Malaysian Institute Of Taxation

Tax Nasional

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Personal liability for Income Tax

Directors and other principal officers of insolvent companies may suddenly find themselves being personally liable for the full amount of the company's taxes.

Too pessimistic a scenario? Perhaps. Nevertheless a possible reality.

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Al-Fatihah

The Council Members

together with the staff and members

of the

MALAYSIAN INSTITUTE OF TAXATION

express their deepest sadness
and offer heartfelt condolences to

The Selangor Royal Family on the
passing of His Majesty

Seri Paduka Baginda Yang Di-Pertuan Agong XI
Sultan Salahuddin Abdul Aziz Shah Alhaj
Ibni Almarhum Sultan Hisamuddin Alam Shah Alhaj

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Malaysian Institute Of Taxation

How to become a member of the Malaysian Institute of Taxation

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The Principal benefits to be derived from membership are:

1. Members enjoy full membership status and may elect representatives to the Council of the Institute.
2. The status attaching to membership of a professional body dealing solely with the subject of taxation.
3. Supply technical articles, current tax notes and news from the Institute.
4. Supply of Annual Budget Booklet and 4 issues of Tax Nasional per annum.
5. Opportunity to take part in the technical and social activities organised by the Institute.

Qualification Required for Membership

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

Associate Membership

1. Any person who has passed the Advanced Course examination conducted by the Department of Inland Revenue and who has not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
2. Any person whether in practice or in employment who is an advocate or solicitor of the High Court of Malaya, Sabah and Sarawak and who has had not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
3. Any Registered Student who has passed the examinations prescribed (unless the Council shall have granted exemptions from such examinations or parts thereof) and who has had not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
4. Any person who is registered with MIA as Registered Accountant and who has had not less than two (2) years practical experience in practice or employment relating to taxation matters approved by the Council after passing the examination specified in Part I of the First Schedule or the Final Examination of The Association Of Accounts specified in Part II of the First Schedule to the Accountants Act, 1967.
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7. Any person who is authorised under subsection (2) (6) of Section 8 of the Companies Act, 1965 to act as an approved company auditor without limitations or conditions.
8. Any person who is granted limited or conditional approval under Sub-section (6) of Section 8 of the Companies Act, 1965 to act as an approved company auditor.
9. Any person who is an approved Tax Agent under Section 153 of the Income Tax Act, 1967.

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1. A Fellow may be elected by the Council provided the applicant has been an Associated Member for not less than five (5) years and in the opinion of the Council he is a fit and proper person to be admitted as a Fellow.
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Every applicant shall apply in a prescribed form and pay prescribed fees. The completed application form should be returned accompanied by:

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

	Fellow	Associate
a) Admission Fees	RM300	RM200
b) Annual Subscription	RM145	RM120

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

The Council may at its discretion and without being required to assign any reason reject any application for admission to membership of the Institute or for a change in the status of a Member.

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

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

Malaysian Institute Of Taxation

President's note

The budget for 2002 was tabled against the backdrop of a slowdown in the world economy and developments following the tragedy of September 11.

In the budget, the Government was seeking to strengthen domestic economic fundamentals by concentrating on increasing domestic expenditure, encouraging consumption, stimulating the private sector and increasing domestic competitiveness. Overall, the economic growth is expected to increase between 4 to 5% in 2002 with GNP remaining high at RM370 billion. Our external reserves have stabilized at a higher level of RM113.7 billion or USD29.9 billion as of 15 October, sufficient to finance 4.7 months of retained imports. The GDP growth, per capita income is expected to increase by 4.7% to RM13,962 in 2002 compared to RM13,333 ringgit in 2001 and with inflation at a low level, per capita income in terms of purchasing power parity will increase by 5.1% to USD9,403 in 2002, thus reflecting a higher purchasing power capability.

Hence, it cannot be denied that we have the basic fundamentals to meet the challenges that are before us and we, as tax professionals should do our part in helping our country overcome these turbulent times.

I wish to highlight that the budget was a pleasant surprise to most Malaysians as the lowering of personal income tax rates was one of the principal Budget measures announced by the Minister of Finance. In addition, the tax rate bands were simultaneously extended to a higher ceiling of RM250,000 coupled with the removal of the bonus restriction.

It is hoped that with this increase of funds in the hands of the consumer, it will either directly or indirectly stimulate domestic spending and act as a vehicle for economic growth.

For your information, MIT has been advocating such a change in the individual tax bands and also the removal of the bonus restriction, in its annual memorandums to the Ministry of Finance.

We are quite pleased that the Government has finally accepted the merits of our proposals. The MIT will continue to advocate the interest of the tax professional by submitting relevant proposals and memorandums to the authorities.

In short, the budget proposals attempted to address issues affecting the current economic environment. As a solution to the current economic problems our country must be economically self reliant by improving the domestic competitiveness and be more efficient. It should also focus on the creation of a skill-based workforce. As stated by our Prime Minister "...A society which is self reliant, upholds noble values and practices good ethic, tolerant, caring and just - as well as equipped with knowledge - will propel the nation towards greater progress and achievements."

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Malaysian Institute Of Taxation

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

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Editor's Note

This is the final issue of Tax Nasional for the year 2001. With this issue we bid adieu to 2001. Reflecting back, the year 2001 has seen some drastic changes in the tax laws of this country. There has been much uncertainty in the direction of our country's economy. The proposals in the budget 2002 will have the effect of giving the country's economy a positive direction.

Transfer Pricing

Transfer pricing involves the price at which transactions between units of multinational companies take place, including the inter-company transfer of goods, property, services, loans and leases.

Failure to integrate transfer pricing policies in the case of mergers and acquisitions is alarmingly common. It is common for companies that have merged to apply the dominant company's transfer pricing methodology. This increases their risk of being taxed on the same profits twice, and falls short of "best of class" behaviour to harness the opportunities presented by such events.

In view of the importance of transfer pricing the Inland Revenue Board has drafted a set of guidelines. The guidelines are still in a draft form. Please refer to the sections on Regulatory Watch for details of this draft guideline.

Self Assessment for the Individual

In line with the Government's intention to implement self assessment for individuals into the Malaysian tax regime the *Income Tax (Amendment) Bill 2001* (ITAB) had its first reading in Parliament the week ending 30 November 2001.

The self assessment system will be operative from year of assessment 2004. Generally the changes introduced by the ITAB reflect the underlying objectives of the self-assessment system; i.e.

- Reducing the Inland Revenue Boards's tax administration burden;
- Facilitating an acceleration in the collection of tax payments; and
- Increasing the level of income tax compliance.

These changes place a greater responsibility on the taxpayer to assess their own tax liability. Briefly the changes introduced by the ITAB are set out under Regulatory Watch.

Personal Tax Liability for Outstanding Taxes of Companies and Bodies of Persons

The recent *Finance Bill 2001* proposed amendments to sec. 75(1) of the *Income Tax Act 1967*, where the Inland Revenue Board intends to collect the outstanding tax liability of companies and bodies of persons from directors, managers principal officers company secretaries treasurers and members with controlling authority. The intention of the Inland Revenue Board is wider than the proposed law. However that intention can be met if some refinements are made.

In view of the serious consequences on the Malaysian economy, Mr. Gurbachan of Khattar Wong, Singapore evaluates the intent and purpose of the proposed amendments as well as the issues that will arise in its implementation in his article entitled "Personal liability for income tax".

Take note that the effective date for this proposed amendment is the date the *Finance Bill* becomes law which should be sometime in late 2001 or early 2002.

Harpal S. Dhillon
Editor of Tax Nasional

Northern Tax Conference 2001

En. Ahmad Mustapha Ghazali, President of MIT delivering his opening address at the Northern Tax Conference 2001

Yg. Bhg. Dato' Zainol Abidin bin Abd. Rashid, Director General of the Inland Revenue Board

Guest of Honour, Dato' Dr Shafie bin Mohd Salleh, Timbalan Menteri Kewangan I, delivering his keynote address at the conference

Following the success of the National Tax Conference on 3rd July 2001 at the Palace of the Golden Horses, Kuala Lumpur, the Inland Revenue Board (IRB) and the Malaysian Institute of Taxation (MIT) combined their efforts again to organise the first ever Northern Tax Conference 2001 at the City Bayview Hotel in Penang on 26th September 2001. The Northern Tax Conference was graced by Yang Berhormat Dato' Dr. Shafie bin Mohd. Salleh, Timbalan Menteri Kewangan I, Malaysia.

As at the National Tax Conference of 3rd July 2001, there was an overwhelming response to the Northern Tax Conference. Despite the economic situation in Penang, there were 250 participants and guests attending the conference.

The theme of the Northern Tax Conference was "SELF ASSESSMENT: TOWARDS SMART PARTNERSHIP". The theme was decided upon bearing in mind the need for parties concerned, be they tax agents, taxpayers and IRB officers to understand their new roles under the self-assessment system. As mentioned by the President of the MIT in his welcoming address, the purpose of the conference was to clarify and illuminate the prevailing uncertainties of the new tax system. The President went on to state, that the time had come for conflict to be replaced with co-operation and hostility is to make way for hospitality. The President ended his welcoming address with a quote by John F. Kennedy, past president of America, "Few will have the greatness to bend history itself, but each one of us can work to change a small portion of an event, and in total of all those acts, will be written the history of this generation."

The Northern Tax Conference then proceeded with an opening address by Director General of the Inland Revenue Board, Dato' Zainol Abidin in Abd. Rashid who raised pertinent issues that are currently affecting the new self assessment tax regime and called on all parties to work together towards a smoother tax system for all. At the conclusion of the opening ceremony, the guest of honour, Yang Berhormat Dato' Dr. Shafie bin Mohd. Salleh Timbalan Menteri Kewangan I, Malaysia, was invited to address the participants on the current issues affecting the self assessment system.

The Northern Tax Conference 2001 then proceeded with the panel discussions.

Dato' Dr. Shafie bin Mohd. Salleh greeting the participants at the Northern Tax Conference 2001

From left:

Mr. Chow Kee Khan
Honorary Secretary of MIT

En. Ahmad Mustapha Ghazali
President of MIT

Dato' Dr. Shafie bin Mohd Salleh
Timbalan Menteri Kewangan I, Malaysia

Dato' Zainol Abidin bin Abd. Rashid
Director General of the Inland Revenue Board

The first panel consisting of Dr. Jeyapalan Kasipillai and Tuan Haji Abdul Rahim bin Abdullah, addressed the issue of Understanding Self Assessment, and mainly focused on the necessity for taxpayers and tax agents to understand the rationale for the shift from the official assessment system to self assessment system. Dr. Jeyapalan touched on the issues of a fairer tax system under self assessment that will directly lead to a reduction of the overall compliance cost for all parties, whereas, Tuan Haji Abdul Rahim enlightened the participants on the IRB's policy and rationale behind the change in tax systems.

The second panel dealt with the issue of Managing Self Assessment and was made up of two very prominent speakers, En. Mohd Saian bin Haji Ridzuan and Mr. M Selveindran and was chaired by Mr. Lee Yat Kong. En. Mohd Saian breached the topic of the general approach in the implementation of the self assessment tax regime. He went on to highlight the need for certainty in the law as well as, the need for taxpayers and tax agents to accept their new roles under self assessment. On the other hand, Mr. M Selveindran shared his views on the new relationship between IRB and the tax profession. Mr. M Selveindran went on to speak on the paradigm shift in matters of judgement, tax mitigation and business reality.

The final panel consisting of Director General of the Inland Revenue Board, Dato' Zainol Abidin bin Abd. Rashid, Mr. Micheal Loh and Yg. Mulia Tengku Kamarulzaman Tengku Ahmad spoke on their respective expectations and hopes for the next phase of the new tax regime. Mr. Micheal Loh mainly addressed the conference on the need for "continuous dialogues", "mutual consultation", "amicable resolution of practice matters" and finally on "combining the resources" of all parties, so as to ensure that all have a common part in the success of the new tax system.

In short, the Northern Tax Conference 2001 was a success as all parties, tax agents, tax payers and IRB officers were enlightened of their new roles and responsibilities under the self assessment tax regime.

Overall the success of the Northern Tax Conference was attributed to the close co-operation between the MIT and the staff of the respective IRB branches in the North. The MIT would like to take this opportunity to specifically thank Yg. Mulia Tengku Kamarulzaman Tengku Ahmad and the staff of the Penang Branch for all their kind assistance and hard work in making the Northern Tax Conference 2001 a resounding success.

Personal liability for income tax

By Gurbachan Singh

Come January 2002, directors and other principal officers of companies should be very wary in all matters pertaining to the taxes of the company. The recent *Finance Bill 2001* has proposed amendments to sec. 75 of the *Malaysian Income Tax Act 1967 (MITA)*. The proposed amendments would effectively allow the Inland Revenue Board (IRB) to go after the personal wealth of principal officers of the company when collecting outstanding corporate taxes. The proposed amendments to sec. 75 MITA read as follows:

"Notwithstanding anything to the contrary to this Act or any other written law, the responsibility for doing all acts and things required to be done by or on behalf of a company or body of persons for the purposes of this Act, including the payment of tax, shall lie jointly and severally:

a) in the case of a company, with

   i. the manager or other principal officer in Malaysia;
   ii. the directors;
   iii. the secretary; and
   iv. any person (however styled) exercising the functions of any of the persons mentioned in the foregoing sub-paragraphs."

Although the proposed section specifically states that it would prevail over any other written law to the contrary, it is still useful to examine how similar provisions have been interpreted in other jurisdictions.

The issue of whether an officer of the company ought to be made personally liable for the taxes of the company arose in the Privy Council case of *Income Tax Commissioner v. Chatani* (1983) STC 477. This case was on appeal from Jamaica. The Privy Council had to determine the scope of sec. 52 of the *Jamaican Income Tax Act* which provides as follows:

"1) Every body of persons shall be chargeable to tax in like manner as any person is chargeable under the provisions of this Act.

