example, compliance with tax laws and regulations, filing of tax returns, compliance with withholding and indirect tax obligations and keeping up to date with changes in tax laws and the tax environment which can affect existing tax exposures
- Operational risk – this relates to the underlying risks of applying the tax laws, regulations and decisions to the day to day business operations of an organisation. Tax risks can arise where there is:
  - a lack of tax awareness within the organisation
  - a loss of knowledge and gaps in corporate memory due to staff movements
  - inadequate documentation of transactions and positions taken; and
  - inadequate controls around financial and tax reporting systems.
- Financial risk – From a tax perspective, financial risk can relate to:
  - inadequate tax provisioning in financial accounts
  - identified but not reasonably quantified tax exposures
  - lack of a reasonable arguable position to support aggressive tax positions
  - undetected tax exposures; and
  - penalties and interest as a result of late payment of taxes or the lodgement of incorrect tax returns.
- Market and reputation risk caused by:
  - loss of shareholder or investor trust or support
  - adverse media or market perception; and
  - negative perceptions by other regulators and stakeholders.

4. How are organisations currently managing tax risk?

There is a growing realisation among organisations of the importance of TRM.

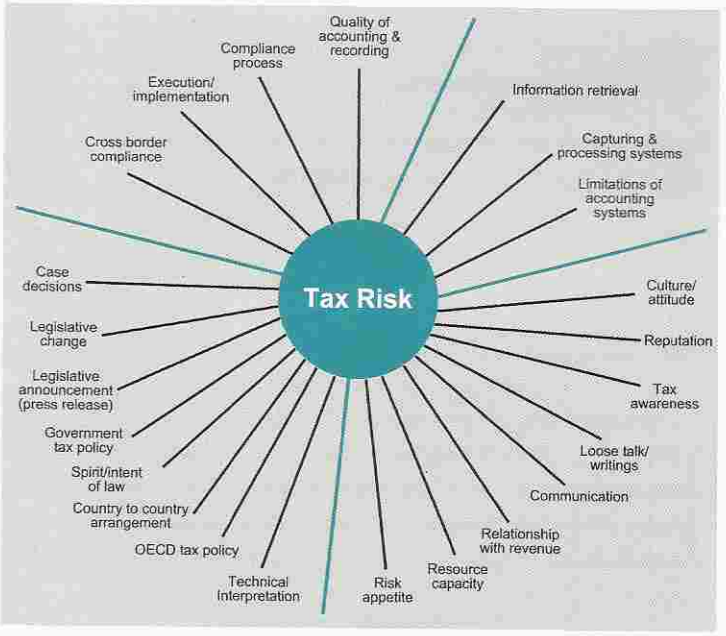
In 2001, 120 of Australia's largest companies were surveyed as to how they responded to the increasing complexity and changes in the tax law. Only 32% of respondents said they had a formal TRM framework in place.[3] This figure increased to 52% in a similar survey undertaken in 2004.[4]

Interestingly, reliance on external advisors increased during this time from 29% to 60% leading to an increase in compliance costs.

To the best of my knowledge, there is no survey data available post 2004; however anecdotal evidence would suggest that the number of organisations which have in place an appropriate TRM framework has increased from the 52% reported in 2004.

5. What influences tax risk?

Many aspects influence the tax risk position of an organisation. Consider the following diagram:[5]



The challenge for an organisation is how best to manage the above risks.

Arguably, the best way to manage tax risk is through the development of a framework that will:

- align tax function goals with the organisation's overall business objectives
- identify and assess risks
- develop and capture appropriate treatment strategies
- identify controls and policies that will manage risks and determine whether tax policy and controls are working
- evidence appropriate and reliable reporting and sign offs
- enable effective and efficient use of the organisation's resources; and
- monitor compliance with tax laws and regulations.

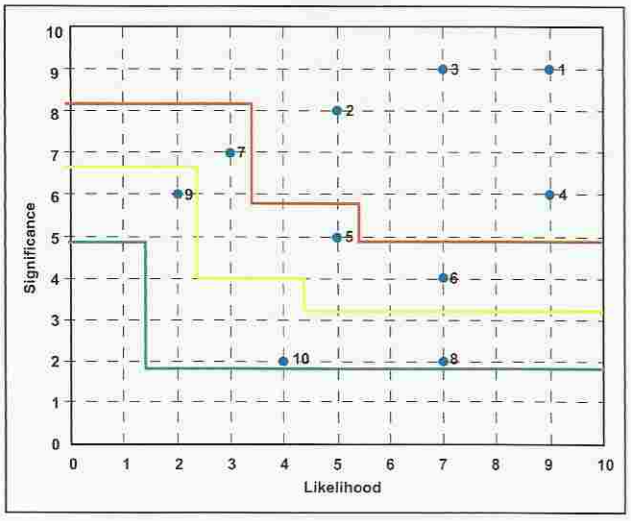
In order to achieve the tax risk objectives above, an organisation's tax function needs to:

- identify all events, both risks and opportunities, which potentially impact achievement of the organisation's objectives
- analyse risks, based on the likelihood of the risks arising and the consequences (impact) should the relevant risk arise to determine how risks should be managed
- determine the severity of the risk (range from low to high and where appropriate allocate potential monetary values to the level of risk)
- develop appropriate implementation actions, such as strategies to deal with risks based on the organisation's risk tolerance. Even if the decision is made to merely accept an existing tax risk with no further action, it is important for tax functions to communicate that decision to appropriate individuals in the organisation
- implement procedures and policies that help ensure risk responses are effectively carried out
- implement systems that support risk mitigation processes
- establish processes for information to flow across all levels of the organisation enabling people to carry out their responsibilities

regularly review and monitor strategies to ensure they remain current and appropriate in order to minimise risk.

The following models are useful in developing an appropriate TRM process to be used by organisations:[6]

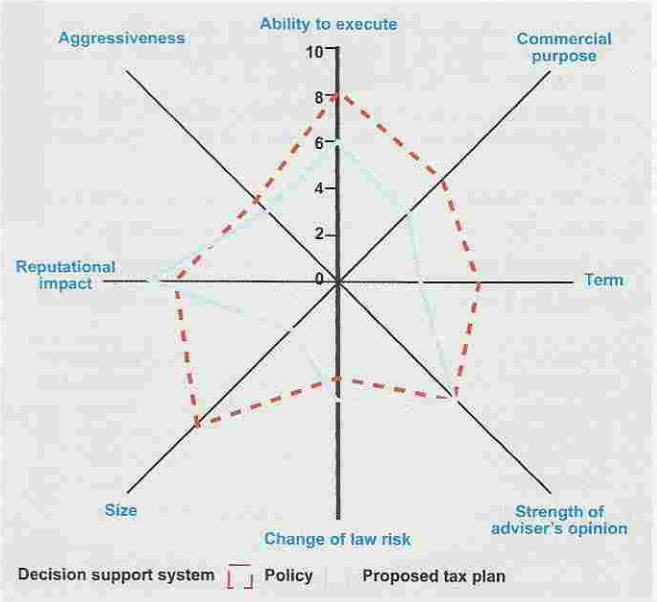
Tax Risk Map



Number	Risk Area	Likelihood	Significance
1	**Outstanding disputes or audit enquiries with the ATO** *Are there any disputes against assessment or outstanding audit enquiries with the ATO that could result in additional costs to the organisation?*	9	9
2	**Timing issues** *Tax costs resulting from a failure to meet compliance obligations or inadequate tax reporting systems and procedures*	5	8
3	**History of losses** *Does the organisation have history of continuous lossess or low effective tax rates compared with business performance*	7	9
4	**Transfer Pricing issues** *Has the organisation appropriate transfer pricing methodologies and supplementary documentation to justify transfer prices for international dealings with related parties?*	9	6
5	**Significant Transactions** *What potential acquisitions, disposals or other/unusual transactions have been initiated or are on the horizon that could lead tax costs?*	5	5
6	**Market Valuations** *Are there distortions and inconsistencies between market valuations?*	7	4
7	**Goods and Services Tax** *Are there significant differences between financial statements and reported GST amounts?*	3	7
8	**Legislative Changes** *Has the business considered tax costs arising from variations in accounting policy or new tax legislation?*	7	2
9	**International Group Structure** *Has the business considered tax sensitivity issues such as debt:equity ratios that could be caught by thin capitalisation rules?*	2	6
10	**Controlled Foreign Companies** *Are there potential CFC issues, undisclosed branch income or residence issues resulting from international transactions?*	4	2

Importantly, the 'Tax Risk Map' enables an organisation to analyse its tax risks across each part of its business.

Decision support graph



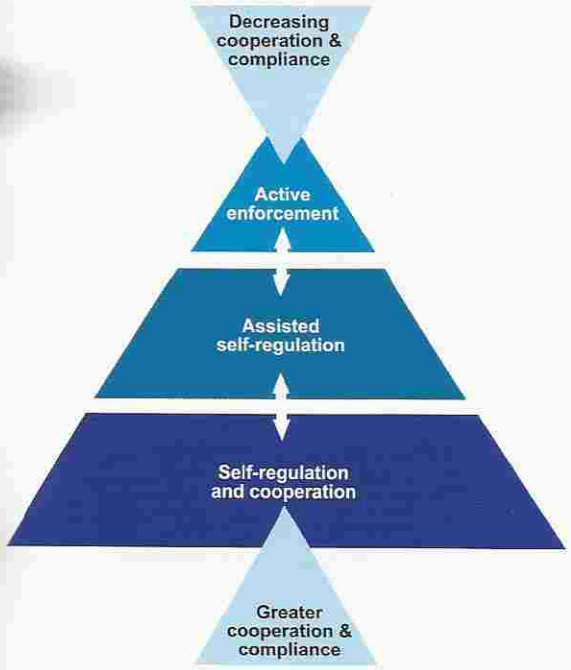
The 'decision support graph' helps a company assess specific transactions from a tax risk perspective. It analyses the factors that influence a tax decision and plots a given proposal against these and the organisation's risk profile. This transparency is critical, because it allows those not familiar with detailed tax policy issues to participate in tax risk assessment and decision making.

Using the tools such as those described above within the broader context of the TRM framework, organisation's can actively manage their tax risk profile and assess operating improvements throughout the organisation.[7]

6. Tax Risk Management- The Australian Taxation Office (ATO) perspective

The ATO applies what is known as the Co-operative Compliance Model (the Model) in its administration of tax risk.

The following diagram demonstrates how the Model is intended to operate:[8]



The diagram shows how co-operative compliance allows for movement both up and down the pyramid, from active enforcement measures at the top down to self-regulation and co-operation at the base.

The base of the pyramid, characterised by a co-operative, self regulatory approach, is the most desirable area of operation for the ATO and for business.

The ATO uses a wide range of possible compliance methods to manage corporate compliance depending upon where in the compliance pyramid hierarchy they consider an organisation's overall risk level resides.

The Model determines the type of compliance response or action to be taken by the ATO depending on the level of co-operation and tax compliance of the organisation.

The compliance options available to the ATO largely fall within three main categories:

Active enforcement:
Where there is a decreasing level of co-operation and compliance, the ATO uses a range of enforcement options including the use of various audit products and the potential use of sanctions and prosecution action. Importantly, non-compliance carries risks to an organisation's financial position as a result of the additional costs of having to deal with an audit or potential litigation.

Assisted self regulation:
Products such as Advance Pricing Arrangements are used to assist organisations in understanding their future tax obligations. Often ATO officers are assigned to a large corporation to provide a direct link in order to help resolve administrative issues and assist them in complying with their taxation obligations.

Self-regulation and co-operation
A technical advice program exists to clarify and communicate the law and provide guidance to corporates. Products such as Public and Private Rulings assist in enabling corporates to self regulate. Private rulings relate to particular circumstances raised by an entity and which relate to that entity. Public rulings impact on a wider group of businesses in the community. Consultative forums between the ATO and large corporates complement an environment of self regulation and cooperation.

The Model emphasises that the business community and the ATO can work together to identify weaknesses in the tax system (both for and against), and develop streamlined cost-effective solutions that increase certainty and overall community confidence.

However whilst the Model is aimed at building a positive professional relationship, it does not preclude a business organisation from disagreeing with the ATO or taking a different view of the law as it applies to a particular transaction.

7. How does the ATO look to apply the Model?

The Model is applied by bringing together the following five processes:

- understanding business and the law
- assessing the risks
- planning strategies
- implementing strategies; and
- reviewing and improving.

The Model is designed to have application regardless of whether the risk relates to a single transaction, a specific entity or group, or whether it relates to a whole of market/industry or the wider community.

Understanding business and the law

The ATO recognises that large business operates within a constantly changing social, political and economic environment that influences decisions and behaviours. To understand what drives business behaviour, the ATO uses the 'BISEPS' system which reflects the fact that compliance decisions and behaviour are effected by a wide range of factors that are often related. These factors are (B) Business, (I) Industry, (S) Sociology, (E) Economy, (P) Psychology and (S) Systems of compliance.

The following table illustrates some examples of the BISEP factors:[9]

B	Business	The extent and nature of the group's business activities and transactions The structure of the entity or group Financial performance and ratios
I	Industry	Industry norms around financial performance and other ratios Industry profit margins and cost structures Conditions affecting the industry such as region, size and participants
S	Sociology	Culture of the organisation and management (i.e. whether risk adverse, aggressive) How the entity or group deals with paying taxes and its financial arrangements Standard of record keeping and lodgement timeliness
E	Economy	Domestic, international environment and trade conditions Government policies – interest rates, inflation, tax system and economic and tax reforms
P	Psychology	Approach to managing risk and drivers of the risk strategies Attitude and relationship with the ATO Management objectives
S	Systems of Compliance	Compliance history Tax analysis of issues Quality assurance standards and corporate governance processes Decision making systems, processes and organisational structure The degree and ease in accessing information

Assessing the risk

It is important for an organisation to understand how the ATO operates in terms of its compliance activities. Such activities are generally undertaken on the basis of assessing identified risks. Risks are analysed and assessed according to the level of risk in order to arrive at an overall risk profile for an organisation and the tax risks that need to be addressed. This risk management approach allows the ATO to tailor its strategies that appropriately addresses identified risks.

As a general rule, the ATO considers the following criteria when assessing risks:

- business structure and transactions
- compliance obligations and systems to measure
- compliance
- application of the law
- materiality levels
- international activity
- attitude; and
- perceptions of stakeholders.

An overall risk ranking that ranges from Severe to Trivial, based on the likelihood and consequence of the risk occurring, is made for each criterion, with an overall risk rating made of the organisation after considering all relevant risk criteria.

A sample risk matrix is contained hereunder:

Criteria	Severe	High	Medium	Low	Trivial
Business structure and transactions	• Complex business structure and transactions • Volatile industry and business activity • Significant internal restructures and/or acquisitions or sell offs				• Simple business group structure • Minimal change in group structure • Straightforward business transactions
Compliance obligations and systems	• Poor compliance history • No effective quality assurance processes • Minimal corporate governance • Lack of compliance processes • Minimal supporting documentation				Excellent compliance history • Quality assurance, corporate governance and tax risk management in place and working • Accurate and supporting documentation of transactions
Application of the law	• Novel applications of the law • Aggressive tax positions • Tax outcomes that are inconsistent with the policy of tax reform				• No novel applications of law • Technical position supported by law or ruling
Materiality	• Very significant impact on revenue				• Minimal risk to revenue
International activity	• Significant cross border and or tax haven activity • International aggressive tax planning activities				• No cross border dealings
Attitude	• Little commitment to compliance • Uncooperative or confrontational approach • No use of self regulatory approaches such as private rulings				• Highly cooperative approach Strong commitment to compliance • Use of self regulatory approaches such as rulings, forward compliance arrangements
Perceptions of stakeholders	• Potential for serious damage to tax system integrity • Significant impact on community confidence				• No impact on community confidence

The risk assessment process enables the ATO to make sense of any information gained either before or during the course of any preliminary review of an organisation's tax affairs. Given that the ATO looks to focus on the most relevant material tax issues, this review process helps to identify and verify whether such risks represent a material tax issue that requires further action. The nature and scope of any further action typically depends on the scope and extent of the risks verified during the course of the overall risk assessment process.

Planning and implementing strategies

The Model draws on the notion of movement between a range of compliance activities, shifting from cooperation and self regulation to active enforcement as required. Just what compliance strategy to use, is determined as a result of the ATO's understanding of the business gained through the risk assessment process described above.

The range of compliance products available to the ATO is extensive with different products developed to suit where in the compliance pyramid an organisation is considered to operate. Some examples of the different types of products available are as follows:

Enforcement options	
Full Audit	Comprehensive examination of a group or business. Generally limited to those businesses that pose the greatest risk.
Specific issues audit	An examination of a limited number of issues of a business or business group.

Assisted self-regulation	
Advance Pricing Arrangement	An agreement with the ATO on the future application of the arm's length principle in respect of international dealings that a business has with related parties.
Test Case	Litigation that is undertaken by the ATO where the interpretation of the law can be tested and clarified by the courts for the benefit of business in the wider taxation system.
New legislation/ ruling review	A review to determine the level of understanding and compliance with new legislation and rulings.

Self-regulation	
Public/Private rulings	Technical advice program to clarify and communicate the law. Private rulings relate to circumstances raised by an organisation. Public rulings impact on a wider group of business in the community. Rulings may be given on questions of law, fact and on administrative issues.
Technical Fact sheets	Guidance issued by the ATO as to how a particular provision of the law operates.

Reviewing and improving

It is essential that the impact of compliance strategies are monitored and effectively measured. What the ATO learns will provide a foundation to build better compliance processes and strategies, and adapt the Model to meet changes in business and the wider environment. Effective monitoring will reveal deficiencies in the system that need to be addressed and may provide insights into areas such as where the law is too complex or onerous and requires amendment to improve the overall level of compliance.

8. What can an organisation do to minimise compliance tax risks?

Tax has always been a significant factor in the overall risk profile of a business. It can eat into the revenue, swell the expense base and erode profitability, thereby requiring organisations to keep it under control.[10] However, in the past there has been a tendency for tax to be viewed as a complex area which was left to the tax professionals. Tax was not commonly subject to oversight by boards, although legislation such as the Sarbanes-Oxley Act 2002 has changed this perspective.

In recent years this perception has changed. In an ATO media release in June 2003, the then Taxation Commissioner, Michael Carmody, encouraged board members, senior executives and tax advisers to take another look at their tax responsibilities as part of good corporate governance. The Commissioner commented that "judgments about tax compliance need to be part of the corporate governance processes of every company and board".[11]

In its examination of large business governance processes, the ATO had noted that management reporting to the board was often done only on an exception basis. Unless a major event occurred, in many cases a board was not sufficiently informed about material aspects of the business, including potentially major taxation risks. In fact, many organisations had delegated the responsibility of tax risk management to the in-house tax manager or outsourced compliance obligations to a professional firm.

In January 2004,[12] the Commissioner wrote a letter to corporate boards encouraging them to identify and manage major corporate risks. The letter was aimed at improving corporate governance processes from a tax perspective through boards providing leadership in managing tax compliance risks.

In writing to board chairs, the Commissioner was not suggesting that directors needed to be tax experts, rather he was writing to them in the context of the accepted responsibility of board's to identify and manage major corporate risks.[13]

Essentially, the Commissioner was saying to boards that TRM requires leadership in ensuring that an organisation has given appropriate attention to having the necessary systems and controls in place in order to meet its ongoing tax obligations. It also requires leadership in seeking advice and understanding the tax risk associated with major corporate transactions that by their nature come to the board for attention. Without sound TRM, financial disclosures and shareholder interests may be compromised.

The Commissioner's letter provided a list of questions (contained hereunder), the answers to which will assist boards in appropriately identifying taxation risks, the extent to which they are prepared to accept those risks and the processes for managing any of the accepted risks.

1. What level of confidence do you have in the correctness of your advice?

   Consider whether advice is provided with a high degree of confidence (almost certain) compared to advice provided on the basis that it is reasonably arguable (is about as likely to be correct as not) or some lesser basis. Consider also the questions you asked to obtain this advice.

2. How likely is it that the ATO will take a different view of the application of the law and assess the company accordingly?

   Consider whether the advice prepared addresses appropriate law, relevant tax cases and rulings or other ATO technical products.

3. If the ATO takes a different view and the matter proceeds to litigation, what is the risk of the Federal Court or the High Court deciding the matter in favour of the ATO?

   Consider the merits of the case, matters of evidence and supporting case law.

4. What is the potential downside if the company is unsuccessful in litigation with the ATO?

   Consider the downside if unsuccessful, the cost of litigation, penalties and interest.

5. If there is a dispute with the ATO, what is the likelihood of it being prepared to settle the dispute and, if so, on what terms?

   The Tax Office has published guidelines on settlement. Where the issue is of precedential importance, the ATO may not settle. However if the issue is a question of quantum, the ATO may be prepared to settle.

6. How likely is it that the ATO will identify the tax issues which arise from the proposed course of action? Allied to that, to what extent will embarking on the proposed course of action increase the tax risk profile of the company and increase the possibility of audit scrutiny?

   Given the ATO has fairly sophisticated risk assessment techniques; it is unlikely that a major transaction and/or major tax issues would go undetected.

7. In light of the potential risk, would it be desirable to approach the ATO for guidance in the form of a private binding ruling?

   Creates certainty. Consider how likely it would be to get a positive ruling response. If unlikely to get positive response, is the risk worth taking? If there are time pressures, it may be possible to fast-track the ruling process.

8. Where a position has been taken on a tax issue, would it be desirable, in the interests of appropriately managing any risk, to be upfront with the ATO identifying the issues before or when lodging the tax return and endeavouring to handle constructively any disagreements which may ensue?

   Could minimise any penalties that may otherwise arise.

9. Is the advice based on the actual transaction or on an expectation of how the transaction will be implemented?

   If based on the expected implementation, any material change in the transaction that is ultimately implemented may impact the validity of the original advice.

10. Are you satisfied that the factual basis of your opinion to the board has been properly checked?

    Were the facts independently verified?

The tax function of an organisation can no longer afford to be isolated from the rest of the business organisation. The board of an organisation needs a clear understanding of the work the tax function is doing and its effect on overall risk. It is considered therefore that the board should ensure through its discussions with the tax function of the organisation that they:

- have agreed reporting procedures to the board
- have an appropriate strategic tax risk policy and appropriate tax risk tolerance boundaries. Tax risk management policies should be reviewed regularly to take account of changes in the organisation and external developments
- seek the board's direction, and authority where necessary; and
- have a tax risk framework that effectively manages tax planning and compliance. In this regard, as mentioned earlier in the paper, such a framework should enable the organisation to:
  - identify and assess risks
  - develop appropriate implementation strategies
  - deploy appropriate resources and obtain external advice as required
  - implement robust reporting procedures around tax risk management; and
  - identify controls and policies to manage tax risks.

9. An organisation needs to be able to explain the following:

The ATO considers that the following factors will assist organisation's to determine whether there are any potential taxation problems in the group that are likely to attract their attention, and if so, whether they can be explained by the organisation :

- financial or tax performance that varies substantially from industry averages and pattern
- significant variations in the amounts and patterns of tax payments compared to past performance and relevant economic indicators and industry performance
- unexplained variations between economic performance, productivity and tax performance
- continuous or unexplained losses, low effective tax rates, and cases where all or part of the group consistently pay little or low amounts of tax
- a history of aggressive tax planning by the corporation, group, board members, key executives or advisers
- significant cross border and/or tax haven dealings
- distortions and inconsistencies in market valuations

- complex arrangements that generate GST benefits
- weaknesses in the group's structure, processes and approach to tax compliance; and
- tax outcomes that are inconsistent with the policy intent of the law.

10. Managing an organisation's internal relationship between its tax function and the board

As part of its tax risk management policy, it is critical that the internal tax function of an organisation have agreed reporting procedures to the board. In developing such procedures an organisation should consider the following:

- the nature and form of reports for each meeting
- the organisation's tax risk appetite; and
- the materiality level of what should be reported to the board.

Information that an organisation may look to provide to a board each time it convenes could include whether:

- the organisation has a tax exposure. If so, information should be provided as to what processes or controls have been put in place to minimise such exposure and strategies to reduce future exposures and what penalties have been or will be applied
- the organisation is under audit or has been notified that it will be subject to an audit. If so, information should be provided detailing the scope of the audit, processes that have been or are to be put in place to manage the conduct of the audit, what disclosures are required or have been made including the cost of such disclosures, and any penalties including any interest component that may be applicable
- there is a current dispute with the ATO and the likelihood of settlement of the dispute, whether there is a reasonably arguable position and the potential exposure to primary tax and penalties
- there are any outstanding objections or audit requests, and the progress of any current tax litigation
- the organisation is considering or in the process of making a private binding ruling and/or class ruling request
- there are any outstanding lodgement of tax returns or other outstanding compliance obligations around indirect tax obligations
- there have been any key tax developments
- there are significant transactions the organisation has entered into or is proposing to enter, the level of risk associated, whether appropriate advice has been received or is to be received, what is the implementation strategy and to what extent it will increase the tax risk profile of the organisation
- the organisation has made any losses and if applicable whether there is an explanation for those losses that is likely to satisfy any ATO enquiries; and
- the organisation's financial performance or tax performance varies substantially from past years, and if so, reasons for the variation.

11. Some ways an organisation can look to obtain tax certainty

Provision of written advice

The written advice regime is designed to provide taxpayers with certainty around arrangements or schemes they are seriously contemplating or have entered into. Written advice provided by the Tax Office comes in many forms. Examples include:

- Public rulings
- Class rulings
- Product rulings
- Private Binding rulings
- Administratively binding advice; and
- Written general advice.

Under the regime, a ruling may deal with anything involved in the application of a tax law or provision. This includes issues relating to liability, administration, procedure, collection and ultimate conclusions of fact.

The level of protection varies from product to product. For example, public rulings provide taxpayers who act in accordance with them, protection from additional primary tax, penalties and interest.

In addition, the ATO has recently introduced a priority rulings process that seeks to provide taxpayer certainty around transactions that are prospective, time sensitive, where the tax outcome is a critical element of the transaction and where the transaction has major commercial significance requiring consideration at the board level.

Advance Pricing Arrangement

Advance Pricing Arrangements (APA) can provide significant benefits to a wide range of businesses because they have the capacity to deal with real time business issues, including highly integrated operations and novel situations.

An APA may cover many different types of international dealings with related parties, including transfers of tangible or intangible property, services, cost sharing, global trading and global manufacturing.

As a general rule, an agreement usually covers a period of three to five years and may be reviewed if the trading circumstances of the business materially change.

An APA is a prospective arrangement, negotiated in a cooperative environment. Some of the benefits that may result from the APA process include:

- providing certainty on an appropriate transfer price methodology for the business and therefore enhancing the predictability of tax treatment around international transactions
- ensuring the correct application of the arm's length principle in related party international dealings
- a possible solution to situations where there is no realistic alternative way of both avoiding double taxation and of ensuring that all profits are correctly attributed and taxed
- limiting the prospect of potentially costly and time consuming examination of major transfer pricing issues which would arise in the event of a transfer pricing audit, lessening the possibility of protracted and expensive litigation

- placing the business in a better position to predict costs and expenses, including tax liabilities; and
- reducing the record keeping burden as the business will know in advance which records they are required to keep to substantiate the agreed transfer pricing methodology.[14]

GST Cooperative Compliance Advance Agreements

A GST Advance Agreement is a written agreement that formally acknowledges self-regulation. Businesses are required to satisfy certain requirements before the ATO will agree to enter into a GST Advance Agreement. These requirements are that they have:

- demonstrated a high level of self compliance with the GST law
- performed a rigorous self-examination of processes and system controls
- demonstrated a high level of commitment toward cooperative compliance; and
- agreed to allow Tax Office staff to have full and free access to systems, training and system manuals and relevant personnel.

Forward Compliance Arrangements

The concept of Forward Compliance Arrangements (FCA) is a new and innovative approach to the management of tax risk across all taxes that is currently being piloted. An FCA is seen as providing an alternative to traditional compliance approaches.

It is a voluntary arrangement between a large business and the ATO which sets up an agreed way of working together on a forward basis.

Entry into such an arrangement will enable a corporate to minimise tax risk and plan from a position of greater certainty. However, it is recognised that entry will require a significant investment by a corporate in their tax risk management processes (including their systems) together with a commitment to transparency and continuance disclosure, therefore it may not suit everyone.

A key element of the process is a due diligence verification of the corporate which includes a health of the systems review across all taxes to examine the adequacy of the systems, governance framework and controls in place to effectively manage tax risk.

12. Conclusion

Every organisation needs to manage its tax risk. The benefit of an organisation having a tax risk management framework in place is that:

- tax risk exposure is minimised
- tax risks are able to be detected early and assessed as to their relevance and materiality
- audit risk is reduced and relationships with the ATO can be enhanced
- compliance costs are reduced and it facilitates a more appropriate allocation of resources
- there are fewer surprises
- there is likely to be a much greater alignment of the organisations tax strategy to its business objectives
- compliance with regulations and tax laws is likely to be improved; and
- there is a greater awareness and understanding of what transactions may present tax issues and which risks are acceptable and which are not.

As a final point, whatever tax risk model is implemented, there needs to be an appropriate control framework in place. It is important that any control framework include identifying indicators or warning lights to signal that a risk is arising, so that it can be addressed before it manifests into a real problem.

The views in this document are those of the author and do not represent the views of Deloitte Touche Tohmatsu or any of its related practice entities (Deloitte). This document is provided as general information only and does not consider any one's specific objectives, situation or needs. You should not rely on the information in this document. Neither the author nor Deloitte accept any duty of care or liability to anyone regarding this document or any loss suffered in connection with the use of this document or any of its content.

Australian Stock Exchange (ASX) Principles of Good Corporate Governance

Principle 1:
Establishing the roles of management and the board.

Principle 2:
A balance of skills, experience and independence on the board appropriate to the nature and extent of company operations.

Principle 3:
Integrity among those who can influence a company's strategy and financial performance, together with responsible and ethical decision-making.

Principle 4:
Presenting a company's financial and non-financial position requires processes that safeguard, both internally and externally, the integrity of company reporting.

Principle 5:
Provide a timely and balanced picture of all material matters.

Principle 6:
The rights of company owners, that is shareholders, need to be clearly recognised and upheld.

Principle 7:
Every business decision has an element of uncertainty and carries a risk that can be managed through effective oversight and internal control.

Principle 8:
Formal mechanisms that encourage enhanced board and management effectiveness.

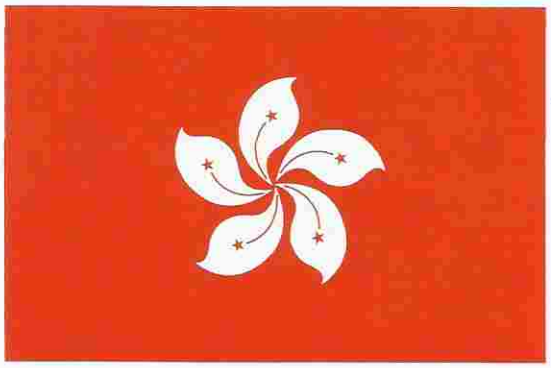
Principle 9:
Rewards are needed to attract the skills required to achieve the performance expected by shareholders.

Principle 10:
Good corporate governance recognises the legitimate interests of all stakeholders.

1. See, for example, Michael D'Ascenzo, "Making choices: Risk management in action" (2004) 19 Australian Tax Forum 525; Andrew Mills, "Tax risk management: You might be an aristocrat but are you fireproof?", paper presented at Tax Institute of Australia New South Wales Annual Intensive Retreat, 5 November, 2004; Frank O'Loughlin, "Tax risk management: Rulings – real protection or a false sense of protection?", paper presented at Tax Institute of Australia 20th National Convention, 17 March, 2005; "Tax risk management: a routemap to compliance" – Deloitte, 2005; "Forward thinking tax risk management: Deloitte Tax LLP's point of view" – Deloitte, 2005; John A Stacey "Managing tax risk" – Deloitte & Touche LLP, 2005.
2. As this paper focuses on tax, these principles are reproduced at Annexure 1 to this paper
3. Survey conducted by Ernst & Young – "Maximising value in the Australian corporate tax function", see E&Y Press Release (7 February 2002) at < > (accessed 29 June 2006).
4. Gilbert + Tobin (2004) "Tax as a corporate governance issue – emerging trends in corporate Australia"
5. Stephen Green, "Managing tax risk in an international tax group", paper presented at 2005 Taxation Institute of Australia Financial Services Taxation Conference.
6. Deloitte, "Overcome hurdles – Tax risk management: a route map to compliance" (2005) available at <http://www.deloitte.com/dtt/cda/doc/content/dtt_ie_IAASA_overcomehurdles_0505.pdf> (accessed 29 June 2006).
7. Deloitte, "Forward thinking – Tax Risk Management – Deloitte Tax LLP's point of view"–(2005), available at <http://www.deloitte.com/dtt/cda/doc/content/us_tax_trm_point-of-view_061605.pdf > (accessed 29 June 2006).
8. Australian Tax Office, "Cooperative compliance – Working with large business in the tax system" (2004), available at <http://www.ato.gov.au/content/downloads/compliance.pdf> (accessed 29 June 2006).
9. BISEPS factors and examples taken from ATO Cooperative Compliance Model
10. KPMG, "Tax risk management in the financial services industry – An international KPMG survey" (2004) available at <http://www.kpmg.com.au/Portals/0/FSTaxRiskManagement.pdf> (accessed 29 June 2006).
11. ATO media release Nat 03/54 (10 June 2003).
12. Letter to chairpersons of listed public companies on the role of boards of directors and good governance in managing tax risks sent on 29 January 2004.
13. ATO Commissioner Carmody's speech to country CFO forum (4 May 2004) available at <http://www.ato.gov.au/corporate/content.asp?doc=/content/sp200402.htm> (accessed 29 June 2006).
14. ATO, "International transfer pricing – Advance Pricing Arrangements" available at <http://www.ato.gov.au/content/downloads/LBI_35286_Advanced_pricing_arrangements.pdf> (accessed 29 June 2006).

Author's Profile

Mr Gary Christie *is a tax partner in the Melbourne office of Deloitte Touche Tohmatsu and the head of National Tax in Australia.*



Hong Kong

Mr Luis Coronado, Mr Philip Wong and Mr Anthony Lo

1. Intoduction

The Hong Kong Special Administrative Region is well known for its relatively simple tax system. For a company carrying on business in Hong Kong, the only tax on income is a 17.5% profits tax levied on profits arising in or derived from Hong Kong from the business carried on in Hong Kong; there is no indirect taxation in Hong Kong. In terms of profits tax compliance, companies operating in Hong Kong are only required to file a simple annual profits tax return, supported by an audited accounts and tax computation showing adjustments from accounting profits to assessable profits based on the Hong Kong Inland Revenue Ordinances (IRO).

With a relatively low profit tax rate and not complicated profits tax compliance requirements, most companies in Hong Kong generally do not see the need to allocate too much effort to tax risk management. Another major reason for the lack of emphasis on internal tax risk management is the lack of local legislation imposing internal tax risk management requirements on companies listed on the Hong Kong Stock Exchange.

While the Hong Kong Inland Revenue Department (IRD) has always been diligently going after companies suspected of under-reporting their income, in the last few years it became apparent that the IRD has also increased scrutiny of tax avoidance and evasion cases focusing on (i) the use of offshore vehicles closely linked to Hong Kong operating companies and (ii) tax planning arrangements without genuine commercial motives. In cases where the IRD can successfully challenge the offshore transaction or a tax planning arrangement as nothing more than a simple siphoning from Hong Kong of profits, which should have

been subject to profits tax, the IRD may invoke the penalty sections in the IRO in addition to a recovery of the underpaid tax. It follows that management of Hong Kong companies should not underestimate the importance of tax risk management as part of corporate governance. Indeed, where the circumstances so warrant, the management should act decisively to deploy adequate resources to manage tax risks, rather than to take a "wait and see" attitude. Following are some of the tax risk management areas that should warrant special attention and resources.

2. Transfer Pricing

The IRO does not contain specific provisions outlining the transfer pricing methodology acceptable to the tax authority. However, there is a provision requiring an arm length's return for a Hong Kong company when dealing with a closely connected non-resident person, which may ultimately affect the liability of the non-resident person. Under such provision, the IRD is empowered to tax the non-resident person who conducts business with a resident person using a transfer pricing arrangement where such arrangement brings no or less than the ordinary profits to the resident person.

Although transfer pricing audits are not the current main priority for the IRD, the IRD would nevertheless attack transfer pricing arrangements between group companies during field audit, especially if a tax haven group company involved in the transaction were shown to earn an "unreasonably high" profit. Moreover, it is seen that transfer pricing enforcement is being taken more and more seriously by other tax authorities in Asia and other countries. Tax authorities in many different countries are gradually introducing new and detailed local transfer pricing rules and compliance requirements. It may not be long before the IRD increases their focus in that area and starts auditing transfer pricing arrangements with Hong Kong based groups involving transactions between resident and non-resident affiliates.