2) The manager or other principal officer of every body of persons shall be answerable for doing all such acts, matters and things as shall be required to be done by virtue of this Act for the assessment of such body and the payment of the tax".

The Privy Council interpreted sec. 52 as merely charging the principal officers of the company with administrative or ministerial responsibilities necessary to ensure that the company was assessed to and paid tax, and in the absence of clear and explicit words rendering them jointly and severally liable with the company for the payment of the company's tax, it was the company itself which was liable for payment. The decision of the Privy Council was arrived at after a two-fold reasoning offered by Lord *Keith*. Lord *Keith* explained on p. 477 :

Firstly : "... there can be no doubt that the words 'the payment of tax' are to be linked, not with the words 'answerable for' but with the words 'doing all such acts, matters and things as shall be required to be done by virtue of this Act for ...' In that situation the plain intention is that the manager or other principal officer of a company or other body is to be responsible (which is what 'answerable' must mean in this context) for taking all administrative or ministerial action which the Act requires to be taken for the assessment of the body and the payment of tax to which it is chargeable. It is the body itself which is made chargeable to and liable for tax."

His Lordship went on to explain :

"Their Lordships can find no indication of an intention that the manager or other principal officer of the body is to be liable jointly and severally with the body for payment of the latter's tax, which is the result which would follow if the commissioner's contention were correct. It is to be observed that s 41 of the Act, which deals with payment over to the revenue of tax deducted at source, provides, by sub-s (4), that, where a body corporate has deducted tax and failed to pay it over by the due date, the directors of the body at that date are to be jointly and severally liable with it to pay or account for the tax. This provision is subject to a proviso relieving from liability a director who proves inter alia that there was no negligence on his part. It thus appears that where in the Act the legislature intended to make officers of a body corporate jointly and severally liable with it to pay tax for which the

body was accountable, it expressed that intention explicitly and in clear language. If a similar intention had existed as regards the content of Section 52(2), one would have expected it to be clearly expressed there also."

How should the new Section 75 MITA be interpreted?

In the light of *Chatani's* case, it seems unequivocal that the legislative intent of the proposed sec. 75 MITA is clearly to impose personal liability on officers of a company, in respect of the company's tax. The drafters appear to have satisfied the conditions laid down in *Chatani's* case. To make doubly sure that there would be no room for doubt, the application of any other law to the contrary has been denied.

Whilst it is clear that the proposed amendment to sec. 75 MITA will achieve the said objectives, the proposed amendment will have the effect of making an individual chargeable for the taxes for which a company is liable for. If the intention of the legislative is to ensure that the IRB will be able to collect outstanding taxes from officers of the company, it may perhaps be more appropriate to make the necessary amendments to Pt. VII instead. To charge an individual for a company's taxes is tantamount to lifting the corporate veil, an act even courts are very slow to do. The main attraction of doing business via a corporate entity is the advantage of having a separate legal entity to assume liabilities and responsibilities. If the corporate veil can be so easily lifted, the idea of having a company as a vehicle for business would significantly seem less appealing.

Statutory interpretation aside, a very pertinent question to ask is whether on policy grounds such an avenue of redress should be created for the IRB. The new sec. 75 MITA imposes strict liability on officers of a company to pay up any taxes which the IRB is unable to collect from the company. There is no room for pleading non-negligence on the part of the officers. Such an onerous burden on officers would deter many a suitable candidate from taking on such positions in companies. Even the most vigilant and effective officers would not be safe from the far-reaching tentacles of the new sec. 75 MITA as the IRB would be empowered to collect any shortfall in taxes from the officers.

It is submitted that the proposed amendment would grant extensive powers of redress to the IRB and would create too draconian a mechanism of tax collection as the IRB can now look to any or all controlling officers of the company for payment, regardless of culpability. It is a power which is open to abuse as there is no longer a need to religiously pursue the taxpayer company for payment of outstanding taxes. Adopting a pessimistic extrapolation, the IRB could even bypass collecting corporate taxes from the company and turn to the officers at the first instant for the outstanding amount. This could very well be a reality as the new sec. 75 MITA makes the relevant principal officers of the company liable for the company's tax liability.

If the intent is to promote better corporate governance, it may be more effective to impose personal liability on officers only upon proof that some negligence or omission on their part had caused the IRB to be in a position where they are unable to recover taxes from the taxpayer company. Section 107 MITA has a parallel regime in relation to employers and employees. Employers have a duty to notify the IRB if they know that an employee will be ceasing employment. In addition an employer has to withhold any monies which are due and payable to the employee for a specified period. During that time, the IRB may direct that the sums withheld should be paid over to the IRB in discharge of the employee's taxes. If an employer fails to give notice or withhold the sums due, the IRB is entitled, under sec. 107 MITA to look to the employer for the amount of tax which the employer had failed to deduct. This regime is clearly more reasonable than the one proposed by the new sec. 75 MITA. The employer is not charged with paying the tax liability of the employee. Section 107 MITA is a recovery provision, enabling the IRB to have an alternative party for the recovery of taxes. The amount which can be recovered from the employer is not the full amount of tax payable by the employee but only such amount which was due and owing to the employee and which should have been withheld by the employer. This would surely be as effective in achieving the aim of promoting good corporate governance without bordering on unreasonableness or the risk of abuse.

It is interesting to note that sec. 67 MITA provides that if any person is appointed to be vicariously responsible for the tax liability of any other person (the principal), the representative charged with such a responsibility is only required to pay such tax from accessible moneys which is simply money which is due and payable to the principal and which the representative is able to demand for. Unfortunately the wording of the proposed amendment precludes the applicability of this provision.

The potency of the proposed sec. 75 MITA is all the more stark in these uncertain economic times. Directors and other principal officers of insolvent companies may suddenly find themselves being personally liable for the full amount of the company's taxes. It is not hard to imagine what this would then lead to. Hot on the heels of the insolvent companies, would come their bankrupt directors and principal officers. Too pessimistic a scenario? Perhaps. Nevertheless a possible reality. One wonders whether this is a step in the right direction when vigorous efforts are being made to attract foreign investment and MNC's to set up shop in Malaysia. In the interest of commerce, if nothing else, this is undoubtedly, a huge step backwards.

The Author: Gurbachan Singh is a senior partner specialising in revenue law matters in the law firm of M/s Khattar Wong & Partners. He is the Head of the Tax Department. He has been involved in tax work for about 25 years. In 1977, he was appointed a State Counsel and Legal Officer in the Inland Revenue Department and later served as a Judicial Officer in the Subordinate Courts until 1988. He has tutored at the National University of Singapore on a part-time basis and conducts Postgraduate Practice Law Course classes for the Board of Legal Education. He is the Honourary Tax Advisor to the Real Estate Developers' Association of Singapore (REDAS). Mr. Singh is also a Registered Trust and Estate Practitioner (TEP) and a member of the UK Society of Trust and Estate Practitioners. The nature of his work continuously engages him in income tax, property tax, estate duty, stamp duty, goods and services tax, trust, estate and probate cases. He has spoken at both local and international seminars on tax issues. The International Tax Review and Mondaq regard Mr. Singh as one of the leading tax advisers in Singapore.

The 2002 Budget

Appreciating the Strategies & Highlights of the Proposals

By Antony Tong

Each year, the annual Budget Speech is analysed by economists, research houses, bankers, investment analysts, accountants, tax professionals, politicians and the man-on-the-street. In trying to understand the "why" of a particular Budget proposal, the macro picture or the big picture is often forgotten or overlooked. For a better appreciation of the intent of a proposal, we need to return and focus on the strategies as announced in the Budget Speech.

Three Strategies

The 2002 Budget sets out the following three strategies that the Government has formulated to strengthen the economy of the country and it is within these strategies that the Budget proposals are grouped:

1. Strengthening the nation's economic growth through increased domestic expenditure, enhancing the role of the private sectors and increasing competitiveness;

2. Diversifying sources of growth through trade and domestic industrial activities without reducing the role of foreign direct investments as well as ensuring the continued expansion of the nation's exports; and

3. Ensuring equitable distribution of wealth between urban and rural areas, between high and low-income groups and between the more developed and less developed states.

The accompanying table shows the strategies and the relevant proposals for the implementation of that strategy, as announced by YAB Dato Seri Dr Mahathir Bin Mohamad, Prime Minister and Minister of Finance on 19 October 2001. These strategies were formulated in the light of increasingly difficult global economic outlook and greater challenges encountered as well as the need to address domestic issues. In an annual exercise, these broad-based budget strategies and macroeconomic targets are circularised in a call circular to all ministries and agencies by the Treasury each January. The circular requires these ministries and agencies to submit budget proposals for the following year to achieve these strategies. Then, the process of budget examination by the Treasury begins through the regular review of the progress of existing programmes and projects. New programmes and projects are also monitored to ensure that they comply with the broad strategies and criteria set out in the call circular. Invitations are also sent out to non-governmental bodies to elicit proposals for considerations by the Government. After elaborate consultation and reviews, the national consolidated budget is finalised and submitted to Parliament for approval in late October. Therefore, knowing what the Budget strategies are and how they were formulated will give us a better appreciation of the intent of the Budget proposals.

Table

Strategy 1

Strengthening the nation's economic growth through increased domestic expenditure, enhancing the role of the private sector and increasing competitiveness

1. Increasing public expenditure

> A fiscal stimulus of RM100.52 billion is allocated in the 2002 Budget. Higher Government expenditure will stimulate the economy.

2. Encouraging consumption

> To increase the disposable income of the rakyat, the individual tax rates for 2002 onwards will be reduced by 1-2% for all income bands. The maximum tax rate is reduced from 29% to 28%. The chargeable income subject to the maximum tax rate be increased from RM150,000 to RM250,000. The tax rate for cooperatives is reduced by 1% across the board while the rate for non-residents reduced to 28% from 29%.

3. Further stimulating the role of the private sector

> Reinvestment allowance period to be extended to 15 years from five years, to encourage existing investors to reinvest.

> Expenditure incurred by multinational companies in pioneering RosettaNet (internet based common order code) for the benefit of small and medium-scale companies gets income tax deduction.

4. Increasing competitiveness

To reduce the cost of doing businesses and increase global competitiveness in the face of AFTA-

> Hotels are entitled to industrial building allowance.

> Industrial building annual allowance be increased from 2% to 3%.

> Capital expenditure incurred in acquisition of building also entitled to 10% initial allowance.

2002 Budget Highlights

No cut in the corporate tax rate

It was widely expected but it never came, the 1% to 2% cut in the corporate tax rate of 28%. The Government's reason for not caving in to pressure was that Malaysia's rate is still competitive in comparison to many ASEAN and other developed countries. True, Malaysia's rate is one of the lower rates amongst Asian nations, lower than Thailand and Indonesia which stand at 30%, Philippines at 32%, China at 33% and India at 37.5%. The countries whose rates are lower than Malaysia are Hong Kong at 16%, Taiwan at 25% and Singapore at 25.5% (24.5% in YA 2002). But certainly during these times of economic slowdown, a cut would have the immediate effect of reducing business costs and thereby increasing after-tax corporate profits. This would have been a welcomed helping hand to businesses. In addition, the call for the cut was somewhat influenced by the fact that foreign direct investments have dropped substantially in Malaysia and in evaluating whether the nation is a favorable place to invest in, Malaysia's tax rate is an attractive factor to draw on diminishing available Foreign Direct Invesments (FDIs). The Government however, reiterated that factors other than the tax rate are equally important; i.e. the offerings of extensive tax incentives supported with liberalised equity ownership, foreign exchange and repatriation policies.

Cut in individual tax rate

What was given instead was a cut in the individual tax rates for 2002 onwards by 1% to 2% in all income bands. The maximum tax rate was also reduced from 29% to 28% to be in line with the corporate tax rate and the chargeable income subject to the maximum tax rate was increased from RM150,000 to RM250,000. Indeed next year, individuals earning less than RM2,400 a month are exempted from paying income tax. Previously, the minimum monthly income eligible for income tax was RM2,301. This proposal will cost the Government RM873 million in revenue, which is the amount of disposable income that will be placed in the hands of the public to spend and stimulate economic activities and contribute towards GDP growth. However, given the uncertain and sluggish economic situation in the country and an expectation that things will cost more next year (the day after Budget Day, the price of petrol went up by 10 cents per litre), there are doubts whether these various disposable income-boosting measures like those introduced by the Government over the past 12 months; i.e. higher tax rebates for individuals, reduction of employees' contribution to the EPF as well as the removal of the RM50 charge on credit cards will result in higher consumer spending. What will probably happen is that the excess money will most likely be saved, rather than spent.

Extension of reinvestment allowance

Rather than banking on FDIs for investment growth, the Government's move to extend the eligibility period of the reinvestment allowance from 5 to 15 years may be far more effective in stimulating private sector investments than a reduction in the corporate tax ratecut. This move was widely lauded by all as a right step in encouraging reinvestment at home. Persuading existing investors in Malaysia to step up their productive capacity with a tax incentive is perhaps easier than attracting foreign investors, which in any case have all but become a trickle in the region. On a related matter, whilst the extension in the eligibility period is welcomed, the fact that it is now given for 15 consecutive years of assessment means that other incentives that are mutually exclusive cannot be claimed during the same 15-years' period. This can be tax disadvantageous in certain circumstances for instance, a manufacturing company with substantial exports. For the remaining years after its reinvestment (within the 15-years' period), it cannot claim the incentive granted by the *Income Tax (Allowance for Increased Exports) Rules 1999*.

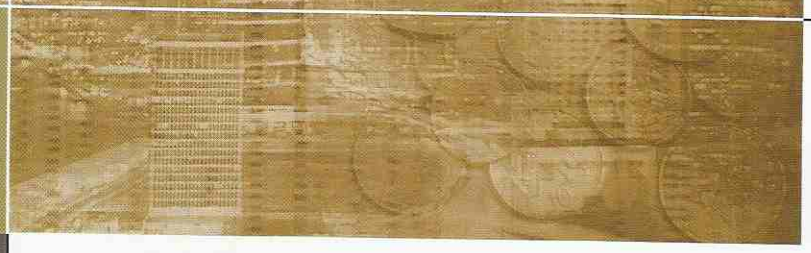
- Income received by non-residents from renting containers to shipping companies in Malaysia be exempted from income tax.
- Annual deduction on expenses incurred in acquiring proprietary rights such as patents, industrial designs and trade marks be increased from 10% to 20% for a period of five years.
- Expenditure incurred by any person in providing practical training to individuals who are not their employees be given deduction for purposes of income tax.
- Restriction on bonus abolished.
- Statutory income from subscription fees of trade associations be exempted from income tax.
- Smart cards and its related equipment be given sales tax exemption.
- Tax on income derived from offshore trading through websites in Malaysia be reduced from 28% to 10% for a period of five years.
- Cost incurred in the development of websites for business be granted an annual deduction of 20% for a period of five years.
- Listed companies with unsatisfactory financial position or with issued capital below the minimum threshold, are given an extension up to December 2002 to comply with the listing requirements of the KLSE.

Strategy 2

Diversifying sources of growth through trade and domestic industrial activities without reducing the role of foreign direct investment as well as ensuring the continued expansion of the nation's exports

1. Manufacturing sector

- Income tax exemption for companies in the production of machine tools, plastic injection machines, material handling equipment, robotic and factory automation equipment and parts and components be increased for Pioneer Status and Investment Tax Allowance to 100%.
- For companies which manufacture machinery and other equipment such as fabricated cranes, the value-added criteria for the purpose of granting the 70% Pioneer Status or 60% Investment Tax Allowance be reduced from 30% to 20%.
- Advertising cost for Malaysian brand names registered overseas and professional fees paid to Malaysian brand management companies be given double deduction for purposes of income tax.



Bonus restriction removed

Among the proposals introduced to increase the competitiveness of domestic businesses and reduce costs is the removal of the restriction on bonus. Previously, any bonus paid in excess of two-twelfths of an employee's salary is disallowed as a tax deduction for the employer. This removal will encourage efficiency and productivity as it enables employers to reward deserving employees based on performance without the penalty of a tax disallowance. However well received, the timing of the removal may not have its desired effect as in this climate of downsizing, lay-offs and VSS, we seldom hear of companies giving more than a two-months' bonus to their employees. Employers may also use the excuse of "bad times to come" not to pay higher bonuses to deserving employees. Nonetheless, this removal eliminates the difficulty of defining what is "bonus" as this includes certain types of commission, discretionary and gratuitous payments linked to performance and profits. Under self-assessment, the removal of bonus restriction simplifies the process for accountants and tax practitioners.

Exemptions from withholding tax ("WHT")

The 2002 Budget also saw the exemption from withholding tax for the rental of ISO containers (10% WHT under sec. 109B(1)(c) of the *ITA 1967*) and payments of royalty for franchised education schemes (10% WHT under sec. 109 of the *ITA 1967*). The rationale for these exemptions is to reduce the cost of doing such businesses in Malaysia. This shows that whilst WHT is a tax liability of the non-resident recipients, they continue to pass the WHT cost to the payer, a practice that is commonly encouraged in Malaysia. Companies which re-gross the payment to factor in the WHT would not get a tax deduction as the Special Commissioners in the Esso case have ruled that the WHT portion borne by the Malaysian taxpayer was a tax, and not an expense. Therefore as a tax, it was not deductible under sec. 33(1) of the *ITA 1967*.

Boost for tourism

In the aftermath of the September 11 tragedy, concerns about the safety of air travel resulted in the worldwide decline of inbound tourist arrivals. For Malaysia, tourism represents high foreign exchange earnings and potential growth as Malaysia is an attractive tourist destination and has the advantage of offering one of the cheapest room rates in the region, coupled with varied local destinations as well as affordable shopping and sporting activities. Up to August 2001, a total of 9.5 million tourists visited Malaysia, an increase of 44.1% (2000: 40.4%). To promote tourism, the Government has extended by another five years to year of assessment 2006 the incentives for tour operators for tax exemption on income derived from the business of operating domestic tour packages that brings in at least 1,200 local tourists per year and tax exemption on income derived from the business of operating group tours that brings in at least 500 foreign tourists per year. There is also now a 100% tax exemption on statutory income granted to activities related to the organisation of international trade exhibitions. To encourage affordable hotel room rates, hotels that are registered with the Ministry of Culture, Arts and Tourism now qualify for industrial building allowances. Hotels that are not four-star or five-star and do not qualify for pioneer or investment tax allowance can now enjoy industrial building allowances. During the second quarter of 2001, the occupancy of three-star hotels increased to 50.2% (second quarter 2000: 46.7%). And to promote the rental of our national cars by tourists, car rental operators are exempted from excise duties on the purchase of national cars.

2. Agriculture sector

> Reinvestment in food production activities undertaken by existing companies be granted 100% income tax exemption of statutory income for a period of five years.

> Capital expenditure for food production incurred for agricultural projects such as vegetable and herb farming, breeding of fish including ornamental fish, cockles and oysters be given 100% deduction against aggregate income.

> Rearing of chicken and ducks in the Eastern Corridor of Peninsular Malaysia, Sabah and Sarawak be granted Pioneer Status with income tax exemption of 85% or Investment Tax Allowance of 80% for a period of five years.

> Companies that reinvest in the production of resource-based products be granted income tax exemption of 70% or Investment Tax Allowance of 60% for a period of five years.

3. Services sector

> Income from rental of luxury yachts and motorboats be exempted from tax for a period of five years.

> Import duty on luxury motorcycles be reduced from 120% to 60%.

> Import duty on other motorcycles be reduced from between 80% and 100% to 60%.

> Foreign and local tourism businesses' exemption be extended for another five years.

> Car rental operators be granted excise duty exemption on purchase of national cars.

> All private institutions of higher learning and private language institutions be granted exemptions on import duty, excise duty and sales tax on educational equipment, including laboratory fittings, workshops studios and language labs.

> Royalty payments received by non-residents from private institutions of higher learning for franchised educational schemes be exempted from income tax.

> Higher value-added manufacturing activities such as logistics services, integrated market support services and also utility services centers be given either income tax exemption of 70% against statutory income for a period of five years or income tax exemption of 85% against statutory income for a period of five years for projects located in the Eastern Corridor of Peninsular Malaysia, Sabah and Sarawak and import duty and sales tax exemptions on equipment.

Alarming Section 75 of the Income Tax Act 1967

Amidst all the tax incentives and reductions, there were also some unwelcomed proposals. Perhaps the most alarming aspect of the 2002 Budget was something seemingly innocuous and quietly slipped in through the *Finance Bill 2001* as clause 6 entitled "Amendment to section 75". This amendment to sec. 75(1) of the *Income Tax Act 1967* seems to pave the way to give power to the authorities to now demand unpaid corporate taxes from a company's principal officers, personally, where the company fails to settle its taxes. The Explanatory Statement to the Bill unfortunately did not shed any further light to the intention of the amendment but guidance can be gleaned from Australia's sec. 8Y of its *Taxation Administration Act 1953*. The effect of sec. 8Y is to deem an officer of a corporation as committing a taxation offence where the corporation commits the taxation offence. Unpaid taxes of the corporation also constitute a taxation offence for which the officer can be deemed personally liable to settle. It will be helpful if the Malaysian Revenue authorities respond quickly to either allay or confirm the fears of directors and principal officers over this new amendment. Perhaps some clarification like what was done via *Public Ruling No 8/2000 "Wilful Evasion of Tax and Related Offences"* dated 30 December 2000 to explain sec. 114(1A) of the *ITA 1967*, would be of assistance.

Closing a loophole in reinvestment allowance (RA)

Also in the *Finance Bill 2001*, an anti-avoidance provision was introduced without any fanfare as the new para. 1B to sch. 7A, effective from YA 2002 and subsequent years. Paragraph 1B prevents a company from taking undue advantage of a claim for RA where assets are transferred in a "controlled transfer" situation where at the time of the acquisition:

a) The acquirer of the asset is a person over whom the disposer of the asset has control;
b) The disposer of the asset is a person over whom the acquirer of the asset has control;
c) Some other person has control over the acquirer and disposer of the asset; or
d) The acquisition is effected in consequence of a scheme of reconstruction or amalgamation of companies.

How this new paragraph works is to grant RA for the acquirer based on the tax written down value of the assets acquired from the disposer. Prior to YA 2002, the acquirer could claim RA based on the price paid for the assets though the disposer has very little remaining tax written down value (TWDV) on the same assets. This then resulted in a second round of RA on the same assets.

Conclusion

On 6 December 2001, the *Finance Bill 2001* was tabled before Parliament by the Deputy Finance Minister, Datuk Chan Kong Choy. But even before year 2001 comes to an end, the Government has already proactively taken steps such as announcing the availability of RM100,000 grants for companies in the electrical and electronic sectors under the RM5 million fund given to the RosettaNet initiative. Another welcomed step was the recent move by the authorities' to allow property developers to issue bonds and ease the granting of bridging loans and financial options by banks to these developers.

An encouraging piece of news from the Government is that FDI inflows have started to increase again, rising by RM3.8 billion in the third quarter of 2001 - the first increase in FDIs since early 2000. In the new year, we can indeed expect to see in the succeeding months, the Government implementing the 2002 Budget proposals to achieve the specific national strategies.

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4. Enhancing exports

> Malaysian trading companies that are approved as international trading companies be granted income tax exemption equivalent to 10% of the increased export value

> Income tax exemption for companies engaged in the export of services be increased from 10% to 50% of the increase in export value

> Income tax exemption be given to organisers of international trade exhibitions which attract at least 500 foreign visitors per year

> Double deduction for income tax be extended to other expenses incurred in promoting exports of goods and services, such as participation in virtual trade shows and expenses incurred on feasibility studies for participation in overseas tenders.

> Single deduction for income tax be allowed on expenses incurred in registering patent overseas and on hotel accommodation provided for potential importers of Malaysian goods.

Strategy 3

Ensuring the Equitable Distribution of Income between Urban and Rural Areas, between High and Low Income Earners as well as between the more developed and less developed States

> Widows will continue to receive their late husband's pension even if they re-marry

> The Government will provide a matching ringgit for ringgit grant for sums raised by voluntary non-governmental organisations to step up activities in AIDS prevention and drug abuse as well as the HOSPIS programme for treating serious cancer patients, up to a maximum of 1 million ringgit

> Import duty on cigarettes be increased from 180 ringgit per kilogramme to 216 ringgit per kilogramme while excise duty be increased from 40 ringgit per kilogramme to 48 ringgit per kilogramme.

> Service tax threshold for restaurants, bars, snack bars and coffee houses, private clubs and advertising companies be reduced from an annual sales turnover of RM500,000 to RM300,000

> Service tax threshold on professional services be reduced from an annual sales turnover of RM300,000 to RM150,000

SOUTHERN TAX CONFERENCE 2002

Self Assessment: Towards Better Compliance

24 January 2002, Thursday, The Puteri Pan Pacific, Johor Bahru

VISION

Following from the successes of the National Tax Conference 2001 in KL and the Northern Tax Conference 2001 in Penang, the Lembaga Hasil Dalam Negeri (LHDN) and the Malaysian Institute of Taxation (MIT) are proud to organise the first ever, Southern Tax Conference (STC) 2002 in Johor Bahru.

The STC is expected to be officiated by the Deputy Minister of Finance.

This will be followed by a panel discussion on "Managing Self Assessment". A senior LHDN officer is expected to touch on a myriad of operational issues, including the role and purpose of the Pusat Pemprosesan in KL. While, an established practitioner is expected to speak on the paradigm shift in the responsibility and obligation of a taxpayer, tax agent and LHDN officer.

The second panel will focus on the roles of tax agent, taxpayer and LHDN officer. To add flavour to the discussion, the LHDN officer will speak on the role of a tax agent and taxpayer whereas, the practitioner will instead address the issue of the role of the LHDN officer. It is hoped that this exchange of "roles" will shed light on the prevailing misconceptions and misunderstandings between officer and the person under the self assessment.

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- To address issues of the LHDN's experience and taxpayers' concern
- To identify and understand how the current tax issues will impact taxpayers in the near future

LHDN MALAYSIA

Jointly organised by:

Malaysian Institute Of Taxation

PROGRAMME OUTLINE

Registration and arrival of guests		
Welcome address	:	Encik Ahmad Mustapha Ghazali President of Malaysian Institute of Taxation
Opening address	:	Yg. Bhg. Dato' Zainol Abidin bin Abd. Rashid Director General of the Inland Revenue Board
Keynote address by Guest of Honour	:	**Yg. Bhg. Dato' Chan Kong Choy Deputy Minister of Finance, Malaysia**
Panel One	:	**Managing Self Assessment**
Chairperson	:	Tuan Haji Ab. Rahim bin Abdullah
Speaker One	:	Encik Mohd. Saian bin Haji Ridzuan
Speaker Two	:	Encik M. Selveindran
Panel Two	:	**Playing It Right Under Self Assessment**
Chairperson	:	Encik Tony Seah
Speaker One	:	Puan Ng Oi Leng
Speaker Two	:	Encik Ronnie Lim
Panel Three	:	**The Next Leap Forward**
Chairperson	:	Tuan Haji Abdul Hamid bin Mohd Hassan
Speaker One	:	**Yg. Bhg. Dato' Zainol Abidin bin Abd. Rashi**
Speaker Two	:	Encik Michael Loh

WHO SHOULD ATTEND

Tax Agents, Tax Practitioners, Accountants Academicians, CEO / Directors / Senior Managers, Company Secretaries, Bankers, Financial Planners, Advocators & Solicitors. Person in commerce interested in or concerned with taxation matters in Malaysia.