Furthermore, transfer pricing could be seen as a key element of tax risk management for Hong Kong based multinationals with outbound investments in countries with onerous transfer pricing rules already in force. This may stem from the fact that Hong Kong based multinationals are more accustomed to the simple tax system in Hong Kong and may be less familiar with the need to undertake transfer pricing studies to support their pricing methodologies for inter-company transactions.

3. Offshore Income Planning

Unlike some other jurisdictions that impose income tax on their resident companies on a worldwide basis, the IRO adopts a territorial concept to profits tax. Only profits that arise in or are derived from Hong Kong from a business carried on in Hong Kong are liable to profits tax.

With this concept in mind, an increasing number of Hong Kong based groups attempt to structure their businesses in such a way that part of the group income is treated as offshore income and therefore exempt from Hong Kong profits tax. These structures mainly involve setting up group companies in tax haven locations (e.g. British Virgin Islands, Mauritius, etc.) with the objective of taking a part of the group operations offshore, i.e. profits related to those operations are captured offshore and should not be subject to tax in Hong Kong.

The IRD has always been skeptical about the use of tax haven companies to derive tax savings without sufficient and adequate business and/or commercial substance and motives. In recent years, the IRD has increased scrutiny of taxpayers having transactions with related tax haven companies. The IRD has included a specific section in the Hong Kong Profits Tax Return requesting taxpayers to declare whether they have any transactions with a closely connected non-resident person and if so, the IRD may issue future enquires. Recent court cases have also indicated that the IRD has not only become very stringent when examining and acceding to offshore claims, but also routinely challenges offshore claim positions. If the IRD is successful in challenging a tax planning scheme and establishing that the scheme is tax avoidance in nature, the IRD may invoke penalty sections in the IRO (which include a maximum penalty at 300% of tax underpaid) in addition to recovering any underpaid tax. Hence, Hong Kong based groups that utilize tax haven vehicles and claim offshore income should adequately manage the tax risk e.g. by maintaining sufficient documentation that can justify and support their offshore claim position.

In Hong Kong, the IRD will allow for apportionment of profits (i.e. 50% offshore and 50% onshore) derived from sales of goods manufactured in the People's Republic of China (PRC) under certain type of processing or assembly arrangements with local PRC entities. However some taxpayers are not exactly clear on what type of processing arrangement is entitled to this apportionment treatment and this may result in significant tax risk if an improper 50:50 offshore claim is made.

There are two common types of processing and assembly arrangement in the PRC generally described as the contract processing arrangement and the import processing arrangement. In contract processing arrangement, a Hong Kong company will provide equipment, technical know-how, design, and supervision to a PRC entity which will carry out the processing

manufacturing in the PRC. The PRC entity in a contract processing arrangement is responsible for providing factory premises and local labor to render processing to the raw materials consigned from the Hong Kong companies. The finished goods are then exported to Hong Kong company. In an import processing arrangement, a PRC entity will purchase raw materials from a Hong Kong company for manufacturing the goods on its own, and sell the finished products to the Hong Kong company that has supplied the raw materials.

The IRD in recognition of the involvement of the Hong Kong company in a contract processing arrangement in the PRC, will accept that profits on the sale of goods derived by the Hong Kong company can be apportioned on a 50:50 basis such that only 50% of the profits will be subject to tax in Hong Kong. Import processing arrangement however is regarded by the IRD as a simple sale of goods by the PRC entity to Hong Kong company, with the PRC entity undertaking the manufacturing of the goods in the PRC on its own basis. Hence IRD will regard the Hong Kong company under an import processing arrangement as carrying on trading business so that the profits derived from sales of goods will not be entitled to the 50:50 apportionment.

While contract processing arrangement is very common in Southern China in 1990's, in the recent years Hong Kong based groups have gradually established their own legal entities in the PRC and converted their contract processing arrangements into import processing arrangements. Despite the conversion, the relevant Hong Kong companies may continue to make the 50:50 offshore claims by arguing that the contract processing and the import processing arrangements are only different in form and not in substance. On the other hand, the IRD has increased scrutiny of such offshore claim and disallow claims which are based on import processing arrangement. Hence, Hong Kong based groups should review their processing arrangement to ensure any 50:50 offshore claim is supported by the correct form of subcontract processing. If IRD is successful in challenging the validity of the offshore claim, the IRD may invoke penalties as earlier described.

4. Permanent Establishment Exposures in the PRC or Other Countries

Many Hong Kong based groups have extended their operations beyond Hong Kong to overseas territories and most commonly to the Mainland of China. Most foreign tax systems use the concept of permanent establishment (PE), defined in the local tax laws or double taxation agreements (DTAs). In general, a non-resident company can be considered having a taxable base in a foreign country when the non-resident company's activities undertaken in the foreign country reach a certain level. When such taxable base in a foreign country is established, it is considered to be a PE, which gives the country the right to tax profits of that PE.

In terms of PE definition in DTAs, Hong Kong recently signed a DTA with the Mainland of China on August 21, 2006 which will become effective with respect to Hong Kong taxes from the year of assessment beginning on or after April 1, 2007 and with respect to Mainland taxes for the taxable year beginning on or after January 1, 2007. Besides, Hong Kong has entered DTAs with Belgium and Thailand. All of the above Arrangement and DTAs contain definitions of PE. Apart from the above three countries, other non-DTA countries would apply their own definitions of PE under their respective domestic tax laws to Hong Kong companies having activities in such foreign jurisdictions.

It is not uncommon that a Hong Kong company lodges an offshore claim to the IRD on the basis that all of its activities are undertaken in Mainland China. According to the newly signed DTA between Mainland China and Hong Kong, a lodgment of an offshore notice may provoke mutual exchange of information between the IRD and Mainland China's tax authority, i.e. a Hong Kong company would essentially be volunteering to provide information on the existence of a PE in Mainland China to the IRD. The failure or inability of a Hong Kong based group to manage its PE exposure can trigger tax audits or tax disputes in Mainland China and other foreign jurisdictions. Without an in-house team that focuses on tax risk management, this type of tax exposures can hardly be identified and managed by the ordinary accounting or finance functions.

5. Summary

Despite the simple tax system in Hong Kong and in the absence of local laws imposing compulsory internal tax risk management, it is still important for Hong Kong companies to self-impose certain effective tax risk management strategies and system to identify and manage tax risk exposure, especially in the specific areas described earlier in this article.

It should also be noted that while companies may engage external tax advisors to assist in designing tax risk management process and provide advice on the implementation process, the ultimate successful running of an effective risk management process would still rely on the company's willingness to allocate resources and prioritize this matter in the overall corporate governance model. Companies who take a more serious view on tax risk management tend to have in-house core tax or finance team, including dedicated tax personnel, to

monitor, identify, and assess potential tax exposures and provide proper preventative measures to manage and/or resolve the situation. On the other hand, companies that do not see tax risk management as an important matter may question the need for allocating resources on tax risk management.However, when there is a major tax audit or a significant unexpected tax assessment, the past oversight in tax risk management will be unveiled.

Author's Profile

Mr Luis Coronado *is a tax partner in Deloitte's Shanghai office and the leader of the transfer pricing team in China.*
Mr Philip Wong *is a tax partner and* ***Mr Anthony Lo*** *is a senior manager in Deloitte's Hong Kong office.*

China

Mr Luis Coronado, Ms Vicky Wang and Mr Hong Ye

1. Introduction

Tax risk management is not a new concept in the People's Republic of China (PRC). The business communities and academia have published many articles on tax risk management but formal regulation of this subject has been lagging behind. It is not until very recently that the Chinese government published regulations dealing with internal controls of Chinese listed companies, which also indirectly cover tax risk internal controls. For many foreign-invested enterprises owned by a multinational corporation and not listed on the Chinese stock exchange, there are still no mandatory official risk management procedures to follow under the Chinese regulations, although many of those enterprises are following internal tax risk management guidelines set forth by the parent company in accordance with a foreign legislative requirement, such as the United States Sarbanes-Oxley Section 404 requirements.

Unmonitored tax risks may result in government sanctions (which may be of monetary or even criminal nature) and reputation losses. Tax risks may arise as a result of not appropriately applying tax laws to the company's operations or transactions or not complying with the relevant reporting requirements. If not properly disclosed in the financial statements, material tax risks may also distort the financial information of a company, misleading investors. A company's management thus has fiduciary obligations to properly monitor tax risks to minimize a potential damage to the shareholder value.

2. Contributory Risk Factors in China

Tax risks often arise from both intentional and unintentional actions. Similar to many countries, the management integrity, mentality on risk tolerance, internal control systems, and the regulatory environment, may all contribute to the risk factors. In China, since the tax system is still in a developing stage, the regulatory environment often becomes a relatively higher-weighing contributory risk factor, in addition to the commonly seen risk factors in countries with more developed tax systems. Specifically, the following elements are commonly seen in the Chinese tax system:

Incomplete tax law

As China modernized its tax code only in the early 1990's, and taking into account the fact that China has so far maintained two tax systems, i.e. one for domestically owned enterprises and one for foreign-invested enterprises, the tax law is often incomplete and unable to cover all types of transactions and taxpayers. In addition, case law is essentially nonexistent in China, thus resulting in even more limited citable sources in this area. Due to the incompleteness of the tax law and in the absence of specific regulations, many taxpayers tend to take advantage of various loopholes.

This approach increases tax risk, as some of the positions may subsequently be considered by the tax authorities as being in violation of the spirit of the fundamental law principle.

Non-transparency of the tax law

It is not uncommon for the local tax authorities to stipulate local regulations or administrative measures, which are

intended to supplement the national law. However, some of these regulations or measures are not well communicated to the general public but rather remain as internal enforcement guidelines. Such non-transparency of the tax law further increases non-compliance risks for the taxpayers.

Inconsistent interpretations of the law

Given the developing stage of the Chinese tax legislation, many terms in the tax law are not yet fully defined in the published tax circulars. Interpretation of the published law by local tax authorities often becomes the determining factor in concluding a particular tax position. Some interpretations may be to the advantage of a taxpayer, while some to the disadvantage. If a taxpayer has operations in multiple locations in China, the interpretations from different localities may be inconsistent, thus again causing compliance difficulties. In addition, some interpretations by the local tax authorities may not be viewed as being in line with the national policy upon a subsequent review by the national tax authority, taxpayers may therefore be exposed to the potential of being subsequently challenged by the national tax authority with adverse consequences if a locally approved practice is revoked and retroactive action is taken.

Inconsistent enforcement of the law

There are occasions where the tax law is published but not actively enforced in practice due to macroeconomic control needs. For example, the land value appreciation tax was published in late 1993 with the intention to curb land speculation at the time. However, in practice, this particular tax was not collected for a long time, due to the subsequent real estate market trends and economic control needs. Situations like this pose a financial statement disclosure challenge and require companies to assess the risk in view of the overall regulatory environment and likelihood of the risk.

Lack of a regular ruling system

The private ruling system is not well established in China (except in the case of transfer pricing where the Advanced Pricing Arrangement (APA) regulations have been in place since September 2004). For most of the transactions, taxpayers may only find out the exact tax treatment after a transaction has taken place, which increases the risk and potential cost of a transaction.

That said, the management integrity and risk tolerance levels continue to be the most important factors contributing to tax risks, which often determine the level of the effectiveness of an internal control system and related measures.

Based on our experience, tax risks for a Chinese taxpayer often arise from the following areas:

- Transfer pricing, both domestic and cross border transactions;
- Indirect tax and customs duty, especially related to complicated processing models;
- Withholding tax, especially on service fees attributable to both onshore and offshore services;
- Permanent establishment of a foreign principal;
- Corporate income tax incentive entitlement; and
- Individual income tax reporting and withholding of expatriate employees.

3. Tax Risk Management

For many companies in China, tax risk management means:

- ensuring that tax accounting (i.e. financial statement presentation) is properly done;
- ensuring that tax personnel are knowledgeable about Chinese tax laws and practices;
- maintaining proper documentation and invoicing;
- knowing how to respond to a tax audit; and
- reducing the tax burden effectively and legitimately so that the tax position taken can sustain any future challenges.

Tax risk management is embedded in the company's culture and is often driven by the top management's attitude toward this subject. A more risk-avert management team (often of a public company) would tend to impose stricter internal control to ensure regular compliance and approval procedures for aggressive tax positions. In China, as perhaps in any other country, an ideal "perfect compliance" with the tax law may prove to be extremely costly. This is especially true when doing business in China, considering its currently imperfect tax system. Therefore, understanding and controlling tax risks at acceptable levels is a more realistic approach than trying to completely eliminate tax risks.

Facing the fast-changing Chinese tax regulatory environment, companies are advised to consider consulting external tax professionals for assistance with better understanding of the tax risks involved in a complicated situation or transaction. This will also allow the company to make an informed decision dealing with the tax risks. Companies should also consider using internal control specialists to help implement and monitor effective internal control systems if the existing internal resources are not sufficient to meet the needs. This is particularly the case in view of recently published regulations, as discussed below.

4. Recent Developement on Internal Control

China's relatively short history of public listing of companies began in the early 1990's. Although the corporate law has adopted the basic principles and concepts of Western countries, it still lacks detail in the areas of explanation and implementation. Enron's demise and the enacting of the Sarbanes-Oxley Act in the United States generated much debate on corporate governance and management's

responsibility in China. But it was not until the late 2005, that China released the rule that called for management's responsibility for internal controls for publicly listed companies in China. In October 2005, the State Council issued an opinion prepared by the China Securities Regulatory Commission (CSRC) aimed at improving the quality of the corporate governance in public companies (the Opinion). Guofa (2005) 34. In the Opinion, the CSRC called for establishment of an internal control system by public companies. The Opinion requires that public companies periodically engage external auditors to conduct audits on its internal control systems and conduct self-reviews and assessment of the effectiveness of its internal control systems via internal reviews. The relevant information is then required to be disclosed to the public.

Following the issue of the Opinion, the Shanghai Securities Exchange issued Guidelines on Internal Control by the Companies Listed on the Shanghai Securities Exchange (the Guidelines). The Guidelines were issued on 5 June 2006, and became effective on 1 July 2006. They require that all companies listed on the Exchange prepare annual internal control self-assessment reports and have them audited by Chinese Certified Public Accounting (CPA) firms. The Guidelines further stipulate that the internal controls should cover all aspects of the business operations, including, but not limited to, areas such as revenue recognition and transfer pricing policies and documentation of related party transactions, which are closely related to tax risk management.

It appears the overall regulatory environment in China has been increasingly calling for a tighter control system for risk management purposes, similar to those in many western countries. Now, as public companies are called upon to set up internal control systems, tax risk management is poised to become a hot topic and an increasing focus in China.

Author's Profile

Mr Luis Coronado *is a tax partner in Deloitte's Shanghai office and the leader of the transfer pricing team in China/HK.*
Ms Vicky Wang *is a tax partner and* ***Mr Hong Ye*** *is manager in Deloitte's Shanghai office.*

Acknowledgement

We thank the International Bureau of Fiscal Documentation and the respective authors for their consent to reprint the above series of articles on Tax Risk Management and acknowledge that they were originally published in the "Asia-Pacific Tax Bulletin" Volume 12, No.5 2006.

UPDATE:

China's SAT Announces Signing of First Bilateral APA with U.S.

Mr Luis Coronado, National Transfer Pricing Leader, Deloitte China/HK

On 11 January China's State Administration of Taxation (SAT) announced the conclusion of the first bilateral Advanced Pricing Agreement (APA) entered into by China and the United States. This is a milestone announcement and reflects China's footprint in the field of mutual agreement procedures in the context of APAs. It is the second bilateral agreement concluded by China following the APA with Japan 2005.

SAT Commissioner Mr. Xuren Xie signed the bilateral APA during his visit to Washington, D.C., after two rounds of negotiations that started in June 2006 and concluded on 22 December.

Wal-Mart is the taxpayer that obtained the APA, according to the official announcement by the SAT.

This case will certainly provide taxpayers assurance on making use of treaty provisions in negotiating for prospective, as well as renewing, bilateral APAs, thus minimizing any potential double taxation that can occur from carrying out business globally.

The SAT issued China's formal APA rules in September 2004 and has recently indicated that during its case selection process it will focus on technical aspects of transfer pricing, as well as cutting-edge topics such as intangibles and cost sharing.

An APA is an agreement concluded between the relevant tax authority and a taxpayer that allows transfer pricing issues related to transactions between associated enterprises, such as pricing policies and calculation methods and other relevant important assumptions, to be determined for a given period in the future, generally four years. Under the SAT APA rules, the agreed APA terms can be rolled back to the year in which the APA application was submitted although rollback to earlier years is negotiable and not guaranteed.


Malaysian Institute Of Taxation
The premier body for tax professionals
TAX
RISK MANAGEMENT IN MALAYSIA
A TAX PAYERS GUIDE TO MINIMISING RISK
Catch the Early Bird fee before
13 April 2007
8
CPD HOURS
Tuesday, 3 May 2007
Best Western Premier
Pacific Kuala Lumpur
(formerly known as Pan Pacific)
For enquiries, please contact
Cik Nur/Ms Latha at tel: 03 2162 8989 ext 106/108 fax: 03 2162 8990 email:cpd@mit.org.my

The Arm's Length Principle in Singaporean Transfer Pricing

Associate Professor Dr Lee Fook Hong

Transfer pricing refers to the determination of prices at which goods and services are transacted between related parties particularly with regard to cross-border transactions. For transactions between independent unrelated parties, market force will decide the commercial pricing of the goods and services transacted. However if transactions involve related parties, the lack of independence in commercial and financial relations can lead to the setting of prices that may be different from independent commercial prices. This may result in distortion of profits and the tax liabilities of each of the related entities.

With the increasing move towards globalization and international trading, more organizations especially multinational corporations (MNCs) are now engaged in cross-border transactions. Goods from the production division of one company may be sold to the marketing division of another related company overseas within the same group with the choice of transfer pricing affecting the division of the total profit among the various companies within the same group. This has led to the imposition of transfer pricing regulations as governments seek to stem the flow of taxation revenue overseas, making the issue one of great importance for MNCs.

Where the related companies are located in different tax jurisdictions with different tax rates, the potential distortion in profits and tax liabilities of each company may give rise to a greater concern as there are incentives to plan more profits for related companies operating in jurisdictions of low tax rate while little profits or no profits are allocated to companies operating in countries with high tax rates. So the overall tax liability of the whole group of companies is reduced to a minimum.

Singapore does not have formal transfer pricing rules in its income tax legislation. The arm's length principle is deemed to apply as a matter of fundamental tax treatment. Singapore adopts and adheres to the OECD principles. For effective tax planning in relation to transfer pricing transactions, taxpayers should follow the OECD Transfer Pricing Guidelines closely in evaluating their compliance with the arm's length principle.

Although Singapore tax legislation does not contain specific provisions stipulating the use of the arm's length principle for related party transactions, various sections of the Singapore Income Tax Act (SITA) imply or refer to the concepts or the use of the arm's length principle. In addition, the arm's length principle is also found in all of the Singapore's comprehensive Double Taxation Agreements (DTAs). Hence, the adoption by the Inland Revenue Authority of Singapore (IRAS) of the arm's length principle for related party transactions is enshrined in the SITA and Singapore's double tax treaties.

The arm's length principle is the internationally endorsed standard for transfer pricing transactions between related parties. The arm's length price is the price at which two unrelated parties agree to a transaction. However this is most often an issue in the case of companies with cross border operations where international subsidiaries trade with one another. When related parties adopt a transfer price which adheres to the arm's length principle, they would reflect comparability in the pricing that independent commercial entities in similar situations would transact. Therefore theoretically there will be no distortion of profits and tax liabilities.

The Transfer Pricing Guidelines released by Singapore's tax authority (IRAS) will help taxpayers in applying the arm's length principle and the preparation and maintenance of documentation to demonstrate compliance with the arm's length principle.

IRAS endorses the use of the arm's length principle for several reasons. Firstly, Singapore believes that the market forces of supply and demand is an important factor for

consideration in allocating resources and rewarding good efforts. IRAS agrees with what is cited in the OECD Transfer Pricing Guidelines i.e. that the application of the arm's length principle treats related and independent entity transactions equally for tax purposes and hence avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive position of either entity. Secondly, the arm's length principle is adopted by most tax jurisdictions. By so adopting and complying with this internationally accepted principle, taxpayers and tax authorities will have a common basis to deal with related party transactions. This would reduce the incidence of tax adjustments and avoid transfer pricing disputes and double taxation.

The application of the arm's length principle is however not straight forward or without difficulties. For instance, certain business structures are so complicated that no similar arrangement can be identified between independent parties. This will render the comparison difficult for applying the arm's length principle. Another difficulty is the obtaining of relevant data and information which may not be available or which may be confidential in nature and cannot be disclosed without revealing business secrets. Because of such difficulties in mind, IRAS has provided guidance on the application of the arm's length principle.

While there is no legislation specifically dedicated to transfer pricing in Singapore, two sections in the SITA are relevant to transfer pricing and these can be used by IRAS to adjust transfer prices. Firstly, Section 33 of SITA allows IRAS to disregard or vary an arrangement if its purpose, whether directly or indirectly, is to alter the incidence of tax payable; or reduce or avoid any tax liability imposed or would have been imposed. However Section 33 will not apply if the arrangement was carried out for bona fide commercial reasons and did not have, as one of its main purposes, the avoidance or reduction of tax.

In addition to the Section 33, Section 53(2A) of SITA allows IRAS to assess a non-resident person and charge any tax due to a resident person if the transactions between a resident person and a non-resident person, are arranged so that the business done by the resident person, owing to the close connection between the two and to the substantial control exercised by the non-resident person over the resident person, the course of business is so arranged that the resident person derives no profits or less than the ordinary or normal profits .

IRAS recommends that taxpayers adopt the following 3-step approach to apply the arm's length principle in their related party's transactions. The recommended steps are, however, not mandatory or prescriptive.

I) Conduct a comparability analysis

The arm's length principle is based on a comparison of prices and margins obtained by related parties with those obtained by unrelated parties engaged in similartransactions. For such price comparisons to be meaningful, the relevant characteristics of the situations compared to each other should be substantially similar.

There are factors affecting comparability. A comparability analysis should examine the comparability of the transactions with regard to the characteristics of goods or services. The specific characteristics of goods and services may affect the pricing significantly. For instance, a product with better quality would fetch higher selling price. Therefore, characteristics of goods and services must be assessed carefully to identify their difference. Similarities in actual characteristics of the goods and services are most critical when one needs to compare prices of related party transactions against independent ones.

Other than the characteristics of goods and services, the functions performed and risk borne and assets employed by the businesses are also important considerations that may affect a comparability analysis. Therefore, a comparability analysis must include a comparison of the economically significant functions performed, risks assessed and assets employed by the related party with those performed by the independent party. The functions that should be included in the comparison include design, development, research, manufacturing, distribution marketing and financing. The analysis should also take into account of assets used such as factories/plants, machineries and other valuable intangibles. An appraisal of the risk(s) undertaken is also important in determining arm's length prices. The possible risks that should be considered in the functional analysis should include market risks, risks in cost of production, foreign exchange and interest rates.

Prices may vary across different markets even for transactions involving the same goods and services. In order to make meaningful comparisons of prices and margins between entities, the market and economic conditions in which the entities operate or where the transactions are undertaken should be comparable. Government policies and regulations may have anan impact on prices and margins. Business strategies should also be examined in determining comparability for transfer pricing purposes. An entity may embark on a business strategy of temporarily charging a lower price for its products compared to similar products in the market to expand its existing foothold or penetrates into new segments of the market.

II) Choosing the appropriate Transfer Pricing method and tested party

Over the years there have been a number of methods developed in the international arena for evaluating transfer prices/margins against a bench mark based on the prices/margins adopted in similar but independent transactions. The OECD Transfer Pricing Guidelines recommend the following five methods:

1) The Comparable Uncontrolled Price (CUP) method

The CUP method compares the price at which a controlled transaction is conducted to the prices at which a comparable uncontrolled transaction is conducted. This makes it easier to conceptually determine the arm's length price by using the sale price between the two unrelated corporations. However, the fact that virtually any minor change in the circumstances of trade may have a significant effect on the price, makes it exceedingly difficult to find transactions that are sufficiently comparable.

By comparing the price of the transactions, the CUP method employs the most direct assessment of whether the arm's length principle is complied with. In practice, CUP method is usually most suitable for evaluatingmost suitable for evaluating transactions involving products with similar characteristics and undertaken in similar market conditions. Notwithstanding that, the CUP method requires a high level of comparability to produce reliable results.

2) Resale Price (RP) method

The RP method is found by working backward from transactions taking place at the next stage in the supply chain. It is determined by subtracting an appropriate gross markup from the sale price to an unrelated party with the appropriate gross margin being determined by examining the conditions under which the goods and services are sold. This method is applied where a product purchased from a related party is resold to an independent party. The resale price to the independent party is reduced by a comparable gross margin to arrive at the arm's length price of the products transferred between the related parties. Under arm's length conditions, the resale price margin should allow the reseller to recover the cost of sales as well as a reasonable profit margin based on the function performed.

3) Cost Plus (CP) method

The CP method is generally used for the trade of finished goods. It is determined by adding an appropriate markup to the costs incurred by the selling party in manufacturing/purchasing the goods or services provided, with an appropriate comparable markup being used on the profits of other companies. This method is useful where semi-furnished goods are sold between related parties or where the related party transactions involve the provision of services.

4) Profit Split (PS) method

The PS method is applied when the businesses involved in the examined transactions are too integrated to allow for separate evaluation and so the ultimate profit derived from the transactions is split based on the level of contributions of each of the participants in the project.

The PS method basically involves two steps. First it identifies the profit to be split. This may be the total profit arising from the project. The second step involves splitting the profit by reference to the relative contributions of the parties in the transactions. These contributions are assessed based on the functions performed, assets employed and risks assumed by each party.

5) Transactional Net Margin method (TNMM)

The TNMM is a method that requires a thorough examination of the company in question in order to determine the net profit margin relative to an appropriate base of costs to be realized through the examined transactions. TNMM is essentially a unified version of RP and CP method. This means that this method requires a level of comparability similar to that required for the application of the two traditional transaction methods. The primary difference between the TNMM and RP/CP methods is that TNMM focuses on net margin instead of gross margin.

III) Determining the Arm's Length Results

After the appropriate transfer pricing method has been chosen, the method is applied on the data of independent party transactions to arrive at the arm's length result. Knowing that it is generally difficult to arrive at a specific price or margin that is the arm's length price or margin, IRAS is prepared to accept transfer pricing analysis using a range of prices or margins to determine an arm's length price so long as the comparables are reliable. With the arm's length results determined, taxpayers would be able to adopt the result for their transfer pricing practices.

Singapore taxpayers however should also regularly monitor their business activities for structural changes in the location of group functions, assets employed and risks assumed to ensure that their transfer pricing practices are always aligned with the changes in their businesses.

Transfer pricing documentation

Singapore Transfer Price Guidelines are consistent with the approaches recommended in the OECD Transfer Price Guidelines although IRAS does not impose a formal requirement to prepare transfer price documentation. However, IRAS expects taxpayers to exert reasonable effort to undertake a sound transfer pricing analysis to ascertain the arm's length pricing as well as to demonstrate that such analysis has been performed. The keeping of records to demonstrate that such efforts have been undertaken to conform to the arm's length principle is known as "documentation". Taxpayers who violate the record keeping requirements under Sections 65, 65A and 65B of the SITA would not in anyway be precluded from enforcing these provisions.

The main objective of preparing and maintaining documentation is to place the taxpayers in a position where it can readily demonstrate that it has exerted reasonable efforts to ensure that its transfer prices are consistent with the arm's length principle. Adequate documentation will facilitate reviews by tax authorities on a taxpayers' transfer pricing analysis and help resolve any arguments that may arise.

In their attempt to cut costs, taxpayers may choose not to keep their transfer pricing documentation up to date. IRAS is conscious that keeping adequate documentation may result in compliance and administrative costs for taxpayers. IRAS therefore adopts the following principles with regard to documentation:-

- Taxpayers are only required to prepare or obtain documents necessary to allow a reasonable assessment of whether they have complied with the arm's length principle. Taxpayers should evaluate the complexity of the related party transactions as well as the costs of compliance arising from documentation.

- Unlike other tax jurisdictions, IRAS does not impose a penalty specifically for lack or insufficiency of documentation. In the absence of provisions for penalties, taxpayers must bear in mind the relevant provisions of the SITA in relation to record keeping and try to keep proper and adequate documentation. With the proper and adequate documentation, taxpayers will have proof to show that the arm's length principle has been complied with. This will put the taxpayers in a better position to defend their transfer pricing analysis and avoid unnecessary disputes with and adjustments by the tax authorities.

The documentation required depends on the specific facts and circumstances of each case. The taxpayers who have the most intimate knowledge of their businesses are therefore in the best position to explain their approaches to transfer pricing. Although it may not be possible to specify a comprehensive list of documentation requirements for all the taxpayers, generally taxpayers involved in related party transactions should at least prepare "cost and risk" transfer pricing documentation with all relevant information to demonstrate that they have assessed and considered their transfer pricing risk profile.

Details on the information that should be documented include the following:-

- Detailed information of the group showing the organization structure, location and ownership linkage, nature of business activities and functions performed by each party in the group.

- Detailed information on each related party in Singapore, the entity's business models, its functions, risks and assets employed.

- Details on transactions between related parties and their contractual terms of transactions, segmental financial accounts and information in regard to the transactions

- Transfer pricing analysis comprising choice of the tested party and reasons substantially the choice as well as details on comparables, and comparability analysis. The analysis should also include the transfer pricing method chosen and reasons to support the method adopted. The determination of the arm's length price/margin with detailed computation and explanation must also be included.

Although transfer pricing documentation may include sufficient information, nevertheless in certain circumstances of Singapore's transfer pricing perspective, taxpayers should always bear in mind the consideration of whether such transfer pricing documentation is sufficient from the perspective of its foreign associates as different countries have different transfer pricing requirements.

Availability of Mutual Agreement Procedures (MAPs) and Advance Pricing Assignment (APAs)

Singapore currently has a network of more than 50 comprehensive double taxation agreements (DTAs) in force. All the DTAs provide for the Mutual Agreement Procedures to resolve instances of double taxation. Where a tax authority makes adjustments to the transfer prices of the transaction between the related parties, double taxation will arise. Taxpayers in such cases may apply to the competent authorities to invoke MAP in order to eliminate double taxation. All related parties involved should notify the relevant competent authorities in their respective jurisdictions of their intention to invoke the MAP within the time limit specified in the relevant DTA. Failure to notify the competent authorities within the applicable time limit may result in the tax authorities' rejection of MAP request and the double taxation suffered may not be relieved.

An APA determines in advance an appropriate set of criteria to ascertain the transfer prices of specified party transactions over a specified period of time. It is an

agreement between the taxpayer and the competent tax authority that a future transaction will be conducted at the agreed-upon price which is recognized as the arm's length price.

There are two types of APAs namely unilateral and multilateral APAs. A unilateral APA is an agreement between a taxpayer and IRAS while a multilateral APA involves agreement between Singapore and one or more of its tax treaty partners. A Unilateral APA is simpler to implement but may not be recognized by a third foreign tax authority and taxpayer may run the risk of being assessed should the foreign tax authority does not agree with the method of computing the arm's length price. A Multilateral APA also provides such coverage although their implementation requires a more lengthy application process including consultation between and the agreement of all competent tax authorities involved.

There is no mandatory requirement for taxpayers to seek an APA. However, in recognition of commercial needs, IRAS is making APA facilities available to taxpayers who are involved in cross-border related party transactions.

As outlined in the Transfer Pricing Guidelines, the taxpayers' cooperation with IRAS is said to be critical to the success of the APA and MAP process. Full co-operation would include accurate responses or clarification to the queries raised by the competent authorities and furnishing of good quality analysis of the issues.

APA is regarded as binding on the tax authority and on the taxpayer. When implemented in accordance with the stated conditions, tax authorities would suspend audits and would not impose penalties with respect to the transactions involved. Hence, taxpayers should enter into APAs in good faith with the aim of obtaining certainty in complying with arm's length principle.

Concluding remarks

The release of the Transfer Pricing Guidelines is timely. This shows that IRAS is now focusing more attention on issues of the transfer pricing in Singapore. The Transfer Pricing Guidelines will go a long way to clarify IRAS expectation of Singapore taxpayers in relation to their cross-border related party transactions. The guidelines give guidance to taxpayers on to how to comply with the arm's length principle. It also gives recommended preparation and maintenance of documentation to demonstrate compliance with arm's length principle. Besides, the guidelines also set out procedures for applying for the MAP and APA facilities in order to avoid double taxation. This will be very useful as there have been increasing cross border transactions in the Asia Pacific region, and more and more multinational companies are searching for more efficient way to compete in the global trading environment.

Hopefully with the release of Transfer Pricing Guidelines, taxpayers may now have better understanding regarding the transfer pricing requirements and hence take steps to reduce the risk of double taxation.

Author's Profile

Associate Professor Dr Lee Fook Hong *PhD FCIS FAIA MCIArb*

Formerly an Adjunct Professor at Nanyang University, Singapore. Presently a Consultant of Lee Fook Hong & Co. and an Adjunct Professor at SIM University (UNI-SIM).

entertainment tax

- Life is pleasant. Death is peaceful. It's the transition that's troublesome.
- Help a man when he is in trouble and he will remember you when he is in trouble again.
- Complex problems have simple, easy to understand wrong answers.
- Whoever said money can't buy happiness, didn't know where to shop.
- Alcohol doesn't solve any problems, but then again, neither does milk.
- Most people are only alive because it is illegal to shoot them.

An Introduction to the Transfer Pricing Policy in Malaysia

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

1.0 Introduction

In July 2003, the Inland Revenue Board of Malaysia (IRB) issued the Transfer Pricing Guidelines (the Guidelines), which aimed at providing multinational enterprises (MNEs) with all the necessary information pertaining to the transfer pricing policy in this country. By doing so, Malaysia has joined other developed countries and many newly industrialised nations in having a policy that basically explains the essence of transfer pricing concept and practice in examining the price charged in a transaction between related parties (Easson, 2003). The Guidelines also elucidate on the application of the arm's length principle and the recommended preparation and documentation in line with the arm's length principle (IRB Malaysia, 2003).

The term transfer pricing refers to the determination of prices at which goods and services are transacted between related parties, especially between related companies in different tax jurisdictions (Ault, 2004). The Guidelines make it very clear that the transfer pricing between entities in a group of MNEs should not differ from the prevailing market price. Generally, when independent enterprises deal with one and another, their commercial conditions and financial relations are determined by market forces. However, when associated enterprises deal with each other, they may not be directly affected by external market forces. This results in the distortion of tax liabilities of the associated enterprises and tax revenues of the host nations.

Like other competent tax authorities, the IRB hopes the Guidelines would ensure the transfer pricing methodologies used by the MNEs are reasonable. The IRB also aims to ensure the Guidelines apply not only to transactions between associated enterprises, but also to transactions between a permanent establishment and its head office or other related IRB branches.

2.0 The Arm's Length Principle

The arm's length principle is the internationally accepted and adopted principle that determines the transfer pricing standard between related parties (Tiley, 2006). Following the Organisation for Economic Co-operation and Development's (OECD) recommendation, the Guidelines expressly acknowledge the arm's length principle as the governing standard for transfer pricing in Malaysia. The arm's length principle is defined in paragraph 1 of Article 9 of the OECD Model Tax Convention 2003 as follows:

> *"(When) conditions are made or imposed between the two enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."*

Meanwhile, paragraph 2 of Article 7 of the OECD Model Tax Convention 2003 states:

> *"Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment."*

Paragraph 2 of Article 7 basically corresponds with the application of the arm's length principle and perhaps explains the IRB's stand to extend the application of the Guidelines to transactions between a permanent establishment and its head office or other related branches.

The arm's length principle has gained universal acceptance as it provides broad parity of tax treatment for MNEs and independent enterprises. The principle also avoids any possible distortion of relative competitive positions of associated enterprises as it puts the former and independent enterprises on an equal footing (OECD, 2000). The IRB's stand to accept this principle should be welcomed as it is an internationally recognised concept in many tax jurisdictions, both in OECD member and non-member countries.

As the Guidelines point out, section 140(1) of the Income Tax Act 1967 **(the Act)** will be applied in the adjustment of transfer prices and the Director-General of Inland Revenue (DGIR) may disregard transactions that are not made at arm's length and make the necessary adjustments.

3.0 Comparability analysis

The arm's length principle is based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent enterprises. The Guidelines explain that the transactions are deemed comparable if there are no material differences between the compared transactions or if it only requires minor adjustments. The OECD Transfer Pricing Guidelines further add that an understanding of how transactions between unrelated enterprises work is required to determine the degree of comparability (OECD).

There are a few characteristics outlined in the Guidelines that should be taken into consideration in determining comparability:

(a) characteristics of property or services:

Similarity in the characteristics of the property or services transferred plays a vital role in determining their values in the open market, this including:

- the physical features, quality and the volume of supply of property,
- the nature and extent of services, and
- the form of transaction and type of property.