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Registration Form

* ☐ MIT member only **(on or before 10 Jan 2002)**	RM 250
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- The Need for Restructuring
- The Objective of Restructuring
- Types of Restructuring
- Competing Interests
- National Interest
- Corporate Debt Restructuring Committee

Legal Issues in Restructuring

Presented by: Ms. Chen Lee Won,
Advocate & Solicitor, Shearn Delamore & Co

- Form of Restructuring
- Restructuring Plan
- Appointing the Advisors
- Restructuring Documentation
- Legal Issues in Restructuring
- Due Diligence
- Implementation and Completion

Pre & Post Restructuring Some Taxation Issues

Presented by: Mr. Anand Raj,
Advocate & Solicitor, Shearn Delamore & Co

- Tar Due Diligence — legal issues
- Income Tax — considerations and concerns
- Real Property Gains Tax — considerations and concerns
- Service Tax — inter company transactions
- Stamp Duty — applicability and exemptions

Pre & Post Restructuring Some Employment Law Issues

Presented by: Mr. Vijayan Venugopal,
Advocate & Solicitor, Shearn Delamore & Co

- Reorganization of Staff Upon Restructuring
- The Need to Retrench - legal considerations
- Selection of Employees for Retrenchment
- Termination Benefits Upon Retenchment
- Challenges to the Retrenchment of Staff
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- ❑ Junior

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- ❑ (48) Telecommunications
- ❑ (60) Financial & Accounting services
- ❑ (64) Insurance
- ❑ (65) Real Estate
- ❑ (67) Consultancy
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- ❑ (81) Legal Services
- ❑ (82) Education Services
- ❑ (86) Associations
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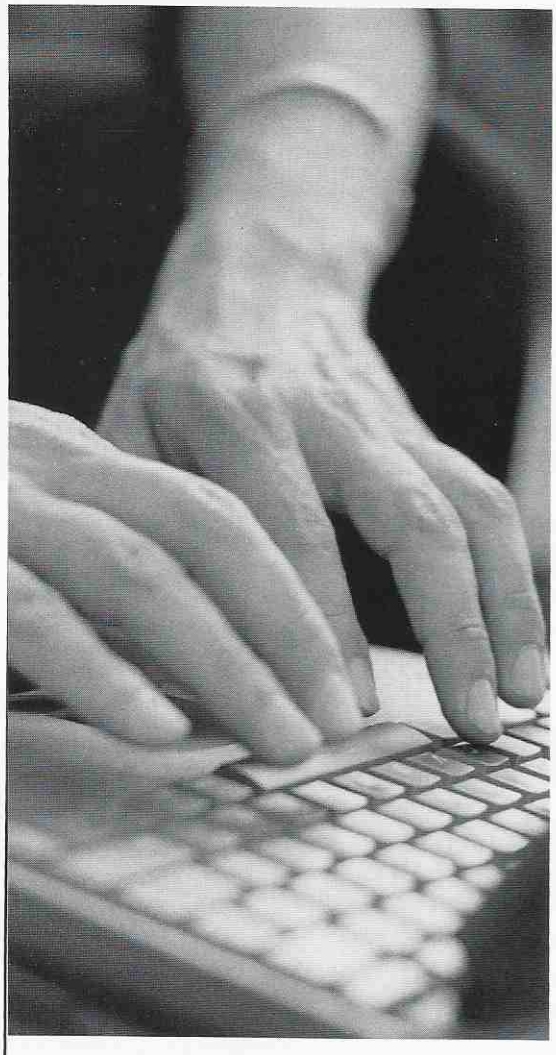
Taxation of cyberspace trading

and its impact on Malaysian business

By
Dr Jeyapalan Kasipillai



Cyberspace trading has the potential of being one of the most outstanding innovations of the twenty-first century and Revenue authorities have a role to play in utilising this potential. "Cyberspace" is the term used to describe the amorphous place where the Internet, the World Wide Web and other instruments of communication technology, such as e-mail, operate. Advanced information technology has the ability to dismantle national borders and to alter the face of domestic and international trade. Consequently, on-line transactions pose some of the biggest problems to the government in their efforts to collect taxes. The problems arise as a business can now engage in cyberspace trade without having a physical presence: the virtual corporation concept is way beyond what was imagined during the formative stages of present day tax laws. Furthermore, cyberspace trading creates opportunities by removing barriers of time and space. The most common perceived benefit of cyberspace trade is that it provides for expanded geographical coverage. Enterprises are currently exploiting these advantages to rationalize their supply chains and register more direct relationships with their end users, providing better customer service, offering self-tailored products and a shorter time to market. Revenue authorities in various countries such as Australia, Singapore, UK and the US are making efforts to ensure that tax laws do not lag too far behind the progress made in trade practices as well as new developments in electronic payment systems. The terms "electronic commerce" and "internet trade" are often used interchangeably with cyberspace trading.

Currently, the taxation principles that guide governments in relation to conventional commerce also guide them in relation to electronic commerce. This is also true in the case of Malaysia. However, with the tremendous growth in information and communication technology (ICT), it is uncertain as to whether existing taxation laws can be implemented effectively. While important issues remain unresolved and represent problems for the tax authorities, these uncertainties may also present opportunities for legitimate tax planning resulting in firms paying lower taxes in most or all the countries in which they operate.

Tax Structure

Economists generally split taxes into two broad classifications:

a) **Direct tax**
This is a tax which is paid directly by those on whom it is levied. Examples of Malaysian taxes are income tax, real property gains tax, estate duty and stamp duty. In the past, other direct taxes that were imposed included estate duty and film hire duty.

b) **Indirect tax**
This is a tax which is generally collected via some third party. An indirect tax is generally an addition to the price of a product or service and is collected by an intermediary who will then remit it to the tax authorities. Examples of indirect taxes are sales tax, service tax, excise duty, import and export duties and value added tax.

The Basis of Malaysian Taxation

The imposition of income tax in Malaysia depends as much on the establishment of sources and residence as on whether income has been derived, and if so, when and by whom. From an income tax compliance perspective, the question of who derives the income can be ascertained by tracing who owns the investment which generates the income. However, in cases involving transactions done electronically, ascertainment of who derives specific sales income will be problematic if a history of transactions is not kept. Furthermore, transactions may be made off-shore, making it difficult to enforce third-party information reporting.

The following section covers scope of charge, significance of residence status and classes of income.

i) **Scope of Charge**
The basis of taxation is the derived and remittance scope. Income of an individual is only assessed if it is derived in Malaysia or received in Malaysia from abroad. However, only income of a non-resident that is accrued in or derived from Malaysia is subject to tax. Foreign income received in Malaysia by resident companies are, however, excluded from the scope of taxation by virtue of the *Income Tax (Exemption) (No 48) Order 1977*. The exception to this rule is when a resident person carries on banking, insurance or air/sea transport operations. In such cases, the resident person carrying on such operations is assessable to tax on worldwide income even though the income is not received in Malaysia.

A summary of the scope of charge to income tax applicable in Malaysia is presented in Table 1.

ii) **Significance of Residence Status**
The residence status of individuals is determined under Sec. 7 of the *Income Tax Act 1967* ("the ITA"). In general, residence is determined by the number of days an individual is present in Malaysia, that is a quantitative test. This quantitative test determines whether an individual is:

- exempted from remittances of income from abroad, and
- entitled to personal reliefs.

Individual residents are granted personal reliefs and their income is taxed on scale rates ranging from 0 to 29 percent (0 to 28 percent with effect from year of assessment 2002) depending on their marginal income. Non-residents normally do not benefit from any of the personal reliefs and are taxed on a fixed rate of 29 percent (28 percent with effect from year of assessment 2002) on their taxable income

iii) **Classes of Income**
Income is categorised into various classes such as business, employment, interest, rent, discount, premium, pension, annuities, royalties and other gains. The classification, however, does not exhaust all the possible sources of income since there is a catch-all category, (Section 4(f) of the ITA) which includes all the incomes not elsewhere classified. In the case of other income, it should be noted that income should have the characteristics of one or more of the specific classes of income in order for it to be considered as the catch-all category and subjected to tax.

Need for Flexibility in Tax Law

Some of the cardinal principles of taxation dictate that there should be

Table 1 Scope of Charge to Income Tax

Scope of Charge	Territorial or Derived Basis	Derived and Remittance Basis	World Income Basis/Scope
Particulars			
Basis of Chargeability	Income accruing in or derived from Malaysia	Income accruing in or derived from Malaysia or received in Malaysia from abroad	Income wherever arising from carrying on the business of sea and air transport, Insurance and banking
Chargeable Person	Resident company (other than sea and air transport, insurance and banking company on that specific source of income) and non-resident person	Resident person (other than a company) of sea and air transport, insurance and banking	Resident company carrying on the business

Regional Update

> Thailand

Thailand initially took a bold step to grant tax-free status to cyberspace trade transactions in order to encourage internet activity. However, with Thailand's participation in the WTO, the government has repealed the tax-free status and commenced training its officials in cyberspace trade taxation with a view of prosecuting e-commerce tax evaders.

> India

In India, there is little guidance on cyberspace trade from tax authorities. It has, however. taken draconian tax measures on cyberspace trade transactions. As long as there is the "availability of work-station software installed in an Indian-based office", there is a persuasive likelihood for profits arising from cyberspace trade to be subject to income tax.

> Japan

In Japan, the National Tax Administration ("NTA") has yet to provide guidance on e-commerce taxation due to inherent difficulties in identifying parties to an e-commerce transaction and enforcing the record keeping requirements for such transactions (Owaki and Tamazawa, 1999). The NTA is, however, planning to tax e-commerce transactions at the time of payment to credit card companies for goods and services. These rules are expected to be implemented in 2002.

> Republic of South Korea

The South Korean government has to-date not imposed any customs duty on goods delivered on line (Famulak *et al., 1999*). In attempting to address some of the emerging e-commerce issues, the National Tax Administration (NTA) of South Korea has introduced the *Basic Act on Electronic Commerce and Signature Law (Jeong 1999).*

> Australia

Australia tends to adhere to a residence-based taxation for e-commerce transactions. According to Economist Intelligence E-Business (2001) rankings, Australia ranks second only to the United States as the country most conducive to Internet-based commerce. The proportion of medium-sized businesses in Australia with an enthusiastic Internet site increased from 56 percent in May 2000 to 67 percent by may 2001 (Layton, 2001).

> New Zealand and the UK

The New Zealand government has maintained the principle of tax neutrality and echoed the Organisation for Economic Co-operation and Development's ("OECD") call for a tax system that is both easy to comprehend and simple to manage. New Zealand adheres to a residence-based taxation for e-commerce transactions. The New Zealand Inland Revenue has issued guidelines for small businesses involved in cyberspace trade. The UK government has stressed that any taxation framework for e-commerce must not impose new taxes and must not impede the development of e-business.

> Hong Kong

The Hong Kong Government in its 1999/2000 Budget indicated its intention to develop the island into a Cyber-city. In this regard, the Hong Kong Society of Accountants established a WebTrust Committee in 2000 to explore the development of WebTrust service. The service is to provide assurance of control and security in a website and the transactions and throughput related to the site. Such a move would provide more confidence in electronic transactions entered into.

> Singapore

The Inland Revenue Authority of Singapore ("IRAS") has come out with specific guidelines as to how Goods and Services Tax ("GST") should be charged on electronic commerce transactions of physical goods as well as digitised goods and services. The GST is also known as Value Added Tax ("VAT"). GST is a tax on domestic consumption. It is charged on any supply of goods or services made in Singapore by a taxable person in the course or furtherance of any business carried on by a person. The present rate of GST is three (3) percent. All physical goods supplied over the internet attract GST if the supplier is a GST-registered person and the supply is made in Singapore. The principles guiding the charging of GST on e-commerce transactions is the same as that for traditional commerce. Therefore, as a GST-registered person, if one sells goods via the internet and the goods are delivered locally, the person is making a standard-rated supply and GST is chargeable at three (3) percent. Malaysia does not have a VAT system in place.

certainty in the interpretation of tax law, to ensure that the burden of tax is spread fairly and equitably among taxpayers and compliance costs should be as low as possible. More importantly, taxation systems should be flexible and dynamic so as to ensure they keep pace with technological and commercial developments. In cyberspace trade, enterprises encounter risk in the tax treatment of their methods employed to transact business. The risk element is partly due to the uncertainty in the application of the old principles to new technology. Simply put: the traditional tax structure was not designed to deal with new electronically-managed situations. For example, Malaysian tax laws like tax laws elsewhere were written much before the advent of e-commerce and do not address the unique issues raised by cyberspace trade.

The advent of cyberspace trading provides all businesses access to worldwide information. Using sophisticated information, businesses are given the opportunity to trade their products or services globally. Similarly, businesses engaged in cyberspace trading may be located anywhere in the world and their customers will be ignorant of, or indifferent to, their location. In this regard, the OECD Committee on Fiscal Affairs concluded that a web site cannot, in itself, constitute a permanent establishment (Anon, 2000). However, if the enterprise carrying on business through a web site has the server at its own disposal and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise

Nature of e-commerce

Cyberspace trade broadly encompasses two types of transactions:

i) sale of goods and services that are ordered electronically and delivered physically; and
ii) sale of digital products that are ordered and delivered electronically.

The general consensus among revenue officials and tax professionals in most countries is that the existing tax structure

can accommodate the former (see (i)) as it will meet compliance challenges in the normal course of business. There is a certain element of uncertainty in the latter (see(ii)) as it could result in a potential loss of tax revenue to the government. This uncertainty has aroused a policy debate at both domestic and international levels.

Policy Debate

Several policy issues pertaining to taxation of income derived from cyberspace trade has been debated at tax forums and seminar gatherings at an international level. The core issues are outlined here. Cyberspace trade would make it difficult to identify the country or countries that claim to have the jurisdiction to tax such income. Cyberspace trade enables foreign firms to do business with a host country from any jurisdiction. This is because the server used by the foreign supplier to engage in international business can be located anywhere. Additionally, classifying income from transactions in digitized information is problematic as information flow has no boundaries. As mentioned earlier, taxation systems in Malaysia and most other countries are traditionally based on the concept of source or residence. In a borderless world, business transactions are concluded without regard to physical or national frontiers. New challenges would arise in managing tax compliance due to a rise in transactions that leave little or no audit trail, particularly so, if it is done electronically. It would be difficult to trace the relevant parties to the communications and transactions made.

Concept of "Belonging in Singapore"

It is important to identify whether a business has a fixed establishment in Singapore so that the business would be considered as "belonging" to Singapore for tax purposes. A business entity such as a company or a partnership is considered as "belonging" to Singapore if the business establishment is in Singapore or it has a fixed establishment in Singapore. Situations may arise when a businessman may have more than one fixed establishment, that is, both in Singapore and elsewhere. In such a situation, a fixed establishment exists in the place where the services are most directly used or to be used. In the case of individuals, the person is treated as "belonging" to Singapore if Singapore is his or her usual place of residence.

Touching on the thorny issue of digitised transactions involving electronic transmissions, the IRAS has provided some broad guidelines. If a businessman has a Singapore address in a membership database (indicating that he is a regular business client), a Singapore domain name or a Singapore IP address, these are indications that he has a business in Singapore.

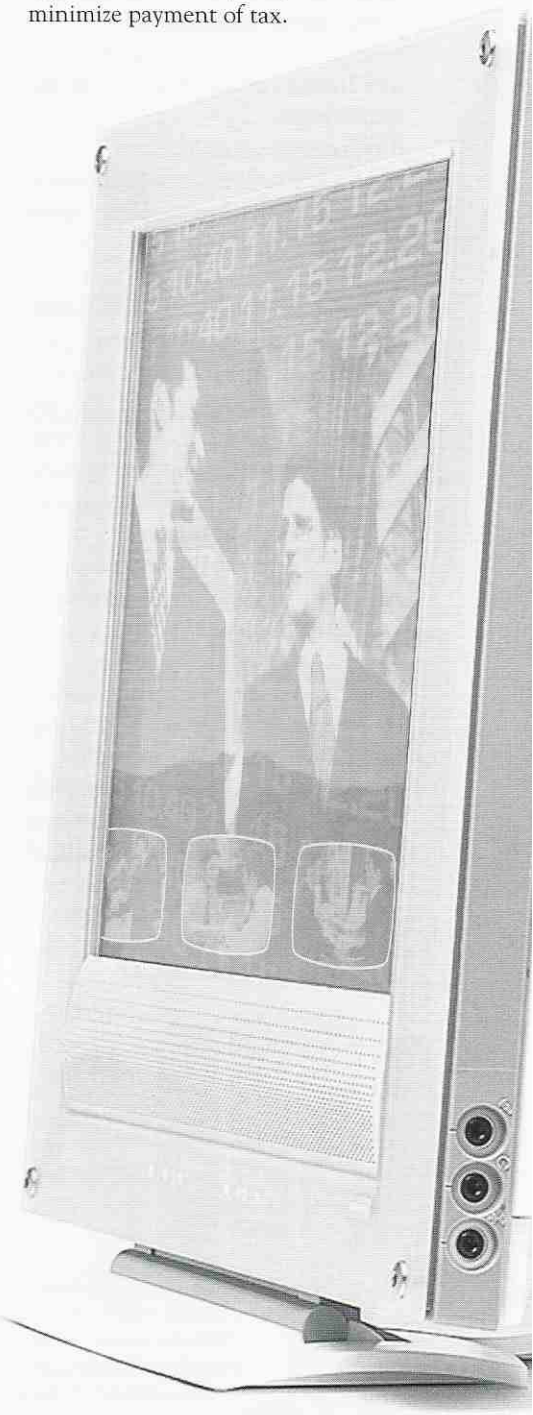
However, the following may indicate that a business client belongs to a country outside Singapore:

- address of the business entity as shown in the host membership database is outside Singapore; and
- domain name or IP address indicates that the business is a foreign establishment; and
- company gives a declaration, at the time of transaction, that the company is located outside Singapore; and
- any other information indicating that the client as "belonging" outside Singapore.

The Singapore government has also introduced a package of tax incentives, effective from year of assessment 1999, with a view of developing the island into a regional cyberspace trading hub. The new tax package is referred to as Approved Cyber Trader ("ACT") Program. A Singapore company that has been granted the ACT status will benefit from a low tax rate of 10 percent for a period of five years. Furthermore, there will be total exemption or marginal withholding taxes on payments which qualify for the ACT program.

Malaysia's Approach to Cyberspace Trade

The Inland Revenue Board (IRB) of Malaysia has not taken any concrete stand to tax income arising from cyberspace trade (e-commerce). It has taken a cautious move to adopt a common platform with other countries through participation in international forums such as OECD, APEC and WTO. The OECD Model Treaty provides a framework for determining general consensus relating to double taxation problems. The model serves as a framework that countries may use or modify to suit their needs in dealing with other countries. In the meantime, existing Malaysian taxation laws govern e-business transactions providing ample opportunities for cyberspace traders to minimize payment of tax.



In the 2002 Budget, the Malaysian Government proposed new incentives to promote the use of Information and Communication Technology (ICT) and accelerate the development of a knowledge-based economy. Patents, know-how, software, copyrights, trademarks and web-sites are a few examples of the expertise and other intellectual properties that serve to differentiate any enterprise in a competitive environment. The proposed incentives to encourage cyberspace trading are deliberated under the following sub-headings:

1. Tax Incentives for Offshore Trading via Websites;
2. Tax Incentives for the Implementation of *Rosettanet; and*
3. Deduction on Cost of Developing Websites.

- **Tax Incentives for Offshore Trading via Websites**

  Currently, an offshore company registered under the Offshore Companies Act 1990 carrying on an offshore trading activity for the basis period for a year of assessment can make an election to either pay tax on its audited accounts at a concessionary rate of three (3) percent or pay tax of RM20,000 for a year of assessment.

  It was proposed that income received by companies undertaking 'offshore trading', that is buying and selling of foreign goods to non-residents via websites in Malaysia be taxed at a concessionary rate of 10% (instead of 28%) for a period of five (5) years. The proposed effective date is 20 October 2001. The company must have the approval of the Minister of Finance. 'Offshore trading' is defined as buying and selling of foreign goods to non-residents.

  Income (after tax) that is distributed to shareholders would be further exempted from tax.

- **Tax Incentives for the Implementation of *Rosettanet***

  The term "*Rosettanet*" refers to the open Internet based common business messaging standard for the supply and management link-ups with global suppliers. The Income Tax Act (ITA) does not recognize capital expenditure for deduction purposes.

  The 2002 Budget has proposed that expenditure incurred on this system (*Rosettanet)* is to be considered a deductible item. Expenditures on equipment like computer and servers, salaries of full time staff or employees seconded to *Rosettanet Malaysia*, sharing of software and programming as well as training of staff of local small and medium scale companies to use *Rosettanet* will now qualify for a deduction with effective from year of assessment 2002.

- **Deduction on Cost of Developing Websites**

  The cost of setting up a website is a capital item and hence not a deductible expense. At the same time, these expenses are not treated as qualifying capital expenditure under sch. 3 ITA.

  Since this expenditure is closely tied up to the tax incentive for trading via websites in Malaysia, the 2002 Budget has proposed that an annual deduction of 20% be given for development costs of websites. Cost of developing a website includes cost of acquiring a domain name. The cost of maintaining a website is a revenue expenditure and hence deductible under sec. 33 ITA. The principal objective of this incentive is to encourage the usage of ICT as well as encourage cyberspace trading in Malaysia. The government is also promoting a knowledge-based economy through the use of electronic media. The amendment is effective from year of assessment 2002.

Recommendations

The Malaysian government too should formulate clear and simple rules for the taxation of electronic commerce so that businesses can anticipate, as far as possible, the tax consequences of the transactions they entered into. These rules should avoid incidence of double taxation. At the same time, the rules should be such that IRB should see to it that risks from increased evasion and avoidance are kept to a minimum. The principle objective should be such that the correct amount of tax is paid at the appropriate time and in the right country. In developing these rules, the guidelines need to be flexible to adopt to changes as more advances are made in the IT world.

The Ministry of Finance has to work closely with the IRB and the Royal Customs and Excise Department in the development of a Malaysian tax policy on electronic commerce. New legislation may be required on disclosure requirements to IRB such as furnishing e-mail and website addresses in the annual tax return as well as mandatory disclosure on gains from business transactions done electronically. It should also keep a close watch on the progress and strategies developed by neighboring and other advanced countries before initiating its own tax policy on cyber trade suited to our own tax structure. The main challenge for the IRB is to develop an e-business taxation system that is equitable to the government and the business community without impeding the advancement of cyberspace trade.

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Budget 2002 and the Service Tax

Service Tax In Malaysia – 25 years on

by A. Jeyaratnam

Malaysia was introduced to taxation on the consumption of services on 1 March, 1975 by way of the *Service Tax Act, 1975* ("STA"). The STA was introduced to positively effect the revenue collection on the provision of goods and services utilised by the growing tourism industry in Malaysia at that time. This is reflected in the types of businesses that were targeted for collection and remittance of the service tax, for example; hotels, restaurants, bars and nightclubs. From a review of the Parliamentary debates during the various readings of the *Service Tax Bill* (Bill) it is clear that the tax was intended to be a "luxury tax" and that the lower income groups were not to be subjected to such tax. The limited scope of the STA at its inception is reflected in the simple language used in the legislative provisions. The STA was designed to be a single stage tax collected at the point of sale and proved to be ideal for the cash based consumer transactions that were subjected to the tax. However, since its inception, the STA has evolved into a tax of a far wider scope whilst the mechanism for collection has remained that of a simplistic single stage consumption tax.

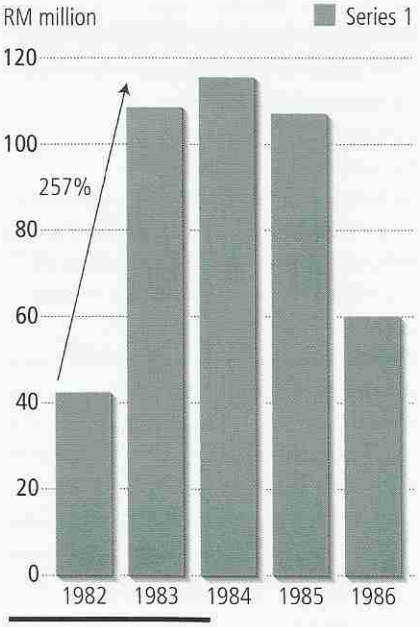
The Malaysian STA can be contrasted with the multi-stage consumption taxes common among most developed countries and also other Asean member states. In comparison, unlike the single stage service tax implemented in Malaysia, a multi-stage tax is levied at each stage of production or sale, with rebates for tax paid on inputs. These forms of taxation provide for the facilities to prevent double taxation whilst permitting a very broad base of transactions to be taxed. The net effect of a multi-stage tax is that the end consumer ultimately pays tax at the appropriate rate on final consumption with the Government's collection of tax occurring at various points along the value adding chain.

In this article we shall examine how service tax has evolved and whether it has outgrown the legislation that brought it to life.

THE EVOLUTION OF SERVICE TAX

Change in the *Rate* of Service Tax

When service tax was first introduced, the service tax rate was 5%. The rate was subsequently increased to 10% on 23 October, 1982 which led to an increase in the Government's collection of service tax by a massive 257% in a single year from RM42 million in 1982 to RM108 million in 1983 (as illustrated below).



Service Tax Revenue Collection

The service tax rate was reduced to the original rate of 5% on 26 October, 1985. This reduction may have been an effort to boost the ailing Malaysian economy caused by the prolonged world economic recession during the 1980's[1] and also to prevent international tourists from seeing Malaysia as an expensive holiday destination. The severity of the recession resulted in Malaysia's annual growth of real GDP falling by 34%, from 8.4% in the period 1974-1978 to 5.5% in the period 1979-1988.

Period	1957-1967	1968-1973	1974-1978	1979-1988	1989-1994	Average 1957-1994
Average annual growth rate of real GDP (%)	6.1	8.5	8.4	5.5	8.6	7.4

Table 1 | Economic Report, Ministry of Finance
Quarterly Economic Bulletin, Bank Negara Malaysia

The increase in the rate of service tax by 100% in 1982 proved to be very successful in the short run as the limited number of businesses subject to the tax simply collected a higher rate of service tax. This increase in revenue collection was not accompanied by an increase in the administrative costs to the business or the Government.