(b) function performed:

The Guidelines also stress that a functional analysis must be carried out in order to ensure the controllable and uncontrollable transactions are comparable. The function alanalysis seeks to identify and compare the economically significant activities undertaken by the independent and associated enterprises. Among the functions that would be taken into account by the IRB are product design, manufacturing, marketing, advertising and research & development.

(c) economic circumstances:

Acknowledging that arm's length prices may differ across different markets, the IRB looks at the geographic location of the market, size of the market, availability of substitute goods and services and the extent of government intervention.

(d) business strategies:

The Guidelines further list innovation and new product design, degree of diversification, market penetration scheme and distribution channel selection as part of the business strategies that would be taken into account.

4.0 Pricing methodologies

The OECD has recommended five methods that could be utilised in evaluating the consistency of the transfer price between the associated enterprises with the arm's length principle. It must be noted that the taxpayer must endeavour to choose the best method, i.e. the method that provides reliable comparability based on sufficient independent sources with minimum or no adjustment by the tax authority. In doing so, they should take note of the following factors (IRB Malaysia):

- the degree of actual comparability when making comparisons with transactions between independent parties;
- the completeness and accuracy of data in respect of the uncontrolled transaction;
- the reliability of any assumptions made; and
- the degree at which the adjustments are affected if the data is inaccurate or the assumptions are incorrect.

A quick glance of the comparability factors drawn up by the Australian tax authority show similar factors are also taken into consideration by them (ATO, 2005):

- the nature of the activities being examined
- the availability, coverage and reliability of the data;
- the degree of comparability that exists between the controlled and uncontrolled dealings or between enterprises undertaking the dealings, including all the circumstances in which the dealings took place, and
- the nature and extent of any assumptions.

Meanwhile, the five transfer pricing methods are:

- comparable uncontrolled price method
- resale price method
- cost plus method
- profit split method
- transactional net margin method

The comparable uncontrolled price method, resale price method and cost plus method are all known as the traditional transactional methods. The remainder two are known as the transactional profit methods. The Guidelines have adopted all the five methods introduced by the OECD. Having said that, the IRB has clearly expressed that the traditional methods should be attempted first before the transactional profits methods are considered. It appears that the latter is regarded as the 'last resort' option.

There is no reason expressed by the IRB in preferring the traditional methods to the transactional profits methods as other tax authorities in Asia Pacific (namely, Singapore, Australia and New Zealand) do not impose such requirement. Nevertheless, the willingness of the IRB to consider the transactional profits methods as an alternative is welcomed as the complexities of the real life business scenarios may impose practical constraints in applying the traditional methods (OECD, 2003).

5.0 The Comparable Uncontrolled Price Method (CUP)

This method focuses directly on the price of the property or services transferred in a controlled transaction to the price charged for the property or services in a comparable independent transaction. Provided both transactions are in comparable circumstances, any price difference between the two may indicate the transfer pricing of the associated enterprises (i.e. in the controlled transaction) is not at arm's length (ATO, 2005 and OECD, 2003). The Guidelines state that the CUP method is appropriate where there is comparability between the transactions and circumstances, and more importantly, it allows the IRB to make reasonable adjustments in the event of some differences.

In undertaking the comparability analysis, the Guidelines emphasise on the need to consider among others, the product characteristics, whether goods sold are compared at the same points in the production chain, costs of transport and whether the products are sold in places where the economic conditions are the same.

6.0 The Resale Price Method

The resale price method focuses on the gross margin obtained by the distributor (Ault). As stated in the Guidelines, the resale price method is appropriate where the final transaction is with an independent distributor. The efficiency of this method depends on the value added or alteration made by the reseller on the product before it is resold. The margin of resale price would be derived from comparable transactions between the reseller and other independent parties (OECD). The Guidelines detailed a list of factors that may influence the resale price margin. This including the functions of activities performed by the reseller and the risks undertaken, employment of similar assets in controlled and uncontrolled transactions, and the time lapse between original purchase and resale of the product as a longer time lapse may give rise to changes in the market.

Example 5.1

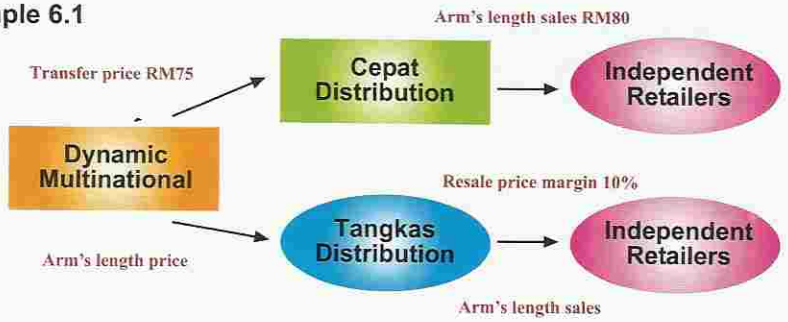
Dynamic Multinational Ltd, which is based in Ireland, manufactures and sells computer chips to Cepat Distribution Sdn Bhd for RM 125 a unit. Cepat Distribution, which is based in Penang, is a subsidiary of Dynamic Multinational. The computer chips are also sold to an independent company, Tangkas Distribution for RM 150 a unit.

It is obvious that there is a difference between the pricing charged by Dynamic Multinational, whereby the computer chips sold at a lower price to the associate company. This may not necessarily reflect an arm's length price as the same product is sold at a higher price to Tangkas Distribution in an uncontrolled transaction.

Provided a functional analysis has been carried out and there is no material difference between the two transactions, the Inland Revenue Board would adjust the transfer price in the transaction between Dynamic Multinational and Cepat Distribution.

It is probable that the arm's length price is RM 150 (as that is the price in an uncontrolled transaction) and as such, the transfer price in the transaction between Dynamic Multinational and Cepat Distribution will be adjusted to reflect this.

Example 6.1



Dynamic Multinational is a multinational entity based in Japan and manufactures high quality computer chips. These computer chips are distributed in Malaysia by Cepat Distribution Sdn. Bhd., a subsidiary Dynamic Multinational. Cepat buys these computer chips for RM 75 per unit and sells it to independent retailers for RM 80 a unit.

Dynamic Multinational also sells the same product to an independent company, Syarikat Tangkas, which distributes the computer chips in Malaysia.

A functional analysis was carried out and both Cepat and Tangkas appear to be carrying out similar functions except that Cepat also performs marketing and promotional functions for Dynamic Multinational.

It appears that the gross profit made by Tangkas is at 10%. As the focus of this method is on margins, the difference between the functions performed by Cepat and Tangkas is immaterial. Dynamic's transaction with Tangkas will be used as a benchmark to determine the arm's length price of the transaction between Dynamic Multinational and Cepat Distribution.

As such, the resale price margin of 10% will be used to determine the arm's length price for the original purchase by Cepat from Dynamic.

Therefore, the arm's length price of the product purchased by Cepat Distribution is:

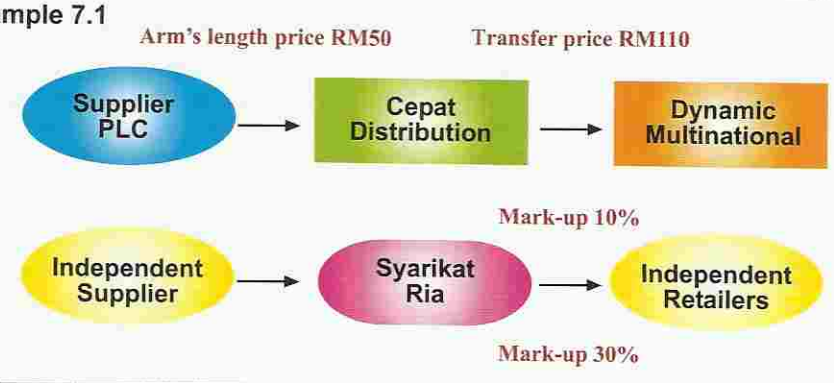
RM 80 – (RM 80 X 10%) = RM 72

Cepat Distribution is advised that the original purchase price of the semiconductors will be adjusted from RM 75 to RM 72 per unit.

7.0 The Cost Plus Method

The cost method plus is appropriate where semi-finished goods are sold between associated parties as the parties could have concluded joint facility agreements or long-term buy and supply arrangements. This method basically looks at the costs incurred by the supplier of property in a controlled transaction for property transferred to a related party (OECD). The Guidelines explain that an appropriate mark-up is added to this cost to find the price the supplier ought to be charging the buyer. The mark-up is established by reference to the mark-up earned by the same supplier from comparable uncontrolled sales to independent parties. Again, the Guidelines stress that in considering comparability, factors like similarity of functions, risks assumed, contractual terms, business strategies and market conditions must be taken into account.

Example 7.1



Example 7.1 (contd)

Cepat Distribution was established in Malaysia by Dynamic Multinational to manufacture specialised semiconductor components. Cepat Distribution obtains the materials used to manufacture this product from Supplier PLC, an independent company based in the United Kingdom, for RM 50 a unit. It costs Cepat Distribution RM 50 to manufacture each unit of the semiconductors and they are sold to Dynamic Multinational for RM 110 a unit.

Meanwhile, an unrelated company, Syarikat Ria, undertakes a similar function like Cepat Distribution, charges an average mark-up of 30% in manufacturing and selling similar product to independent companies. Assuming the functional analysis shows both Syarikat Ria and Cepat Distribution are carrying out a similar function, the average mark-up of 30% by Syarikat Ria, can used to determine the arm's length price.

As such the adjusted price would be as the following:
= RM 100 + (RM 100 X 30%)
= RM 130

Cepat Distribution is advised that the original selling price of the semiconductors to Dynamic Multinational will be adjusted from RM 110 to RM 130 per unit.

8.0 The Profit Split Method

This method seeks to eliminate the effect of special conditions made or imposed on profits in a controlled transaction. This is done by deciding the division of profits that would have realised if the transaction involved independent enterprises (OECD, 2003). The Guidelines have suggested the residual profit split approach and the contribution analysis approach in estimating the division of profits. The strength of the profit split method lies in it not relying directly on comparable transactions (OECD, 2003). This is certainly an alternative method for a taxpayer, who cannot rely on similar transactions involving independent enterprises. The allocation of profit based on the division of functions between the associated enterprises and external data is only relevant to assess the value of the contributions made by each associated enterprise to the transaction.

Example 8.1

Cepat Distribution is assigned by Dynamic Multinational to perform some additional work to the semiconductor components before turning them into final products. These semiconductors are then sold by Dynamic Multinational to Tangkas Distribution, an independent company, for distribution in Malaysia.

There are some reliable information that suggest companies performing similar functions like Cepat Distribution and Dynamic Multinational, respectively have an average mark-up of 20% and 30%.

The simplified trading accounts of Cepat Distribution and Dynamic Multinational are as follows:

	Cepat Distribution (RM '000)	Dynamic Multinational (RM '000)
Sales	200	400
Costs of Goods sold	(120)	(100)
Gross Margin	80	300
Sales & General Expenses	(10)	(20)
Other operating costs	(10)	(20)
Net Profit	60	260

The combined profit of Cepat Distribution and Dynamic Multinational is RM 320,000.

The following two steps are to be adopted to determine Cepat Distribution and Dynamic Multinational's respective share of profit.

Step One: Calculation of the basic return

Cepat Distribution:			
Cost of goods sold		RM	120,000
Cost of mark up (20% X RM 120,000)	+	RM	24,000
Transfer Pricing		RM	144,000

Dynamic Multinational:			
Sales to third party		RM	400,000
Resale margin: 30% X RM 400,000	=	RM	120,000

	Cepat Distribution (RM '000)	Dynamic Multinational (RM '000)
Sales	**144**	
Costs of Goods sold	**(120)**	
Gross Margin	**24**	**120**
Sales & General Expenses	**(10)**	**(20)**
Other operating costs	**(10)**	**(20)**
Net Profit	**4**	**80**

The combined profit of both the companies is RM 84,000.

Step 2: Dividing the residual profit

The residual profit of the companies is RM 320,000 – RM 84,000 = RM 236,000.

This is assumed here that:

(i) the research & development expenses are at RM 15,000 (30%) and RM 35,000 (70%) for Cepat Distribution and Dynamic Multinational respectively, and

(ii) the companies' contributions to the residual profits are a reliable indicator.

As such;

a) Cepat Distribution's share of residual profit is:
(70% X RM 236,000) = RM 165,2000

b) Dynamic Multinational's share of residual profit is:
(30% X RM 236,000) = RM 70,800

The adjusted operating profit of:

a) Cepat Distribution is RM 165,200 + RM 4,000 = RM 169,200

b) Dynamic Multinational is RM 70,800 + 80,000 = RM 150,800

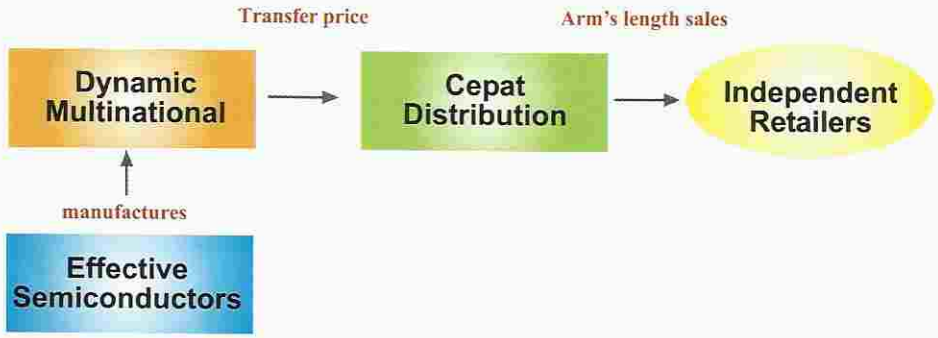
	Cepat Distribution (RM '000)	Dynamic Multinational (RM '000)
Sales	**309.20**	**400**
Costs of Goods sold	**(120)**	**209.20**
Gross Margin	**189.20**	**190.80**
Sales & General Expenses	**(10)**	**(20)**
Other operating costs	**(10)**	**(20)**
Net Profit	**169.20**	**150.80**

The adjustment would result in Cepat Distribution having a sale of RM 309,200 rather than RM 200,000 as declared earlier.

9.0 The Transactional Net Margin Method (TNMM)

The TNMM examines the net profit margin relative to an appropriate base such as costs, sales or assets realised by the MNE from a controlled transaction. As this method uses the margin approach, which are similar to the cost plus and resale price methods, the net margin of the MNEs are established by reference to the net margin that the MNE would have earned in a comparable uncontrolled transaction. One advantage of this method is that it takes into account the function differences between the controlled and uncontrolled transactions, rather than merely looking at the gross profit margins (OECD). The Guidelines recognise that as the net margins are significantly influenced by factors other than products and functions, the application of this method is strictly confided to cases where functions have a high degree of similarity.

Example 9.1



Dynamic Multinational sells semiconductors to Cepat Distributor, an associated company based in Malaysia. Cepat Distributor only sells and distributes the "Advanced" semiconductors manufactured by Effective Semiconductors, another subsidiary of Dynamic in India. All the semiconductors sold by Cepat Distribution bear the "Advanced" trademark.

The trading account for Cepat Distribution is as follows:

Sales	**RM200000**
Costs of Goods sold	**RM175000**
	RM25000
Operating expenses	**RM30000**
Net loss	**RM(5000)**
Margin	**5%**

It is assumed here that the CUP method is not applied as no reasonable adjustments can be made to account for the differences with similar products in the market. It has emerged that Tangkas Distribution, an independent company performs a similar activity and is a suitable comparable company. It also appears that Tangkas Distribution realizes a net mark up of 15%. The TNMM is applied here on the basis of net profit return on sales with a net mark up of 15%.

The computation of the transfer price for the semiconductors purchased by Cepat Distribution is as follows:

Net profit of Cepat Distribution is RM 200000 X 15% = RM 30000

Adjusted cost of semiconductors sold by Cepat Distributors is:
= RM 200000- RM 30000- RM 30000
= RM 140000

10.0 Global Formulary Apportionment

It must be highlighted here that like the OECD member countries, the IRB has categorically stated that the global formulary apportionment is not an acceptable transfer pricing method. This method operates by allocating the global profits of an MNE group on a consolidated basis among the associated enterprises in different countries on the basis of a predetermined and mechanistic formula. The IRB has rejected this method on the premise that it does not satisfy the arm's length conditions.

11.0 Documentation

Section 82(1)(a) of the Act requires taxpayers to maintain sufficient records for a period of seven years to enable the DGIR to ascertain income or loss from business. Section 82(9) of the Act states that 'records' among others include books of account, invoices, vouchers and receipts.

MNEs are required to furnish the IRB information and documentation that contain the following information:

- company details
- transaction details
- determination of arm's length price

Although the IRB's initiative in listing the required documents and information is welcomed, it would be more beneficial to the MNEs and taxpayers if a detailed guidance is provided as to the level of documentation and information expected of them.

Perhaps the Australian Taxation Office approach can be emulated, as they succinctly explain the levels of quality of processes and documentation for transfer pricing involving related parties. (as shown in the table below)

Levels of Quality of Processes and Documentation for International Dealings with Related Parties

1 Low quality	2 Low to medium quality	3 Medium quality	4 Medium to high quality	5 High quality
No analysis of functions, assets risks, market conditions and business strategies	No analysis of functions, assets risks, market conditions and business strategies	Inadequate analysis of functions, assets risks, market conditions and business strategies	Sound analysis of functions, assets risks, market conditions and business strategies	Sound analysis of functions, assets risks, market conditions and business strategies
No documentation or processes to enable a check on selection of methodologies	Insufficient documentation or processes to enable a check on selection of methodologies	Selection of method supported with some contemporaneous documentation	Selection of method fully supported with contemporaneous documentation	Selection of method fully supported with contemporaneous documentation
No comparables used No documentation or processes to enable a check on application of methodologies	No comparables used No documentation or processes to enable a check on application of methodologies	Broad inexact comparables used or comparability based on data from external related party comparables Application of method supported with some contemporaneous documentation	Comparability based on limited data from independent dealings Reliability assessed Application of method fully supported with contemporaneous documentation	Comparability based on adequate data from independent dealings Reliability taken into account in choice of comparables Application of method fully supported with contemporaneous documentation
No effort to implement and review arm's length transfer pricing policies	Limited effort to implement and review arm's length transfer pricing policies	Limited effort to implement and review arm's length transfer pricing policies	Genuine effort to implement and review arm's length transfer pricing policies	Genuine effort to implement and review arm's length transfer pricing policies

(Source: International Transfer Pricing: Introduction To Concepts and Risk Assessment, Australian Taxation Office, 2005)

12.0 Conclusion

The rules governing transfer pricing is significant for both taxpayers and tax administrators because it determines in large the income expenses and taxable profits of associated enterprises in different tax jurisdictions. Businesses should endeavour to practice a high integrity process in determining their pricing method and maintain adequate documentation to justify the selected transfer pricing methodology. It is also equally important for businesses to ensure the methodology chosen by them provides a commercially realistic mechanism when applying the 'transfer pricing' rules.