Widening the *Scope* of Service Tax

The service tax has seen significant expansion in its scope between the years 1992 and 1998. Between these years the Government broadened the tax base by including additional services within the scope of service tax under the Second Sch. of the *Service Tax Regulations, 1975* ("STR") :

- Effective from **1 January, 1992** a new category of "Prescribed Professional Establishments" was introduced to the STA. This change led to services provided by the "professions" such as Public Accountants, Advocates and Solicitors, Professional Engineers, Architects, Surveyors and Consultants being subject to service tax. The services provided by other "non-traditional professions" such as Forwarding Agents, Insurance Companies, Advertising Agencies and Private Hospitals were also included within this heading. At the same time services provided by Motor Vehicle Service and Repair Centres were also subject to service tax;

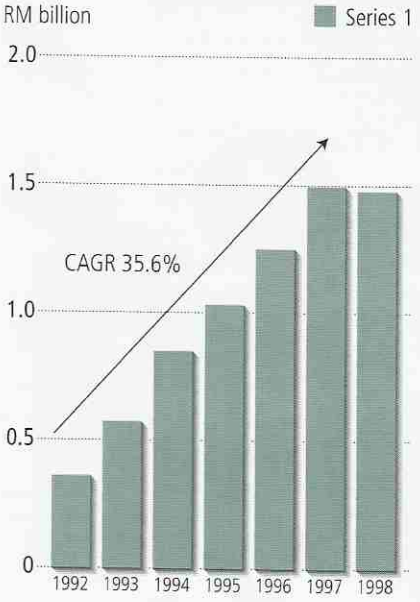
- Effective from **1 January, 1993** telecommunication service providers, private clubs providing sports and recreational services and those providing security guards and protection services became subject to service tax;

- Effective from **1 January, 1994** private dental clinics, private veterinary clinics, the provision of parking space for motor vehicles, and courier services became subject to service tax;

- Effective form **1 January, 1998** services provided by hire-and-drive and hire car companies, employment agencies and management service providers became subject to service tax.

The widening of the scope of service tax introduced in these years led to a substantial increase in revenue with a compounded annual growth rate (CAGR) of 35.6% between 1992 and 1997 (as illustrated in the graph below). The slight drop in 1998 can be explained by the beginning of the severe Asian economic crisis experienced at the end of 1997.

In addition to widening the scope of service tax, a concerted effort was also made to eliminate some of the administrative "loop holes" to prevent leakage of revenue. The concept of "prescribed establishment" and "prescribed professional establishment" was replaced by a wider concept of a 'taxable person'[2] (used in other multi-stage taxes) by the *Service Tax (Amendment) Act, 1999* effective from 1 January, 2000.



Service Tax Revenue Collection

[1] "During the period 1957 - 1994 the yearly average growth rate of real GDP was quite favourable, at about 7.4%. However, the prolonged world economic recession, which began in 1979 and continued into the early 1980s slowed down the Malaysian economy considerably during the mid 1980s. For example, real growth rate of GDP fell by 2.8% in 1985 and shrank further in the following year by 8.4%.

[2] Previously, a "prescribed service" could be linked to the relevant "prescribed establishment" or "precribed professional establishment" providing the service. With the introduction of the wider concept of "taxable service" and "taxable person", a "taxable person" is now linked to the provision of the "taxable services" contained within the same group.

The categorisation of 'taxable persons' and 'taxable services' into groups was meant to prevent service providers from splitting up their business activities in an effort to avoid breaching the relevant thresholds[3]. At the same time the wording of sec. 3 of the STA was amended to accommodate the changes in the Second Sch. of the STR. This grouping coupled with the amendments to the wording of sec. 3 of the STA meant that for the purposes of ascertaining when the qualifying threshold for service tax purposes had been breached, a taxable person would be assessed on all the taxable services provided within the same group.

It was noted in the readings of the Bill that the wording of sec. 3 had been adopted word for word from value added tax ("VAT") legislation, thereby raising concerns about the lack of provisions for the avoidance of double taxation provided in the service tax legislation and the question was asked whether the changes were indicative of a move towards a VAT type consumption tax being implemented.

If this trend of including more services within service tax continues, it would be a matter of time before almost every service provider would be required to be licenced for service tax. Instead of the service tax being limited to certain prescribed services, it would end up including nearly all service providers, similar to a Value Added Tax ("VAT") type system. The only difference being that the service tax would be single stage tax as opposed to a multi-stage tax system with its corresponding input tax credit mechanism.

The problem with a single stage tax is that by increasing the number of persons subject to service tax, the incidence of double taxation is set to increase. Double taxation commonly occurs when a taxable person providing a taxable service subcontracts or utilises the taxable services of another service provider. The subcontracted service, upon which service tax has already been paid, is included within the costing and invoicing of the initial service provider. The entire invoice presented to the end consumer for payment will be subject to service tax. This leads to the situation whereby the subcontracted service (and the service tax paid therein) will be subject to service tax again. Theoretically, this situation is easily avoided by the service provider listing the subcontracted or outsourced services as disbursements in the invoices presented to the ultimate consumer. The commercial reality is that many service providers face business difficulties in disclosing the value of services outsourced or subcontracted, thereby resulting in a situation wherein additional tax is borne either by the service provider or the consumer. This problem is avoided under a multi-stage tax system through the facility of claiming input credits.

The problem with a single stage tax is that by increasing the number of persons subject to service tax, the incidence of double taxation is set to increase.

The past practice of widening the service tax base can be seen as a conscious decision by the Government to reduce the reliance placed on a very narrow segment of the economy for service tax revenue collection. By widening the service tax base a more predictable source of revenue was created. This sudden and dramatic widening of the STA in the 1990's should be viewed in the light of the announcement made by the Minister of Finance in the Budget speeches of 1992[4] and 1994[5] championing a move toward a multi-stage broad based consumption tax in the form of a Sales and Services Tax (SST). Having looked at all the clues, it would be fair to say that the progressive widening of the scope of the STA during those years was a move towards preparing the Malaysian public for the introduction of a multi-stage broad based consumption tax.

THE CUSTOMS' INTERPRETATION OF THE SERVICE TAX LEGISLATION

An observation of the Customs' interpretation of the service tax legislation over the years reveals an increasingly broad view of the types of services subject to the tax. The services prescribed as "taxable services" in the *Service Tax Regulations, 1975* ("STR") are in many cases left undefined and has been left to the Customs Authorities to determine what services should be subject to service tax. This has led to uncertainty and confusion as to whether a particular service should be subject to service tax.

The problem associated with the Customs' interpretation is especially evident in determining what services fall within the definition of consultancy services and management services. In its interpretation of these commonly used terms, the Customs' seem to have taken the view that any services containing an element of consultancy or management, regardless of whether the services are ancillary or internal in nature, are chargeable to tax. This interpretation would in many cases lead to the situation whereby functions that are outsourced will be subject to service tax.

This inclusionary interpretation of the legislation by the Customs' was held by the High Court in the case of *Shell Sarawak Berhad & Anor v. Minister of Finance*[6] to be erroneous and contrary to the wording of the legislation. The High Court found that service tax and a VAT type tax were conceptually and schematically different. It held that Section 7[7] of the STA creates a restrictive charge to tax by way of an exclusionary scope of tax (i.e. all services are excluded from the ambit of the STA unless specifically included) whilst VAT type legislation creates a broader charge to tax by way of an inclusionary scope of tax.

[3] Hansard
[4] The 1993 Budget Siri Ucapan Penting, p24
[5] The 1994 Budget Siri Ucapan Penting, p12
[6] (2001) MSTC 3,851
[7] Section 7 Persons Chargeable to Tax – "Subject to this Act, service tax shall be charged on and paid by any taxable person who carries on business of providing taxable service referred to in section 3"

The court stated:

"Unlike VAT, service tax cannot apply to component activities of a business. Service tax can only apply where a specific business of providing a taxable or prescribed services is carried out".

Budget 2002

The Government's strategy towards service tax in the past has been to widen the categories of services subject to service tax. The approach announced in the 2002 Budget Speech is unprecedented in that it is the first time the service tax base will be broadened by lowering the qualifying threshold applicable to certain taxable persons from RM300,000 and RM500,000 to RM150,000 and RM300,000 respectively. An increase in revenue as evidenced in the Government's past practices could also have been achieved by either:

- increasing the service tax rate; or
- widening the tax base by increasing the scope of service tax.

The proposed lowering of the qualifying threshold will increase the number of persons required to be licenced for service tax purposes, and thus to charge and remit the 5% service tax. The Government is hoping that by doing so it will realise a corresponding increase in revenue. In addition to the forecasted increase in revenue, the problem of double taxation associated with a broad based single stage taxation system as mentioned earlier has been limited to the same category of services.

THE FUTURE OF SERVICE TAX

Since its introduction, service tax has become an increasingly important source of revenue for the Government and has experienced various changes. This reliance on service tax is set to increase for the following reasons:

The Increasing Importance of Indirect Taxes

Since 1985, there has been a trend towards increased dependence on indirect taxes; i.e. altering the tax mix[8]. The income tax rates of individuals have been reduced in stages from a high of between 6% and 55% in 1985 to the current rates of between 0% and 28%. The Government's fiscal strategy as announced in the 2002 Budget speech is to increase the purchasing power of the public by reducing personal income tax and thus relying on the multiplier effect to help the economy avert a full blown long term recession. The revenue foregone through lower direct taxation is compensated by a forecasted increase in indirect tax revenue collection.

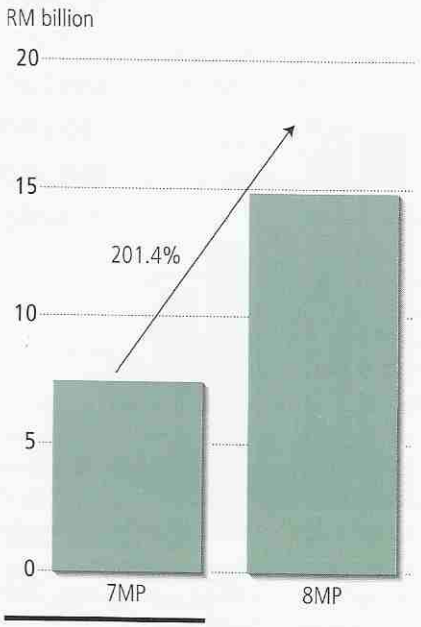
This strategy of increasing the spending power of the public to stimulate the country's economy and the shift towards greater indirect taxation is highlighted in the following extract from the 2002 Budget speech:

"...the reduction and abolition of tax proposals will result in a loss of Government revenue totaling 1.2 billion rinngit. At the same time, the Government has increased expenditure as a measure to stimulate domestic economic activities. Thus, the Government must seek other sources of revenue to strengthen its financial position... by proposing that the threshold... be lowered from 500 thousand ringgit to 300 thousand ringgit and above; and... the threshold of 300 thousand ringgit be reduced to 150 thousand ringgit..."

This shift towards a higher indirect taxation "tax mix" is a common trend seen around the world and has been adopted by Malaysia in the 8th Malaysia Plan where it is stated that:

"...direct taxes will continue to be a major contributor but its growth is expected to slow down in line with Government's efforts to provide a competitive tax structure to further improve the environment for doing business in Malaysia".

This increased reliance on service tax as a source of Revenue is quantified in the forecast of Revenue under the 8th Malaysia plan. Revenue under the 8th Malaysia plan (2000 to 2005) from service tax is expected to increase by 201.4% to RM14.73 billion in comparison to that earned under the 7th Malaysia plan (1995 to 2000) (see graph below).



Service Tax Revenue Collection under the 7th and 8th Malaysia Plans

[8] A tax mix is about changing the mix of direct and indirect taxes which can be achieved simply by changing the tax rates for each type of tax.
[9] The 1993 Budget Siri Ucapan Penting, p24
[10] The 1994 Budget Siri Ucapan Penting, p12

Lower Revenue Collection from Other Forms of Indirect Taxes such as Custom Duties

The forecasted growth in indirect taxes has to be viewed in line with the fact that revenue from certain indirect taxes, namely import duty, are set to fall.

In line with its commitments as a signatory to the General Agreement for Trade and Tariffs (GATT) and under the Common Effective Preferential Treatment (CEPT) Scheme within the Asean Free Trade Area (AFTA), Malaysia has implemented tariff reduction schedules and the easing of non-tariff barriers.

Under the CEPT Scheme, the tariffs for products traded between ASEAN member countries will be reduced to between 0% to 5% by January, 2003 for products with the required 40% ASEAN content (with the exception of motor vehicles, where implementation of the tariff reduction has been delayed until 2005).

The government will need to recover the shortfall in revenue from import duties (and sales tax). The Government is aiming for an increase in revenue collection from service tax by lowering the qualifying threshold for service tax. According to the 8th Malaysia Plan the contribution from service tax is expected to grow by 17.5% per annum, as illustrated in Table 2. The continued broadening of the scope of service tax over the years, including the recent lowering of the threshold, might be evidence of further preparatory steps being taken towards the eventual introduction of a multi-stage broad based consumption tax.

HAS THE TIME COME TO ADOPT A MULTI-STAGE BROAD BASED CONSUMPTION TAX?

The move toward a multi-stage broad based consumption tax in the form of a Sales and Services Tax (SST) was suggested by the Minister of Finance in the Budget speeches of 1992[9] and 1994[10]. The introduction of such a tax would require newly enacted legislation to enable the two separate and distinct forms of taxation to be combined into a single tax. To date, no further official announcement has been made on the proposed SST regime.

The Government has projected that revenue collection from sales tax and service tax will increase by some 282% in the year 2005 compared with revenue collected in the year 2000 (see Table 2), revenue from service tax and sales tax increasing by 295.5% and 223.8% respectively. This large increase in revenue forecasted, given the current economic climate would seemingly require significant changes in some of the following areas to achieve the projected growth rate:

- Increased enforcement which would require further expenditure by the Customs Authorities;
- Further widening of the service tax base;
- Continuing to lower the qualifying threshold for service tax (i.e. reduction of the RM300,000 qualifiying threshold); or
- Increasing the rates of sales tax and service tax.