References

Australian Taxation Office (ATO), (2005) *International Transfer Pricing: Introduction To Concepts and Risk Assessment*, Australian Taxation Office, Canberra.

Ault, H.J., (2004) *Comparative Income Taxation: A Structural Analysis*, Aspen Publishers, New York.

Easson, A., (2003) *Tax Incentives for Foreign Direct Investment*, Kluwer Law International, London.

Inland Revenue Board of Malaysia (IRB), (2003) *Transfer Pricing Guidelines*, Kuala Lumpur.

Inland Revenue Authority of Singapore, (2006) *Transfer Pricing Guidelines*, Singapore.

Organisation for Economic Co-operation and Development (OECD), (2003) *OECD Model Convention On Income and Capital*, Paris.

Organisation for Economic Co-operation and Development (OECD), (2000) *Transfer Pricing Guidelines For Multinational Enterprises and Tax Administrations*, Paris.

Tiley, J., (2006) *Revenue Law 5th Edition*, Hart Publishing, London.

Footnote

The authors acknowledge that examples 5.1, 6.1, 7.1, 8.1 and 9.1 are adapted from the examples contained in the Transfer Pricing Guidelines published by the Inland Revenue Board of Malaysia and Inland Revenue Authority of Singapore.

Author's Profile

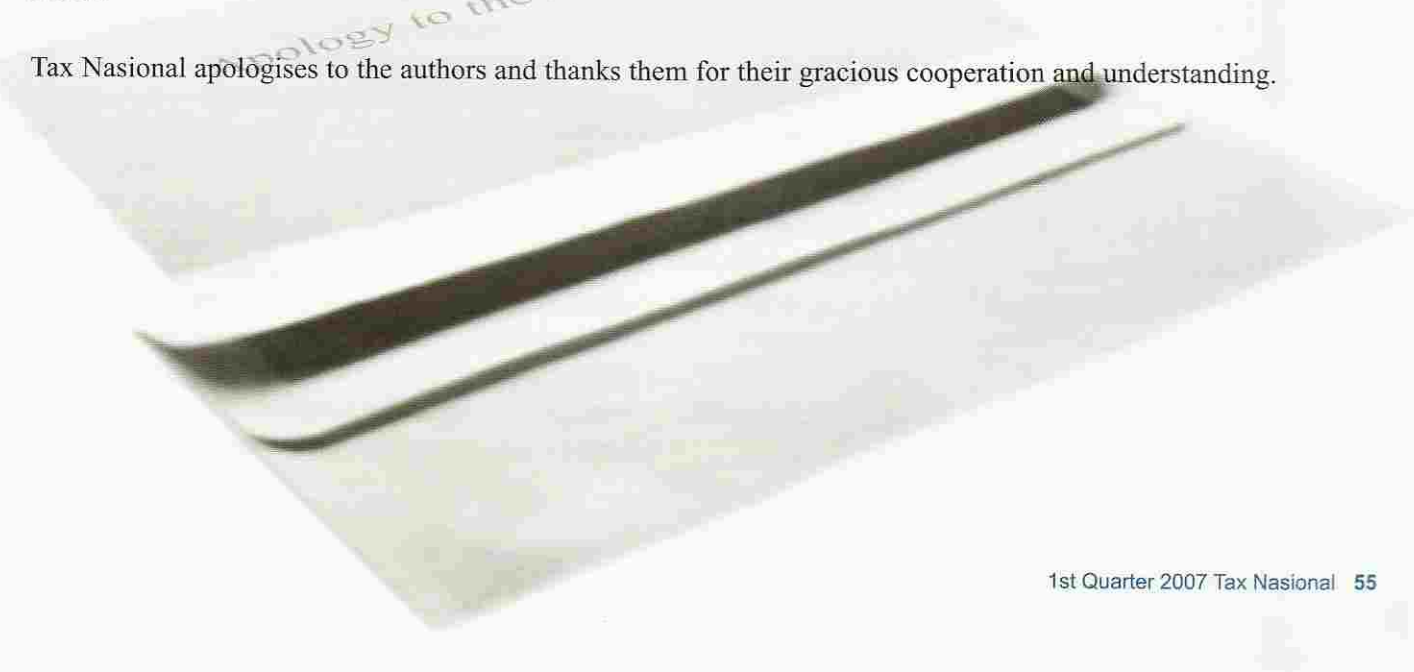
Datuk D.P. Naban *is a partner of LeeHishammuddin Allen & Gledhill.*
Mr S. Saravana Kumar *is reading in chambers and is attached to LeeHishammuddin Allen & Gledhill.*

The authors are grateful to Professor Dr Jeyapalan Kasipillai for having reviewed this article.

Errata

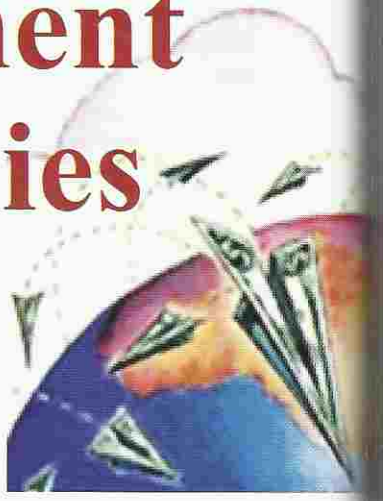
Part I of "An Introduction to the Transfer Pricing Policy in Malaysia" was published in the previous issue (Q4/2006) of Tax Nasional. However there were some "misplaced" sentences /paragraph. Therefore in the interest of continuity and easy reference we are reprinting Part I (in full) together with Part II as one complete article.

Tax Nasional apologises to the authors and thanks them for their gracious cooperation and understanding.



Tax Residence Status of Investment Holding Companies in Malaysia

Mr K Sandra Segaran



Introduction

This article examines the law in relation to the determination of corporate tax residence status under the Malaysian Income Tax Act, 1967 (the Act) and issues arising from the development in other jurisdictions and the application of double tax treaties to the concept of corporate residence. The interpretation of concepts relating to corporate residence has not been the subject of much dispute in Malaysia and hence the lack of reported judgments that can be relied on as precedents. As such the developments in other countries are examined to assist in understanding the determination of corporate residence in Malaysia. An investment holding company for the purposes of this article shall be deemed to be a company that does not carry out any business activity but is only in receipt of investment income.

The Significance of Determining Residence Status

The scope of taxation in Malaysia is largely the territorial basis, i.e., only income that is sourced within Malaysia is subject to tax, except in the case of companies involved in banking, shipping, sea or air transport which are subject to tax on a world scope on their business income. As such, where a resident investment holding company invests offshore, the dividends therefrom are not subject to tax in Malaysia. The offshore income can be credited to an exempt account for the payment of exempt dividends to shareholders. However tax laws of the foreign jurisdictions may be applicable at the source countries of such overseas investment with relevant application of treaty provisions where Malaysia has signed any avoidance of double taxation treaty. For treaty purposes companies may be required to obtain certification confirming their resident status from the Revenue authorities. Under section 8(2) of the Act, where such a determination is made, it shall be presumed that the company is resident in Malaysia for the purposes of this Act for the basis year for every subsequent year of assessment until the contrary is proved. A company which is resident in Malaysia is subject to the provision of Section 108 of the Act, in relation to franking of dividends paid in addition to other responsibilities and privileges.

The Law

In Malaysia, section 8 of the Act provides for the determination of residence status in respect of companies. The residence status is determined under subsection (1)(b) when the company is carrying on a business or businesses and for any other company under subsection (1)(c) as reproduced:

8. Residence: companies and bodies of persons

(1) For the purposes of this Act—

(a) a Hindu joint family is resident in Malaysia for the basis year for a year of assessment if its manager or karta is resident for that basis year;

(b) a company or a body of persons (not being a Hindu joint family) carrying on a business or businesses is resident in Malaysia for the basis year for a year of assessment if at any time during that basis year the management and control of its business or of any one of its businesses, as the case may be, are exercised in Malaysia; and

(c) any other company or body of persons (not being a Hindu joint family) is resident in Malaysia for the basis year for a year of assessment if at any time during that basis year the management and control of its affairs are exercised in Malaysia by its directors or other controlling authority.

Corporate Residence of Investment Holding Companies

As emphasized above, Section 8 (1)(b) provides for a company 'carrying on a business or businesses' while section 8(1)(c) provides for 'any other company', i.e., a category that would include companies not carrying out business, such as an investment holding company, which will be the subject of examination here. As such any reference to the resident status of an investment holding company should be based on section 8(1)(c). The requirements of this section are based on facts with reference to:

- management and control
- of affairs exercised in Malaysia
- at any time during the basis year
- by its directors or other controlling authority

Foreign-Owned Malaysian Companies

Where a company is incorporated under the Companies Act, 1965 it is subject to local company law and accounting standards. Incorporation under the Companies Act, 1965 in itself creates many legal obligations and responsibilities for the company in Malaysia. Although incorporation raises a *prima facie* inference that the company is tax resident in Malaysia, the above mentioned requirements will be the determining factors for tax purposes. Such an impression is created as the local company may have directors resident in Malaysia.

Management and Control

Although the meaning of these expressions has been considered many times by the courts in other countries where the law is similar, it has not been considered in any depth by the Malaysian courts. Foreign cases that defined 'management and control' often dealt with companies carrying out business activities. Although section 8 makes a clear distinction between management and control of a business in subsection 8(1)(b) and management and control of the affairs of the company in subsection 8(1)(c), decisions of foreign courts rarely make such a distinction (see Thornton's Malaysia Tax Commentaries, 2nd. Edition). Most of the foreign authorities have been concerned with defining 'central management and control' while the Act refers to only 'management and control'.

In the UK cases, it has been held that central management and control of a company normally 'abides' at the place where the directors hold their meetings. The residence of individual directors or shareholders or the place of the company's general (i.e. shareholders) meeting are usually irrelevant considerations (see Adrian Shipwright, Textbook on Revenue Law, 1997, pg 556). As such reference to UK cases on corporate residence must be examined with caution as the position in UK itself has changed since 1988. The author has this to say in respect of determining residence status in the UK:

> *Previously the place of incorporation of a company did not matter greatly in determining a company's residence in the UK. There is now a distinction to be made between UK and non-UK incorporated companies as to the test of residence to be applied. Since 1988 a UK incorporated company is treated as UK resident by reason of its incorporation in the UK whether or not by other tests it would be resident outside the UK. If a company is incorporated in the UK it is UK resident by reason of that fact. Other companies (i.e., companies incorporated outside the UK) are treated as resident where the 'centre of management and control' of the company is situated. The meaning of the 'centre of management and control' is a matter of case law.*

In most cases where the function of directors has been considered, it has been in relation to 'central management and control' of the business of a company. Most decided cases show conclusively that the statutory control of a company is vested in its directors and that a company is controlled where its directors effectively exercise that control.

It is submitted that 'management and control' is substantially different from 'central management & control' as the former can lead to dual residence depending on the laws on corporate residence in the countries involved. As such the present legislation in Malaysia may lead to dual residence as the requirement for 'central' or 'effective' management and control is not specifically referred in our domestic legislation. As the Act does not make reference to 'central', defining this expression is beyond the scope of this article.

'Management and Control at any Time in the Basis Year & Central Management and Control'

Since the requirement of section 8 is in reference to management and control 'at any time during the basis year', thus management and control in the Malaysian context need not be exercised over the whole basis year in order to establish a corporate residence in Malaysia. Therefore, the holding of a single board of directors' meeting in Malaysia may lead to the company being resident in Malaysia (see Veerinderjeet Singh, Malaysian Taxation, Administrative & Technical Aspects, 6th. Edition at page 296).

The author goes on to say further that:

> *" It must, however, be noted that for the purposes of the Malaysian Act, it is merely necessary to show in the case of a company conducting a number of business, that the management and control of any one of the company's businesses were at any time in the basis year managed and controlled in Malaysia. There is no need to establish central management and control in Malaysia. Even if central management and control might be exercised outside Malaysia, if it can be shown that there was any meeting of the directors in Malaysia or that at any time in the basis year, the management and control of any business of the company was exercised in Malaysia, then that company would be resident in Malaysia for the basis year.*

The above mentioned opinion was also expressed by the eminent commentary of Leo D Pointon in Revenue Law in Singapore and Malaysia, 2nd. Edition, 1993 at page 239:

> *"Clearly, the residence provisions in Malaysia, while having a superficial similarity to those in Singapore are significantly different. Unlike SITA, MITA looks to test residence in a basis period which is the preceding year.*
>
> *The Malaysian test is more stringent in two further respects. To the extent that management and control is exercised in the basis year in respect of its business or any one of its businesses, the company will be resident. It will also be resident if management and control is exercised at any time during the basis year. That is, only one directors' meeting held in Malaysia may be sufficient to render the company resident, even though all their other board meetings are held outside the Federation."*

In both subsections 8(1)(b) and 8(1)(c), the requirement of control 'at any time during the basis year' is mentioned and as such, from the above, the determination of corporate residence can be inferred from a single meeting of the board of directors in Malaysia.

Dual Residence and Foreign Linked Companies

As the Act does not make reference to 'central management and control' or 'effective management on control' but merely 'management and control by directors or other controlling authority', there is a possibility that the company may be resident in more than one jurisdiction. Furthermore there is no single determining factor or universal definition used by all countries and as such dual residence is a real possibility. In the UK, and in the United States, residence is determined by the *situs* of incorporation. The proposition that a company may be resident in two or more countries at the same time was laid down in the case of *Swedish Central Railway Co. Ltd v Thompson (9 TC 342).*

Where multinational companies and companies within a group operate with a strong influence from parent or holding companies, the issue of real control or central management and control may be raised. In *Bullock v The Unit Construction Co. Ltd* (38 TC 712), where the parent companies usurped the supervision of their affairs of certain East African subsidiaries, it was held that the subsidiaries were resident in the UK. However in a more recent High Court case: *Wood v Holden [2005] EWHC 547 (Ch)* in UK it was opined that the facts in Bullock's case were exceptional. It was a case in which the local boards stood aside altogether, and the parent company effectively usurped what in theory were the functions of the local boards.

Justice Park had this to say:

> *"In the context of a group of companies where matters proceed in a normal way and not in an exceptional way it is to be expected that the parent company will have plans for what it wants its subsidiaries to do, and that the directors of the subsidiaries will ordinarily be willing to go along with the parent company's wishes. If in those circumstances the subsidiaries were resident for tax purposes wherever the parent company is resident the consequences would, in my view, be unsatisfactory, productive of double taxation clashes between different jurisdictions, and disruptive of national tax systems".*

There is a difference between, on the one hand, exercising management and control and, on the other hand, being able to influence those who exercise management and control. In the case of an investment holding company or special purpose vehicle companies, their active affairs may be limited. In many cases the acts of such companies though important, tend not to involve much positive outward activity. So the companies do not need frequent and lengthy board meetings.

Shareholding and Location of Shareholders

The shareholding and location of the shareholders have no relevance to the determination of residence status of an investment holding company under section 8(1)(c), which does not impose any other requirement besides that which are highlighted above. Section 8(1)(c) makes reference to control by 'directors or other controlling authority'. The management and control of companies are usually in accordance with the Articles of Association of companies and usually vests in the hands of the directors unless the facts of a case show that there is another controlling authority. In any case a company is controlled by the directors and not the shareholders (see *Automatic Self-Cleansing Filter Syndicate Co. v Cunninghame [1906] 2 Ch)*.

Location of Investments Outside Malaysia

The location of investment outside Malaysia is of no relevance in determining residence status under section 8(1)(c), which merely requires the management and control of the affairs of the company to be conducted in Malaysia.

It does not matter where the company's assets are situated. Thus a company with assets in India was resident in the United Kingdom as the board of directors met in the United Kingdom *(Calcutta Jute Mills v Nicholson (1 TC 83)*. Conversely, a company with assets in Egypt was held to be resident there as the directors also met there *(Todd v Egyption Delta Land and Investment Co. Ltd (14 TC 119))*.

In De Beers Consolidated Mines, Ltd. v Howe (5 T.C. 198) a company that operated diamond mines in South Africa was held to be resident in the U.K. because the consideration was 'central management and control' as seen from the location of board of directors' meetings and not the location of business activity. As such, the location of investment has no bearing on the determination of residence status. However these cases are cited only to stress that location of business has no bearing in determining 'central management and control' which is a concept alien to the provisions of the Act which only makes reference to 'management and control', thus enabling the possibility of residence in more than one country.

Shareholding by Directors

There is no requirement under the Act or the Companies Act, 1965 that necessitates shareholding by directors. In any case in determining residence status, this is an irrelevant factor and does not affect the determination of residence status of an investment holding company. Shareholder control does not in general matter in determining the residence of a company *(see Kodak Ltd v Clarke [1903] 4 TC 549)*.

Distinguishing Statutory Provisions and Common Law Perspective

The basic test that evolved from these cases is the 'central management and control' test. The test seems to have originated in the Court of Exchequer in 1876: *Calcutta Jute Mills Co Ltd v Nicholson* 1 TC 83, and *Cesena Sulphur Co Ltd v Nicholson* 1 TC 88. It was adopted some thirty years later by the House of Lords in what is generally regarded as the seminal authority on the matter: *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455. Lord Loreburn said at page 458:

> *"... the principle that a company resides for purposes of income tax where its real business is carried on. ... I regard that as the true rule, and the real business is carried on where the central management and control actually abides."*

Several jurisdictions have now amended their provisions and included other requirements especially for companies not incorporated within the jurisdiction. This has now come to be known as the 'statutory test'. Among the countries that have provisions where incorporation is a criterion are Sweden, UK, the United States of America and Australia. For instance in the case of Australia, the 'statutory test' refers to the requirements in paragraph 6(1) of the ITAA 1936 that a company that is not incorporated in Australia must carry on business in Australia and have its central management and control in Australia in order to be a 'resident of Australia'. It was acknowledged in the ATO's Taxation Ruling (TR 2004/15) that in the early cases in Australia, the relevant provision referred to a person being a 'resident' in a particular place and not whether the company was a 'resident of Australia', which is what the statutory definition is concerned with. Similarly in Malaysia, when defining corporate residence, the statutory provisions should not be equated with the requirements of the common law test of 'central management and control' but only to 'management and control' as there are fundamental differences from adding the adjective 'central'. So will the case be if the adjective 'effective' was added. However it is not denied that these foreign cases have immensely contributed in the interpretation of 'management and control'.

Location of Directors

Where the Board of Directors includes foreign based directors, it is not uncommon to have meetings in more than one jurisdiction. Furthermore with the use of modern technology such as video conferencing, e-mail, and internet, and changed business practices (such as theuse of dual listed companies) it is possible to participate in management from anywhere in the world with the use of these technologies (and the efficiencies they provide). Where can then 'management and control' be pin-pointed?

Some jurisdictions focus on where the participants contributing to the high level decisions are located rather than where the electronic facilities are based. Unless there is difficulty in making this judgment, then other factors such as the location of the initiating secretariat will feature in the decision making. One such instance may be when there is an equal number of local and foreign based directors attending a "meeting". In the context of the Malaysian legislation, which provides for such management and control to be exercised at any time in the basis period, then a minimum of one board meeting initiated in Malaysia will suffice.

Fiscal Domicile Article in Avoidance of Double Taxation Treaties

Where the issue of dual residence is confronted among treaty partners, the Article on Fiscal Domicile (Article 3 or 4 in Malaysian Treaties) is resorted to. The OECD Model provides the following:

"Where by reason of paragraph 1, a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of ***effective management*** *is situated"*

The 'effective management test' can conjure a different meaning and connotation as compared to 'management and control' or 'central management and control'. As such it is possible for a subsidiary of a multi-national company to have management and control in Malaysia where the Board of Directors meetings are held and effective management and control in another jurisdiction where the holding company is located and from where the Board's decisions are influenced.

Malaysia has adopted the OECD position in several treaties such as that with France (Paragraph 3 of Article 4), Australia (Paragraph 4 of Article 4), Belgium (Paragraph 3 of Article 4), and India (Paragraph 3 of Article 4) to name a few. However in the case of Sweden, the following was adopted:

> *"3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to settle the question by mutual agreement".*

This is not surprising, as pointed out above, the situs of incorporation is an important determinant in the Swedish provisions. The mutual agreement provision is also adopted in the Pakistan, Thailand, and the 2005 South Africa treaties (not effective yet). However a combination of "effective management" criterion and "mutual agreement" way is adopted in several treaties such as that with South Korea and China. It is also interesting to note a different provision in the case of paragraph 3, of Article 3 in the New Zealand treaty:

> *(3) Where, by reason of the provisions of paragraph (1) of this Article, a person other than an individual is both a New Zealand resident and a Malaysian resident it shall, for the purposes of this Agreement, be treated solely as a New Zealand resident if the centre of its administrative or practical management is situated in New Zealand and solely as a Malaysian resident if the centre of its administrative or practical management is situated in Malaysia whether or not any person outside New Zealand or Malaysia, as the case may be, exercises or is capable of exercising any overriding control of it or of its policy or affairs in any way whatsoever.*

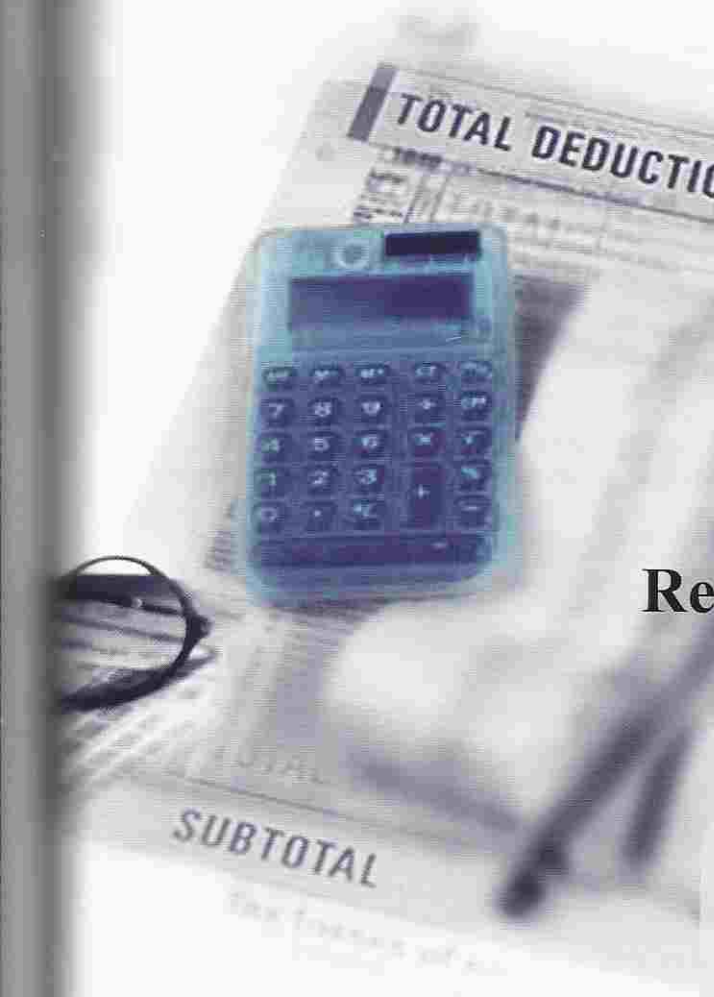
Yet again as highlighted above, different criteria appear to be used in this treaty. These are just several such examples on how the domestic legislation envisaged in section 8 can be modified by treaty provisions. The treaty provisions are resorted to only if the parties (Malaysian authorities and the treaty partner) agree that the question of dual residence arises. However, if for any reason, residence status is denied by any jurisdiction, then the right to invoke treaty provisions as a contracting state becomes questionable.

Conclusion

Section 8(1)(c) must be interpreted from a statutory perspective and foreign case laws that relate to business activity must be examined with circumspect when applied to the context of an investment holding company. Factors other than those envisioned in the section are irrelevant except where it relates to the interpretation of 'management and control of affairs at any time in the basis period'. The direction of the legislation in other countries indicates that the location of incorporation is given great importance. A locally incorporated company should not be denied tax residence status if the company fulfills the requirements of section 8(1)(c) and nothing more.

Author's Profile

Mr K.Sandra Segaran, *holds a B.Econs(Mal), B.Jurisprudence(Hons) degrees and a MBA (Accountancy) from University Malaya and is currently a Technical Director of Deloitte Kassim Chan Tax Services Sdn Bhd. He is also an Associate Member of the Malaysian Institute of Taxation. Mr K.Sandra Segaran served the Inland Revenue Board for 22 years and joined Deloitte in January 2006. The views expressed herein are solely those of the author and do not represent the views of the organisation or MIT.*



Practical Education

Determination of Resident Status: Individuals

Associate Professor Puan Faridah Ahmad

In the last article, we discussed the importance of resident status and the benefits given to a resident individual. In this article we will examine how an individual can obtain the resident status from an income tax perspective. It should not be confused with the permanent resident status granted to an individual by the Ministry of Home Affairs, and resident status is not synonymous with the citizenship of an individual. An individual can be a non-resident in a year of assessment but he can be a Malaysian citizen in the year of assessment concerned.

Resident status is determined by the duration of stay in Malaysia in a calendar year. For example, when we want to determine the resident status for year of assessment 2007, the period reviewed will be the calendar year 2007.

Q1. What are the circumstances under which an individual is deemed to be resident in Malaysia under Income Tax Act 1967?

A1. *There are four (4) circumstances as stated in the ITA under which an individual can be resident in Malaysia for income tax purposes. In determining the status, one must examine the prescribed sections i.e. Section 7(1)(a) to Section 7(1)(d).*

Q2. What is required in order to be resident under Section 7(1)(a)?

A2. *Section 7(1)(a) requires an individual to be in Malaysia physically for at least 182 days in total.*

Example 1:
Puan Kavita, an India national came over to Malaysia to work as a secretary in an accountancy firm on 1 February 2007. She left Malaysia permanently on 30 September 2007 to be with her husband in Hong Kong. Can Puan Kavita get residence status for year of assessment 2007?

Puan Kavita was in Malaysia for a total of 242 days in 2007. Therefore she is resident of Malaysia for year of assessment 2007, under section 7(1)(a).

Example 2:
Mr. Robert, a citizen of Australia recorded the following periods of stay in Malaysia. Determine his residence status.

1.3.06 to 30.6.06 - in Kuala Lumpur
1.7.06 to 15.7.06 - in Hong Kong attending Seminar
16.7.06 to 31.10.06 - in Penang

The total number of days Mr. Robert was in Malaysia is 230 days, therefore, he is a resident of Malaysia for the year of assessment 2006 under Section 7(1)(a).

Q3. If an individual cannot obtain resident status under Section 7(1)(a), can Section 7(1)(b) be used? What is required under Section 7(1)(b)?

A3. *Section 7(1)(b) requires the examination of the number of days that an individual was in Malaysia during the year of assessment under review as well as the number of days that the individual was in Malaysia either the following year (linked to) or the preceding year (linked by). The number of days in the year under review must be less than 182.*

Example 1:
Mr. Lim, a citizen of China, came to Malaysia for the first time on 21 March 2006 and stayed on until 31 March 2007. Can Mr. Lim be resident of Malaysia for both 2006 and 2007?

For YA 2006 : 21.3.2006 to 31.12.2006 = 286 days
For YA 2007 : 1.1.2007 to 31.3.2007 = 90 days

He is a resident for YA 2006 under Section 7(1)(a), because he was in Malaysia for at least 182 days in total. He is also a resident for YA 2007 under Section 7(1)(b) since he was in Malaysia for less than 182 days in 2007 and this period is linked by 2006 and the number of days in 2006 is at least 182 consecutive.

Example 2:
Mr. Peter came to Malaysia for the first time on 1 November 2006 and stayed on until 31 October 2007. Can Mr. Peter be a resident of Malaysia for both 2006 and 2007?

For YA 2006 : 1.11.2006 to 31.12.2006 = 61 days
For YA 2007 : 1.1.2007 to 31.10.2007 = 304 days

Mr. Peter is a resident of Malaysia for YA 2007 under Section 7(1)(a) since he was in Malaysia for at least 182 days, and he was also a resident for YA 2006 under Section 7(1)(b) since he was in Malaysia less than 182 days in 2006 and 2006 is linked to 2007 and the number of days in 2007 is at least 182 consecutive.

Q4. Can an individual still be resident under Section 7(1)(b) in a particular year if he was in Malaysia less then 182 days and this period is not linked to or by and the numbers of days in the following or preceding year is not consecutive in getting the 182 days?

A4. *He can still be a resident under Section 7(1)(b) in the year concerned provided the broken period(s) are due to temporary absence. The broken period(s) are joined by the reasons of temporary absence.*

Q5. What is meant by temporary absence in the context of residence status under Section 7(1)(b).

A5. Temporary absence means an individual was not in Malaysia due to the following circumstances:

- His absence is connected with his employment in Malaysia or due to employment matters (such as attending meetings, workshop, seminars etc.)
- His absence is due to the ill health of the individual or members of his immediate family (such as spouse, children).
- His absence is connected to a social visit not exceeding 14 days in aggregate.

Example 1:
Mr. Chin, a food technologist with a local food manufacturing company forwarded the following periods of stay in Malaysia and overseas.

1.7.2006 to 29.12.2006	- in Malaysia
30.12.2006 to 31.12.2006	- social visit in Beijing
1.1.2007 to 4.2.2007	- seminar in London
5.2.2007 to 3.7.2007	- in Malaysia

For YA 2006: 1.7.2006 to 29.12.2006 = 182 days
For YA 2007: 5.2.2007 to 3.7.2007 = 149 days

He is a resident in YA 2006 under Section 7(1)(a), and he is also a resident in YA 2007 under Section 7(1)(b) because he satisfied the following conditions:

- In 2007 he was physically present in Malaysia less than 182 days
- 2007 is connected to 2006 (by temporary absence of 4 days seminar in London and linked by another 2 days social visit in Beijing).
- The number of days in 2006 is at least 182 consecutive.

Example 2:
Mr. Ibrahim an Indian national came to Malaysia for the first time as a project director of a local company. Mr. Ibrahim recorded the following period of stay in Malaysia and overseas.

2006	1.6.2006 to 14.12.2006	= 197 days in Malaysia
	15.12.2006 to 29.12.2006	= 15 days business trip to Pakistan
	30.12.2006 to 31.12.2006	= 2 days social visit to India
2007	1.1.2007 to 4.1.2007	= 4 days social visit to Jakarta
	5.1.2007 to 3.7.2007	= 180 days in Malaysia

Will Mr. Ibrahim get a resident status for both years?

For YA 2006 he is a resident of Malaysia under Section 7(1)(a), that is in Malaysia at least 182 days in total.

As for 2007 he is a resident under Section 7(1)(b) since he fulfilled the following conditions:

(1) In 2007 he was in Malaysia less then 182 days physically i.e. 180 days.

(2) 2007 is connected to 2006 by reasons of temporary absences i.e. 6 days social visits (Jakarta and India), and 15 days due to official matters relating to employment.

Example 3:
Miss Karen, a dentist with Subang Jaya Medical Centre, recorded the following periods of stay in Malaysia and overseas. Determine her resident status for the years concerned.

2005	1.6.2005 to 14.12.2005	= 197 days in Malaysia
	15.12.2005 to 29.12.2005	= 15 days social visit to Sydney
	30.12.2005 to 31.12.2005	= 2 days social visit to Auckland
2006	1.1.2006 to 4.1.2006	= 4 days social visit to Auckland
	5.1.2006 to 3.7.2006	= 180 days in Malaysia

For YA 2005, she is a resident under Section 7(1)(a) since she was in Malaysia for at least 182 days. For YA 2006, she is not a resident under Section 7(1)(b) since 2006 is connected to 2005 by social visits which is in aggregate exceeding 14 days (4 + 2 + 15 = 21 days).

Q6. What are the other provisions where an individual can become a resident besides Section 7(1)(a) and Section 7(1)(b)?

A6. *There are two other provisions in order to get resident status ie Section 7(1)(c) and Section 7(1)(d).*

In applying Section 7(1)(c), an individual has to examine not only the year under review but also the four immediately preceding years. Under this section, an individual is resident only if he or she is physically present in Malaysia for at least 90 days in total in a year concerned and is either resident or in Malaysia for at least 90 days in three out of the four immediately preceding years.

Example 1:
Miss Veronica has the following patterns of stay in Malaysia. She would like to know how her resident status in being granted to her for the years concerned.

1.9.2003 to 20.9.2003	= 20 days
2.6.2004 to 15.9.2004	= 106 days
1.2.2005 to 30.10.2005	= 272 days
1.4.2006 to 30.11.2006	= 244 days
1.2.2007 to 20.5.2007	= 109 days

She will be given the status of resident according to the following sections:

Year	Status	Sections
2003	Not Resident	< 182 days
2004	Not Resident	< 182 days
2005	Resident	7(1)(a) – at least 182 days
2006	Resident	7(1)(a) – at least 182 days
2007	Resident	7(1)(c) – at least 90 days and three out of four immediately preceding years (i.e. 2006, 2005, 2004) she was a resident or 90 days

Example 2:
Following example 1, can Miss Veronica get a resident status under Section 7(1)(c), for year 2007 if she was in Malaysia for only 90 days in 2005 instead of 273 days?

Yes, she is still a resident since she fulfills the conditions for three out of four immediately preceding years (i.e. either 90 days or resident).

The fourth Section is 7(1)(d). Section 7(1)(d) stipulates that an individual is resident for a particular year if he is resident for all the three immediately preceding years and is also resident for the immediately following year. There is a possibility whereby an individual is not in Malaysia at all for that particular year, but yet he can be resident under Section 7(1)(d) provided he fulfills the other two conditions.

Example 3:
Mr. Tom a British citizen has forwarded the following information with regard to his patterns of stay in Malaysia. Please advise him on the resident status for tax purposes.

2003 : 11.6.2003 to 31.12.2003	=	204 days
2004 : 1.4.2004 to 31.12.2004	=	275 days
2005 : 1.1.2005 to 31.3.2005	=	90 days
2007 : 1.2.2007 to 31.8.2007	=	212 days

Mr. Tom will be accorded the resident status under the following provisions:

Year	Status	Sections
2003	Resident	7(1)(a) at least 182 days
2004	Resident	7(1)(a) at least 182 days
2005	Resident	7(1)(b) less than 182 days but linked by year 2004 and number of days is 2004 is at east 182 consentive
2006	Resident	7(1)(d) not in Malaysia at all by three out of four immediately preceding years (2005, 2004, 2003) he was a resident and the immediately following year (2007) he was a resident.
2007	Resident	7(1)(a) at least 182 days

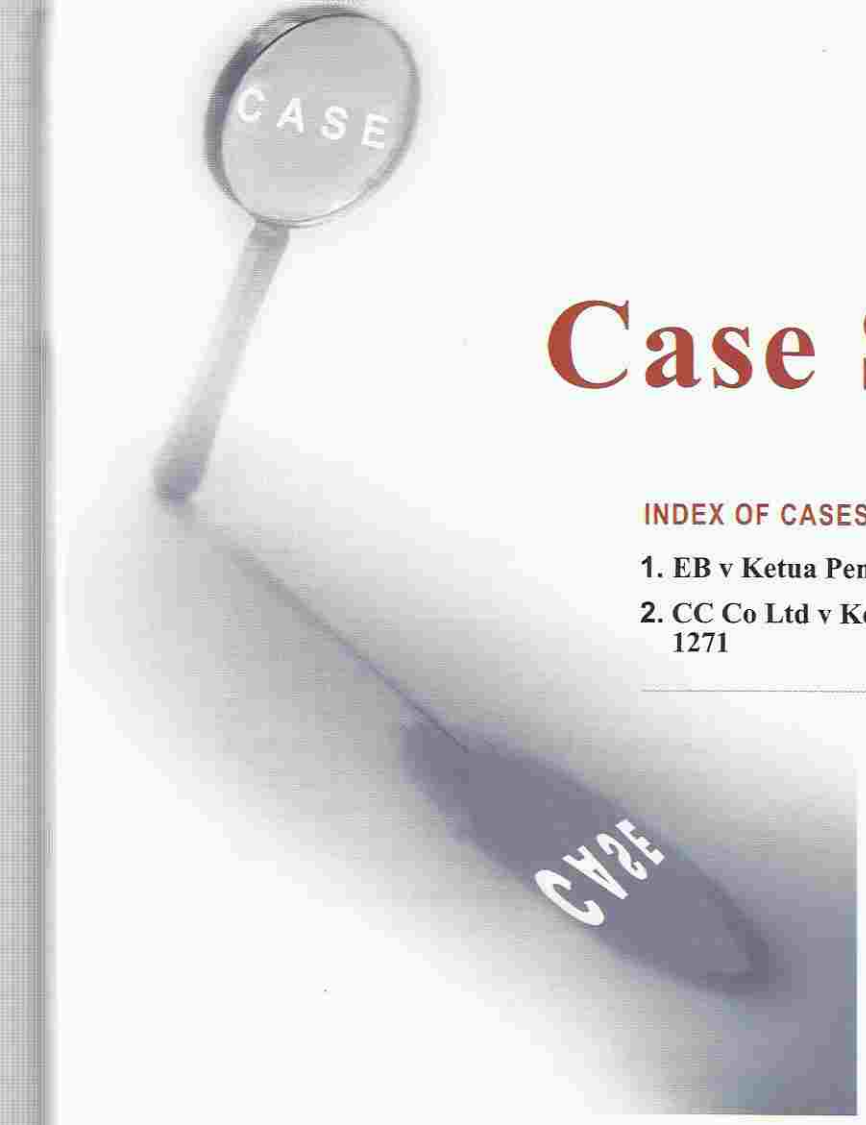
Q7. Will the same provisions apply to determine the resident status of a company?