As has been seen in the past, there are inherent difficulties associated with attempting to collect greater levels of revenue whilst utilising legislation that

FEDERAL GOVERNMENT REVENUE, 1995-2005

Source	RM million					Percentage of Total			Average annual growth rate %	
	Year 1995	Year 2000	Year 2005	Cumulative 7MP	Cumulative 8MP	1995	2000	2005	7 MP	8 MP
Direct taxes	22,699	29,156	37,166	142,702	171,669	44.5	47.1	41.3	5.1	5.0
Indirect taxes	**18,972**	**18,017**	**36,201**	**96,053**	**144,938**	**37.2**	**29.1**	**40.2**	**-1.0**	**15.0**
Export duties	853	1,032	908	4,419	5,003	1.7	1.7	1.0	3.9	-2.5
Sales tax	4,869	5,968	17,637	25,941	64,988	9.6	9.6	19.6	4.2	24.2
Service tax	**1,016**	**1,701**	**3,807**	**7,313**	**14,731**	**2.0**	**2.7**	**4.2**	**10.9**	**17.5**
Import duties	5,622	3,599	4,411	24,843	20,985	11.0	5.8	4.9	-8.5	4.2
Excise duties	5,280	3,803	6,018	23,956	25,622	10.4	6.1	6.7	-6.4	9.6
Other indirect taxes	1,332	1,914	3,421	9,580	13,969	2.6	3.1	3.8	7.5	12.3
Non-tax revenue	8,467	14,097	15,659	59,406	75,873	16.6	22.8	17.4	10.7	2.1
Non-revenue receipts	814	594	996	3,107	4,269	1.6	1.0	1.1	-6.1	10.9
Total revenue	**50,953**	**61,864**	**90,023**	**301,267**	**396,748**	**100.0**	**100.0**	**100.0**	**4.0**	**7.8**

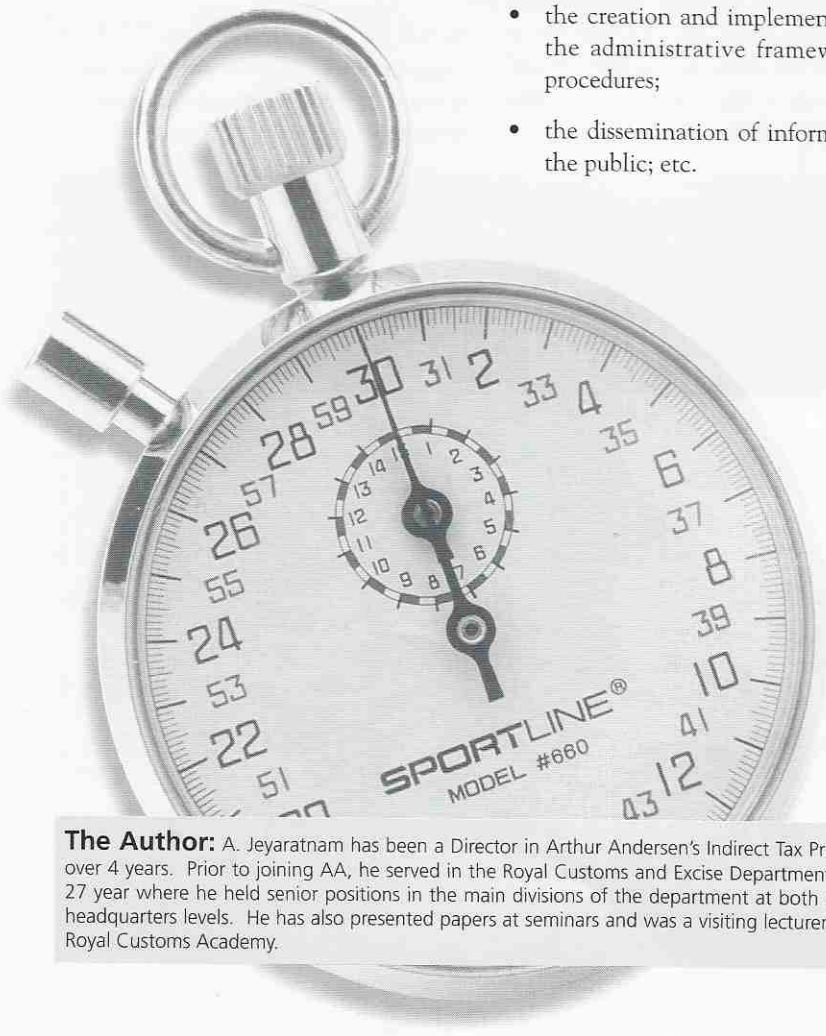
Table 2 | Source: 8th Malaysia Plan

was created to tax specific forms of transactions. The alternative would be for the Government to introduce a broad based multi-stage consumption tax, this would create a much wider base for revenue collection whilst at the same time avoiding the problems associated with a broad based single stage tax. Some of the advantages of introducing an SST would include:

- A single piece of legislation that could cover both the transaction for the supply of goods and services;
- Elimination of the ambiguity associated with the wording of the service tax legislation;
- Prevention or reduction of the incidence of double taxation;
- Elimination of the leakage of revenue caused by favourable pricing arrangements between parties; and
- A more equitable taxation, levied on a wider range of goods and services.

The implementation of an SST is not something that can be achieved overnight. As witnessed recently in Australia, the complexity of broad based multi-stage consumption tax would require a transition period to ensure its smooth and successful implementation which has been estimated to require a minimum period of 2 years. There are many issues that would have to be overcome before a SST could be implemented. Some of the issues to be resolved would include:

- the possible inflationary effects on the economy;
- the types of goods and services that should be exempt or zero rated;
- the training procedures for those implementing the administration and collection of the tax;
- the education of the general public;
- the appropriate rate of taxation to be levied;
- the creation and implementation of the administrative framework and procedures;
- the dissemination of information to the public; etc.



The Author: A. Jeyaratnam has been a Director in Arthur Andersen's Indirect Tax Practice for over 4 years. Prior to joining AA, he served in the Royal Customs and Excise Department for over 27 year where he held senior positions in the main divisions of the department at both state and headquarters levels. He has also presented papers at seminars and was a visiting lecturer with the Royal Customs Academy.

Conclusion

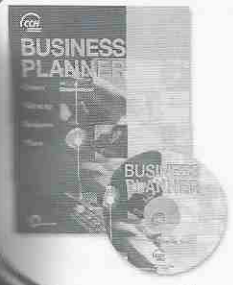
Since service tax was first introduced it has grown in scope and has, as stated earlier, become an increasingly important source of revenue for the government.

The recent amendments to the STA are in part based on the government's trend towards reduced dependence on direct taxes, to ensure that income which currently avoids or evades income tax bears some tax liability when it is spent and to counter balance, the effect of lower import duties.

The lowering of the threshold in the 2002 Budget will rope in many small cash based or "paperless" businesses, thus increasing the cost associated with administrating this tax.

The STA is starting to fray at the edges and it is merely a matter of time before it will need significant amendments or replacement by an entirely new piece of legislation. The question remains whether the amendments to the STR indicate the gradual adoption of a SST or merely the further delay. From a political standpoint, the indefinite postponement in the implementation of a SST in Malaysia is understandable given the initial cold reception received by the introduction of a VAT or Goods and Service Tax ("GST") as witnessed in Canada and Australia. As with the introduction of any new system of taxation, it is the initial stages that will be the hardest to bear. Having overcome the initial teething problems, the VAT or GST taxation systems have proven to work effectively and have continued to be implemented in 29 of the 30 OECD member countries with the exception of the US.

Unfortunately the Malaysian public has been given no clear indication as to when a SST will be introduced in Malaysia, we can only look to past trends and budget speeches to gain some insight on the Government's intentions.



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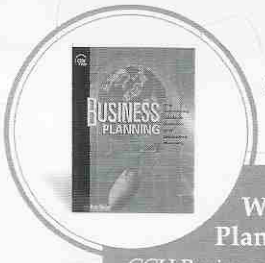

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Widening the service tax net

By Bong Sesh Chin

On 19 October 2001, the Prime Minister YAB Dato Seri Dr. Mahathir Mohamad, acting in the capacity of the Finance Minister, unveiled the Budget 2002. The Budget outlined three main strategies as follows:

- Strengthening the nation's economic growth;
- Diversifying sources of growth; and
- Ensuring equitable distribution of income between the urban and rural areas, between high and low income earners as well as between the more developed and less developed states.

In line with such strategies, the Finance Minister proposed reduction and abolishment of import duties on several selected goods, besides granting tax exemption to certain sectors such as the car rental operators, private institutions of higher learning, etc. This obviously resulted in the loss of government revenue.

Under such circumstances, in order to meet increasing expenditure, the government has to seek other sources of revenue to strengthen its financial position. In this regard, the Finance Minister proposed, among others, the following:

- Increasing the import duty and excise duty on cigarettes and other tobacco products; and
- Lowering the threshold for the imposition of service tax.

Present position

Currently, the service tax legislation prescribes three thresholds for the imposition of service tax:

RM150,000.00

This threshold is prescribed for the taxable persons as stipulated in subheading II of Group G, Second Schedule of the *Service Tax Regulations 1975*. The relevant service providers are as follows:

- forwarding agents licensed under the *Customs Act, 1967*;
- car park operators;
- courier services;
- motor vehicles service and repair centres;
- private agency licensed under the *Private Agencies Act, 1971*;
- provider of employment services.

RM300,000.00

The following service providers are subject to the threshold of RM300,000.00:

- Public Accountants registered under the relevant laws;
- *Advocates and Solicitors* registered under the relevant laws;
- Professional Engineers registered under the relevant laws;
- Architects registered under the relevant laws;
- Licensed or Registered Surveyors including Registered Valuers, Appraisers or Estate Agents licensed or registered under the relevant laws;
- Persons engaging in the provision of consultancy services;



Consumption tax has been highlighted as a source to increase government revenue and to achieve this, the tax base needs to be widened to bring more tax payers into the tax net.

- Operators of hire-and-drive car and hire car services;
- Providers of management services.

RM500,000.00

The threshold of RM500,000.00 is imposed on the following service providers:

- Restaurants, bars, snack bars, coffee houses;
- Food courts;
- Private clubs;
- Providers of advertising services;

The above service providers are required to be licensed under the *Service Tax Act, 1975* when their annual sales turnover of taxable services reaches the respective thresholds. However, there are also services, such as insurance services, telecommunication services that are not subject to any thresholds. Such services are subject to service tax regardless of the annual sales turnover.

Budget proposal

Consumption tax has been highlighted as a source to increase government revenue and to achieve this, the tax base needs to be widened to bring more tax payers into the tax net. In this regard, the Finance Minister announced, when tabling the Budget 2002, the review of threshold for the imposition of service tax. It is proposed that:

- Reduction of threshold for imposing service tax from an annual sales turnover of RM500,000.00 to RM300,000.00 for services provided by the following:
- restaurants, bars, snack bars, coffee houses, in hotels having 25 rooms or less;
- restaurants, bars, snack bars, coffee houses outside hotels, and food courts;
- private clubs; and
- advertising agencies.

Lowering of threshold for imposing service tax from an annual sales turnover of RM300,000.00 to RM150,000.00 for professional and consultancy services provided by accounting, legal, engineering, architectural, surveyor, consultancy firms and companies providing management services including project management and co-ordination services.

The proposal is effective from 1 January 2002.

Implementation

The proposal to lower the threshold for the imposition of service tax will be implemented from 1 January 2002. However, before such proposal may be implemented, it is imperative that the Second Sch. of the *Service Tax Regulations, 1975* be amended accordingly.

Meanwhile, the service providers affected by the proposal are required to apply for the service tax licence if the annual sales turnover of taxable services reaches or exceeds the proposed thresholds. In this case, the application shall be submitted to the senior officer of customs in charge of the district in which the place of business is located.

Determination of threshold

Thresholds are prescribed to determine whether a person carrying on the business of providing taxable services is liable to licensing under the *Service Tax Act, 1975*. In the case of a person already in the business of providing taxable services exceeding one year, the threshold is determined with reference to the annual sales turnover of taxable services for the preceding 12 months. As such, for the implementation of the proposal, the sales turnover of taxable services for the period 1 January 2001 to 31 December 2001 would be considered. If the sales turnover of taxable services for this period does not achieve the proposed thresholds (i.e. RM150,000.00 or RM300,000,00), it is not necessary to apply for a service tax licence until such a date when the threshold is reached in 2002. However, a person may apply to be licensed under the *Service Tax Act, 1975* under the sec. 8A even though the threshold has not been reached.

For a person who commences business of providing taxable services for less than 12 months on 31 December 2001, the threshold is determined with reference to the sales turnover of taxable services beginning from the date of commencement of business until 31 December 2001.

In practice, the Customs Department has adopted the "revolving 12-month method" to determine the annual sales turnover threshold. As such, persons who are not licensed as at 1 January 2002 by virtue of not reaching the threshold, should monitor the sales turnover. Application for service tax licence should be made immediately when the sales turnover of taxable services reaches the threshold, and not wait until the expiry of the 12-month period.

Impact on business

Spirit of the service tax

The *Service Tax Act 1975* was implemented in 1975 for the charging, levying and collecting of service tax. When service tax was first introduced, it was initially charged and levied on taxable services provided by or in the following establishment:

- hotels of 25 rooms or more;
- restaurants, bars, snack bars and coffee houses located in the hotel and those located outside the hotels having annual sales turnover of not less than RM500,000.00 of taxable services.
- private clubs having annual sales turnover of not less than RM500,000.00 of taxable services;
- Night clubs, dance halls and cabarets;
- Health centres and massage parlours.

Such establishments are generally patronised by tourists and affluent consumers. In this case, the principle of taxation, which emphasises on equity of tax, was adhered to where only the rich were taxed.

Following this, the prescribed threshold should instead be increased to take into consideration the rate of inflation. It would be interesting to consider the case of a restaurant. In 1975, a restaurant having an annual sales turnover of not less than RM500,000.00 was considered an expensive outlet and patronised by only the rich. It was therefore alright to tax services provided by such restaurant. However, with the increase of food prices over the years, most of the restaurants would now easily register an annual sales turnover of RM300,000.00 and therefore required to charge and levy tax, with effect from 1 January 2001, on the services for the sale of goods (foods, drinks). The customers, mostly from the working class who patronise such restaurants, would not be spared from the requirement of paying tax. In this connection, there is a deviation from the holy principle of equity of tax.