A7. *As for company, different provision will apply that is Section 8, where the management and control of the company will be used in determining the resident status.*

Author's Profile

A academician of repute, ***Puan 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 organised jointly by ACCA Malaysia, SMEDEC, JELITA and FELDA.



Case Summaries

Ms Lucy Chang

INDEX OF CASES

EB v Ketua Pengarah Hasil Dalam Negeri [2006] AMTC 1197

Special Commissioners of Income Tax – Appeal No PKCP(R) 9/2004

Ahmad Zaki b Husin (Chairman), Ahmad Padzli b Mohyiddin, Sahari b Mahadi, June 12, 2006

Business income – Compensation received for giving up all rights and responsibilities over the design, construction and commissions of hydroelectric generating facility – Income or capital receipts –

In 1994, the appellant was awarded the contract for the privatisation of the Bakun Dam project (the project) and Bakun Hydroelectric Corporation Sdn Bhd (BHC) was incorporated as a wholly owned subsidiary of the appellant to finance, design, construct, operate and maintain the hydroelectric generating facility at Bakun. Pursuant to the conditions imposed by the government and a formal restructuring of BHC, the appellant's shareholding of BHC was reduced from 100% to 42.6% and management control over the project. In 1996, the appellant formally gave up all its rights and responsibilities over the design, construction and commissioning of the project for a consideration of RM300 million. The said RM300 million was recognised in two accounting years i.e. as RM210.6 million in the year ended June 30, 1996 and RM89.4 million in the year ended June 30 1997. The sum of RM210.6 million which was described as a management fee in the appellant's accounts for the year ending June 30, 1996 was assessed to tax for the year of assessment.

It is the appellant's contention that the RM210.6 million is a compensation for the loss of rights to the project and/or for loss of the 100% shareholding in BHC and that as it relates to a change in structure of BHC, it is capital rather than revenue in nature.

The issue is whether the money received for the year of assessment 1997 amounting to RM210.6 million is capital in nature or whether the aforesaid amount received constitutes gross income assessable to income tax.

Held, allowing the appeal

The auditor in charge of the appellant's accounts for the relevant years has explained that the description of the RM210.6 million as a management fee instead of a transfer fee and its inclusion in the turnover is an error. As the sum of RM210.6 million is a non-operating profit it ought to have been shown separately and not included in the turnover. Furthermore, the fact that the figure was arrived at purely on comfort to the parties rather than on actual calculations supports the proposition that it was not a management fee as a management fee would be detailed into various categories and not a round-up figure arrived at by specific agreement. There was also no evidence of withholding or suppression of evidence since parties relevant to the matter, that is, the auditor in charge of preparing the accounts and the appellant's executive chairman and CEO of BHC, had been called upon to testify fully on this matter. As such, the RM300 million paid by BHC to the appellant is for the loss of rights in BHC. This surrender of rights by the appellant and its consequent compensation is capital and therefore not subject to tax.

CC Co Ltd v Ketua Pengarah Hasil Dalam Negeri [2006] AMTC 1271

Special Commissioners of Income Tax – Appeal No PKCP (R) 11/2004

Real property company shares – Whether disposal of shares in subsidiary amounts to disposal of chargeable asset – Real Property Gains Tax Act 1976, paragraph 34A of Schedule 2

In 1990, the appellant entered into an agreement to purchase land at RM12,310,056. In the same year, the appellant then incorporated a subsidiary company in Malaysia for the purpose of carrying on the business of manufacturing electronic products and subsequently, assigned its interest in the sale and purchase agreement to its subsidiary. This subsidiary commenced business during the financial year ended March 31, 1993. By March 31, 1995, its tangible asset had risen substantially to RM138,648,261 and by March 31, 1996 it was RM130,849,713. The share capital of the company was increased from 2 ordinary shares of RM1 each when it was incorporated to 699,998 shares in 1990, 18,000,000 shares in 1991, 34,000,000 ordinary shares of RM1 each and 4,000,000 redeemable preference shares of RM1 each issued at RM5 per share in 1992. For business reasons, the appellant disposed of the shares in 2002 i.e. 12 years after the incorporation of the company.

It is the appellant's contention that the subsidiary was not a real property company within the meaning of paragraph 34A of Schedule 2 to the Act and that therefore the disposal of shares did not amount to a disposal of a chargeable asset pursuant to paragraph 34A of the Second Schedule to the Act.

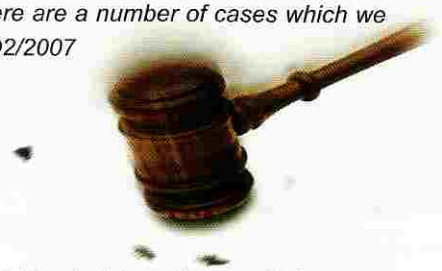
The issue is whether the disposal by the appellant of 56,800,000 shares in its subsidiary in 2002 amounts to a disposal of a chargeable asset pursuant to paragraph 34A(1) of the Second Schedule to the Real Property Gains Tax Act 1976.

Held, allowing the appeal

In resolving the issue as to whether the appellant had made use of its subsidiary to acquire land and then dispose of shares in that company in order to avoid payment of real property gains tax (RPGT) it is necessary to undertake a statutory interpretation of paragraph 34A of Schedule 2 of the Act. In undertaking a purposive interpretation of a deeming provision under paragraph 34A the High Court in *Binastra Holdings Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* [1997-2002] AMTC 2296; [2001] 5 MLJ 481 stated that the correct approach was to give the words their ordinary and natural meaning which reflects the intention of parliament provided that it does not lead to injustice or absurdity. In examining the sequence of events in the share acquisition and subsequent disposal thereof by the appellant it is evident that the appellant had not used the company as a vehicle to acquire land and then dispose of shares in that company at an opportune moment to gain profit so as to avoid payment of RPGT. On this count alone the gains made on the disposal of the shares, had placed it out of the ambit of paragraph 34A of Schedule 2 of the Act. Therefore the shares disposed of by the appellant are not chargeable assets under the Act. It is therefore absurd to use the deeming provision of paragraph 34A as the instrument to impose tax on the appellant under the Act.

Editor's Note:

Please note that there are a number of cases which we will be including in Q2/2007



Author's Profile

Ms Lucy Chang, *is an Associate of Wong & Partners, a member firm of Baker & McKenzie International, a Swiss Verein with member law firms around the world. For any queries, Lucy can be contacted at lucy.chang@wongpartners.com*

Acknowledgement

*We gratefully acknowledge Thomson*Sweet & Maxwell, Asia for their gracious contribution in providing us with these updates from their All Malaysia Law Reports. 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).*

Disclaimer

Book Review by

Mr Kalisewaran Sinniah
LLB(Hons) University of Wolverhampton, CLP

The emphasis on self-assessment puts the burden on the taxpayer, be it individual or corporate. Taxpayers need to be informed about the requirements of the tax code in order to be diligent about their compliance.

This also places a higher measure of care on those responsible for the preparation of tax returns and tax compliance to do the job accurately, veraciously and in a timely manner.

The following two books, although published in 2005 & 2006, are still useful to know deadlines, requirements and ways to comply to avoid getting run-over by unnecessary penalties, avoidable tax liability issues and or challenges by way of tax audits.

100 Ways to Save Tax in Malaysia for "Small Businesses" by Richard Thornton

The private sector in any free economy is the catalyst and fertilizer for sustained economic growth and prosperity. While Government policies and budgets are guidelines for businesses it is private enterprise which, by making the best use of what the tax system has to offer, enhances the nation's competitiveness.

"100 Ways to Save Tax in Malaysia for Small Businesses" is specially designed for sole proprietors, partnerships and small companies to guide them on tax mitigation and to help minimize the exposure of their businesses to tax liabilities and penalties so as to free precious resources for business development.

This book helps taxpayers' on how to structure thier business activities to be most tax efficient.

This book goes hand-in-hand with the following :

100 Ways to Save Tax in Malaysia for "Individuals" by Richard Thornton

We, the common man in the street work, hard for our money. We would like to stretch it and pull it and push it to last as long as possible – well at least till the end of the month! Minimising your tax exposure will help keep some extra after-tax ringgit to take home.

This book gives suggestions, ideas and guidance specially catered for individual taxpayers to plan wisely so as to maximize the tax benefits that are legitimately available.

Regardless of whether you are a tax resident or not and notwithstanding whether you are employed or self-employed this book will help you stay on the correct side of the tax man. Self Assessment is a double edged tool – you must ensure your proper compliance but if you take the initiative to learn about the correct reliefs, rebates and tax exemptions which are available to you, then you can benefit by not falling into the costly pitfalls of avoidable penalties and tax payments.

Editor's Note:

MIT members and participants at selected MIT CPD events can purchase these books as a set for the special price of RM88-00 only! Please see the advertisement on the next page.

entertainment tax

Put your hand on a hot stove for a minute, and it seems like an hour.
Sit with a pretty girl for an hour, and it seems like a minute. THAT'S relativity.
- Albert Einstein

The brain is a wonderful organ. It starts working the moment you get up in the morning and does not stop until you get into the office.
- Robert Frost

The trouble with being punctual is that nobody's there to appreciate it.
- Franklin P. Jones

We must believe in luck. For how else can we explain the success of those we don't like?
- Jean Cocturan

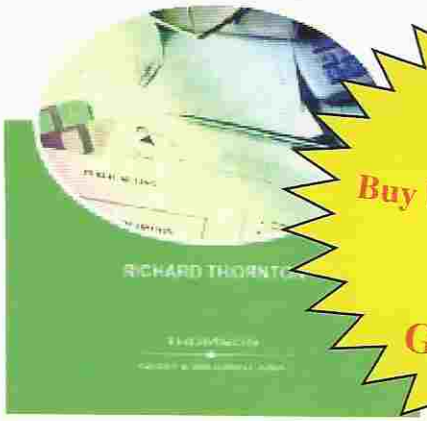
Ilt matters not whether you win or lose; what matters is whether I win or lose.
- Darrin Weinberg

THOMSON
SWEET & MAXWELL ASIA

Available from Sweet & Maxwell Asia

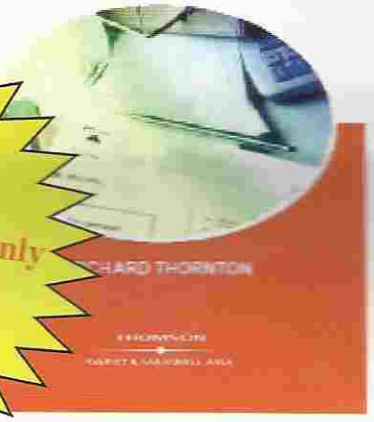
Softcover ISBN 978-983-2631-63-7

100 Ways to Save Tax in Malaysia for Small Businesses



Softcover ISBN 978-983-2631-58-3

100 Ways to Save Tax in Malaysia for Individuals



Great Offer for MIT Road Show participants!
Buy both titles at RM 88.00 only
Retail Price ~~RM120.00~~
(Valid till 31st May '07)
Grab! your set today!

100 WAYS TO SAVE TAX IN MALAYSIA FOR SMALL BUSINESSES

100 WAYS TO SAVE TAX IN MALAYSIA FOR INDIVIDUALS

YES! I would like to order ____ set(s) at RM88.00 per set.

3 Easy Ways To Order

- ☐ Company Account
- ☐ Personal Account

- ○ **Mail** : **Sweet & Maxwell Asia**
  a division of The Thomson Corporation (Malaysia) Sdn Bhd (441723-A)
  17 Jalan PJS 7/19, Bandar Sunway
  46150 Petaling Jaya, Selangor.
  Tel: 03- 5633 0622
- ○ **E-Mail** : smasg.marketing@thomson.com
- ○ **Fax** : 03-5638 4049

Company: _____ Contact Person: _____

Address: _____ Postal Code: _____

Tel: _____ Fax: _____ Email: _____

○ I enclose a cheque payable to " Sweet & Maxwell Asia" for S$_____

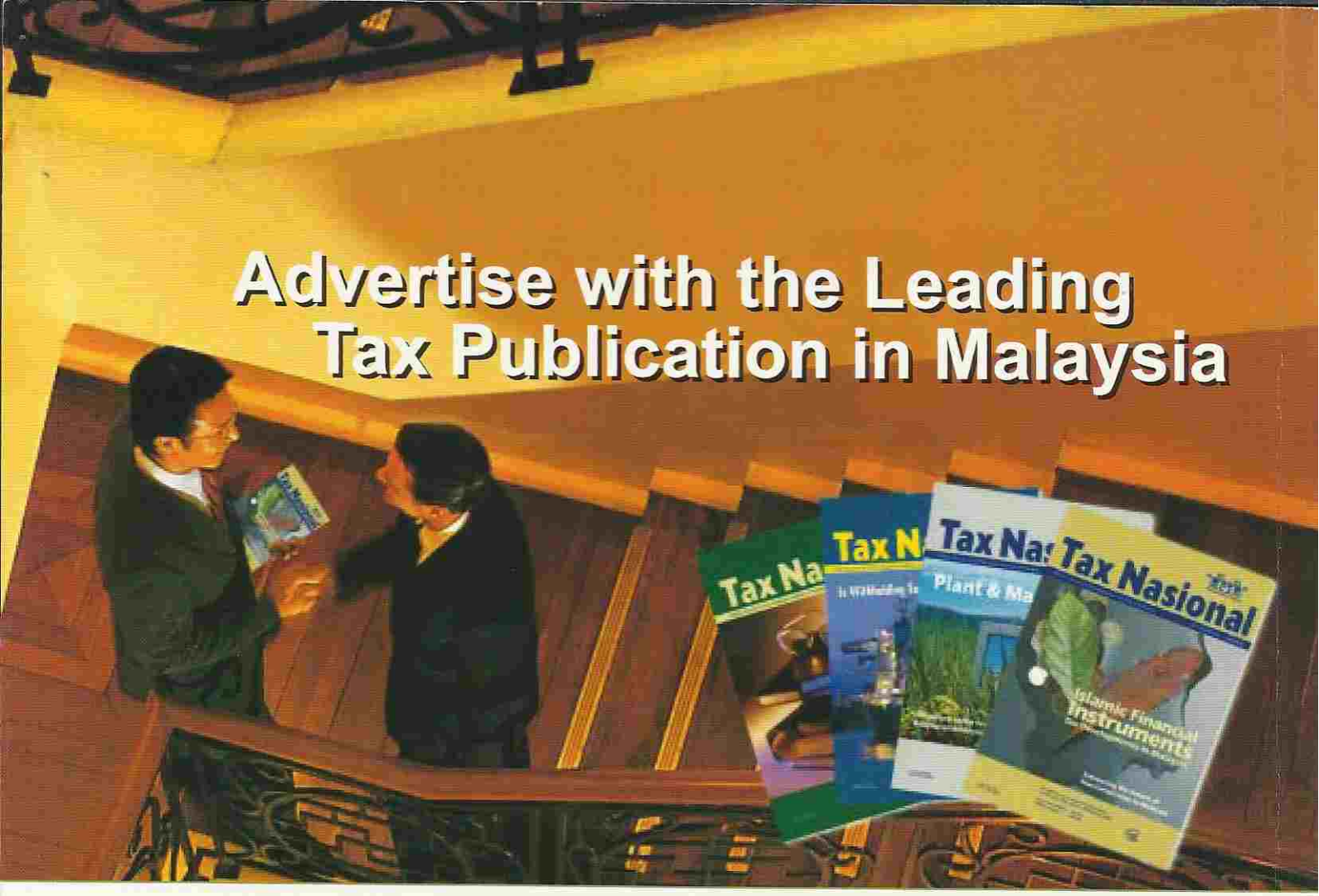
○ Please charge to my credit card : ○ AMEX ○ VISA ○ MASTERCARD Card No. _____

Card Holder's Name _____ Expiry Date _____ Signature _____
(Order not valid without signature)

*Books will be delivered upon receipt of order form together with payment.

*For more product details, visit our website at http://www.sweetandmaxwellasia.com.my

Advertise with the Leading Tax Publication in Malaysia



Tax Nasional, the official publication of the Malaysian Institute of Taxation, is a quaterly tax journal that covers regulatory updates, tax compliance matters, tax developments in the region and more.

It is your most cost-effective means of reaching out to as many as 6,000 top government officials, tax and accounting practioners, lawyers, selected public listed companies, financial controllers, financial institutions, taxation and professional bodies in Malaysia and overseas

For advertising booking enquiries, please contact
Malaysian Institute of Taxation (603) 2162 8989
or e-mail: publications@mit.org.my

ADVERTISEMENT RATES (RM)

	Insertions			
Full Colour	**1**	**2**	**3**	**4**
ROP	2,500	2,375	2,250	2,125
Back Cover (A4)	3,375	3,206	3,038	2,869
Inside Front Cover (A4)	3,250	3,088	2,925	2,763
Inside Back Cover (A4)	3,125	2,969	2,813	2,656
Specified Positions (A4)	3,125	2,969	2,813	2,656
Half Page Specified Positions	2,031	1,930	1,828	1,727
Half Page ROP	1,625	1,544	1,463	1,381
Black & White				
ROP (A4)	1,500	1,425	1,350	1,275
Specified Positions (A4)	1,875	1,781	1,688	1,594
Half Page Specified Positions	1,219	1,158	1,097	1,036
Half Page ROP	975	926	878	829

Advertisement Booking Form
Malaysia Fax: 03-2162 8990

BOOKING DETAILS

Colour ◯ Full Colour ◯ Black & White

Frequency ◯ 1x ◯ 2x ◯ 3x ◯ 4x

Position ◯ ROP ◯ Back Cover ◯ Inside Front Cover ◯ Inside Back Cover ◯ Specified Position

Size ◯ Full Page A4 ◯ Half Page

PARTICULARS

Company: _____

Address : _____

_____

_____

Tel: _____ Fax: _____

email: _____

Contact Person: _____

Job Title: _____