Cost of doing business

Once licensed under the *Service Tax Act 1975*, the taxable person shall comply with the requirements under the Service Tax legislation. Such requirements, among others, include the following:

- to levy and charge service tax on the provision of taxable services;
- to issue invoices and receipts to the customers, and state separately in the invoice and receipt the amount of service tax payable;
- to submit returns and pay the service tax to the Director General of Customs;
- to keep books of accounts and records with respect to the transactions relating to the provision of taxable services.

The requirement to comply with the service tax legislation would certainly translate into higher cost of doing business. The consequent increase in the cost of doing business would not be so significant in the case of the accounting, legal, engineering, architectural, surveyor, consultancy firms and management companies as most, if not all, of these companies already have proper accounting systems. In short, these companies are generally in a position to comply with the provisions under the service tax legislation.

However, the same cannot be said in the case of a restaurant. In practice, most of the restaurants do not have proper accounting system and, in most cases, do not issue invoices or receipts to customers. The requirement to issue receipt, for instance, on sale of a drink costing RM0.80 would greatly increase administrative work and the cost of doing business. It should be appreciated that this would have a severe impact on the restaurant operators, more so when the country is experiencing economic slowdown.

Burden to the consumers

The compliance cost would be imputed into the price of taxable services and, together with the service tax, be passed on to the consumers.

Come 1 January 2002, many companies providing professional services and food and beverage outlets would be charging and levying service tax. Consumers, regardless of rich or poor, would have to pay tax on taxable services consumed. The poor would be heavily burdened; currently they can choose to acquire taxable services, be it professional services or other services, from establishments not subject to service tax. With the amendments there will be very few establishments/professional services spared from charging service tax.

Conclusion

It is appreciated that the government needs to seek other sources of revenue in order to supplement the loss of revenue as a result of the reduction and abolishment of import duties on selected goods. In this case, the government chose to lower the threshold for imposition of service tax to widen the tax net. While the reduction of the respective thresholds leaves much to be desired, it should not be discounted that this reduction of the threshold is a step into the future, the imminent introduction of a new broad base value-added-type tax, ie the Sales and Service Tax (SST).

The Author: Mr. Bong Sesh Chin worked in the Customs Department from 1981 up to 1996. After which he took up employment with PW as a Senior Consultant for indirect taxes. Subsequently he and his partner set up Top Tier Services Sdn. Bhd. Currently he holds the position of Director and is involved in rendering consultancy services in indirect taxes.

Case Digest

Riders on life insurance policies constitute life business

THE TAXPAYER IS A FOREIGN COMPANY CARRYING ON ONSHORE INSURANCE IN LIFE AND GENERAL BUSINESS. THE TAXPAYER APPEALED TO THE SPECIAL COMMISSIONERS AGAINST NOTICES OF ASSESSMENT RAISED BY THE DIRECTOR GENERAL OF INLAND REVENUE ("D.G. OF I.R.") IN RESPECT OF YEARS OF ASSESSMENT 1988 TO 1994. THE ISSUES TO BE DETERMINED BY THE SPECIAL COMMISSIONERS WERE:

i) whether Riders were to be treated as part of the taxpayer's life insurance business or general business; and

ii) whether the International Data Centre (IDC) charges incurred by the taxpayer were deductible for tax purposes if withholding taxes are paid.

a) According to the *Insurance Act 1963*, premiums paid on life business are not taxed. Whereas premiums on general business are taxable. The D.G. of I.R. chose to treat Riders attached to the taxpayer's life policies as part of general business. The taxpayer contended otherwise. On appeal, the Special Commissioners were of the opinion that the D.G. of I.R. had no authority to disregard the character of Riders and that Riders were incidental to life business. Hence, they allowed the appeal in this respect.

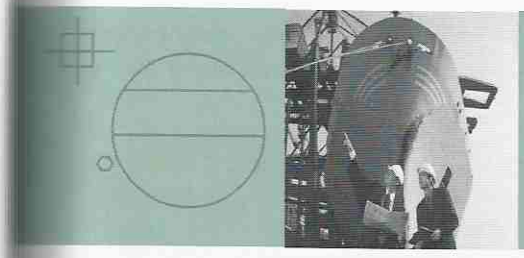
b) IDC is part of the taxpayer's head office in Hong Kong. IDC had entered into service agreements with the taxpayer for the provision of certain services, and these agreements provided for the deduction of withholding tax. The taxpayer did not deduct any such sums from the payments due to IDC.

The taxpayer sought deduction of IDC charges as expenses incurred wholly and exclusively in the production of income. The D.G. of I.R. disallowed the deduction on the ground that the IDC charges were subject to withholding tax, and no such deductions were made.

The Special Commissioners however, took the view that IDC services provided prior to and after the incorporation of IDC were identical; i.e. technical and specialised. As required by the service agreements, withholding tax ought to have been deducted from the payments due to IDC and the taxpayer had failed to do so. Therefore, this part of the appeal was dismissed.

Editorial Note: The D.G. of I.R. lodged an appeal to the High Court. The said appeal has since been withdrawn. The decision of the Special Commissioners will be published in the forthcoming issue of Malaysian & Singapore Tax Cases (MSTC).

A Ltd v. Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax, Malaysia
Appeal No. PKCP(R) 15/99
1 November 2000.



Income derived from shipment of cargo on feeder vessels neither owned nor chartered by the taxpayer is not taxable income.

THE TAXPAYER WAS A SHIPPING COMPANY BASED IN HONG KONG WITH ONLY AN AGENT IN MALAYSIA. CARGO FROM PENANG, PORT KLANG, KUCHING AND KOTA KINABALU WERE LOADED ONTO FEEDER VESSELS BEFORE BEING FORWARDED TO ANOTHER COUNTRY FOR TRANSSHIPMENT ONTO THE MOTHER VESSELS OWNED OR CHARTERED BY THE TAXPAYER, FOR ITS JOURNEY TO THE FINAL DESTINATION. Freight charges for the journey from Malaysian ports to the final destination were received and bills of lading bearing the taxpayer's logo were issued in Malaysia, bearing the names of the vessels carrying the cargo from Malaysia to its final destination. Neither the taxpayer nor its agent took up a major portion of space in any of the feeder vessels.

The D.G. of I.R. raised assessments on income purportedly derived from cargo loaded in Malaysia onto vessels said to be owned or chartered by the taxpayer. The taxpayer contended that the freight income was not taxable as the feeder vessels were neither owned nor chartered by them and appealed to the Special Commissioners.

The Special Commissioners held that the tax liability only arose where the cargo was loaded in Malaysia onto feeder vessels owned or chartered by the taxpayer and the taxpayer's act of booking space on the feeder vessels did not bring it within the meaning of the word "chartered".

The taxpayer's logo on the bills of lading only made the taxpayer the principal for the acts of its agent, in law, and did not render the taxpayer liable to pay tax on the said freight income.

OOCL v. Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax, Malaysia
Appeal No. PKCP(R) 69/99
16 May 2000. (2001) MSTC 3,367

Money received by a taxpayer on the conclusion of a sale and purchase of certain shares, which transaction he was not party to, was deemed a commission.

THE TAXPAYER WAS A BUSINESSMAN WHO HAD AN ANNUAL INCOME OF RM30,000.00 AND WHOSE ONLY FIXED ASSET WAS A HOUSE IN USJ. HE HAD ENTERED INTO NEGOTIATIONS TO PURCHASE THE CONTROLLING STAKE IN A PUBLIC LISTED COMPANY FOR RM77 MILLION. WHEN HE DISCOVERED THAT ANOTHER COMPANY WAS ATTEMPTING A REVERSE TAKE-OVER OF THE SAID PUBLIC LISTED COMPANY, HE TOOK OUT LEGAL PROCEEDINGS TO STOP THE SAME.

Subsequently, there was a settlement where a memorandum of understanding ("MOU") and a letter of undertaking were signed, in which a principal shareholder of the said company undertook to sell the block of shares to the taxpayer or such person directed. The MOU described the taxpayer as "agent for certain principals".

The taxpayer then assigned his right to purchase the said shares to the subsequent buyer for RM10,000.00. Having disposed of the shares to a third party, the subsequent buyer paid the taxpayer RM3.77 million several days later.

The Special Commissioners were asked to determine whether the RM3.77 million received by the taxpayer was a capital gain, which was taxable, or a commission, which was not.

The facts of the case indicate that the payment received by the taxpayer was commission for services rendered. In making this decision, the Special Commissioners took into account the fact that the taxpayer's background was such that he would not have been able to raise the money needed to purchase the block of shares.

Further, it was noted by the Special Commissioners that after assigning his right to purchase the block of shares to the subsequent buyer for RM10,000.00, the taxpayer no longer had any interest whatsoever in the sale and purchase of the shares as he was neither a shareholder nor a director. Therefore, the subsequent buyer had no reason to pay the taxpayer RM3.77 million unless it was commission for services rendered.

OKB v. Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax, Malaysia
Appeal No. PKCP(R) 95/99
29 June 2000. (2001) MSTC 3,374

Is a monetary award received pursuant to the compulsory acquisition of land a taxable gain?

THE TAXPAYER WAS IN THE BUSINESS OF CONSTRUCTING AND SELLING PROPERTY. IN 1981, THE GOVERNMENT ISSUED A NOTICE OF ACQUISITION IN RESPECT OF CERTAIN LOTS OF LAND OWNED BY THE TAXPAYER, BUT LATER WITHDREW THE NOTICE. IN 1982, THE TAXPAYER SUBMITTED PLANS TO BUILD FLATS AND A COMPLEX ON THE SAID LOTS, WHICH WERE CONSIDERED FIXED ASSETS IN THE TAXPAYER'S BOOKS AND CAPITALIZED IN 1982. THE TAXPAYER HAD NO DEVELOPER'S LICENCE FOR THE SAID LOTS AND WAS NOT A DEALER IN LAND. SUBSEQUENTLY, IN 1995 THE GOVERNMENT AGAIN GAVE NOTICE TO ACQUIRE THE SAID LOTS AND A SUM OF MONEY WAS AWARDED TO THE TAXPAYER AS COMPENSATION IN 1996.

The Special Commissioners were of the view that the said lots were stock in trade and disposal of the same led to a taxable gain.

The taxpayer appealed to the High Court. The High Court allowed the taxpayer's appeal and held that compulsory acquisition of the said lots were not disposal in the ordinary course of business. As such, the taxpayer could not be said to be trading in the said lots and intention to trade could not be inferred as the application was only at the contemplation stage.

Further, the application for development of the said lots was not conclusive evidence of an intention to trade in the said lots as it was made in 1982 to enhance the value of the said lots in the light of the Government's intention of acquisition.

Moreover, despite the application to develop the said lots, the taxpayer did not carry out any development and the taxpayer did not have a developer's licence nor was it a land dealer. In addition, the said lots were capitalized in 1980 and trading stock could never be capitalized.

PC Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri
High Court of Malaya, Kuala Lumpur (Appellate and Special Powers)
Civil Appeal No. R2-14-6-2000
22 March 2001. (2001) MSTC 3,866

The fate of income derived from non-charitable businesses

The Sabah Foundation ("SF"), established by the Sabah Foundation Enactement 1966, applied to the Director General of Inland Revenue ("D.G. of I.R.") for tax exemption under Sch. 6, item 13 of the *Income Tax Act 1967* on the ground that it is a charitable institution. By a letter dated 4.4.1998, the D.G. of I.R. refused to grant an exemption alleging that the SF was not established purely for charitable purposes and it had wide powers to engage in business. Following the D.G. of I.R.'s refusal, on 12.3.1999, SF applied to the High Court to quash the D.G. of I.R.'s decision.

The High Court held that the D.G. of I.R. had misconstrued the words, and accordingly its powers, under the relevant provision by concluding that SF was not eligible for tax exemption simply because SF has wide powers to engage in business that went beyond its charitable objects. The relevant provisions recognise that a charitable institution may engage in business that are not in pursuit of its charitable objectives but tax exemption would only be granted to cover business income derived from a business carried out in pursuit of its charitable purposes.

It was also held that the D.G. of I.R. had misdirected itself in law in holding that SF was not a charitable institution. Accordingly, SF's application was allowed and the application for tax exemption was remitted to the D.G. of I.R. for consideration in the light of this judgment.

Editorial Note : The decision of the High Court of Sabah & Sarawak will be published in the forthcoming issue of Malaysian & Singapore Tax Cases (MSTC).

BTSF v. Director General of Inland Revenue
High Court of Sabah & Sarawak, Kota Kinabalu
Originating Motion No. K7 of 1991
28 September 2001

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 (double-spaced, typed pages). They should be submitted in hardcopy and diskette (3.5 inches) form 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. For further information, please contact The Secretariat, Malaysian Institute of Taxation.

Case Note on EPM Inc. v. Ketua Pengarah Hasil Dalam Negeri

The taxpayer, registered in Malaysia as a branch of a foreign company, was in the business of exploration, development and production of petroleum. From 1986 to 1990, the taxpayer incurred costs pursuant to a restructuring exercise. The taxpayer also made payments to its various affiliates for services rendered, the terms of which required that the invoices relating thereto be paid in full. The taxpayer agreed to gross up the invoices concerned such that the service providers would receive the full amount of payment after deduction of withholding tax. The amount of tax withheld was then claimed by the taxpayer for deduction. Subsequent to a tax investigation conducted by the Director General of Inland Revenue in 1993, the taxpayer was served with and objected to the notices of additional assessments raised by the Director General of Inland Revenue (hereinafter referred to as "the Respondent") under the *Petroleum (Income Tax) Act 1967* (hereinafter referred to as "*PITA*").

Issues considered:

The issues before the Special Commissioners of Petroleum Income Tax ("SCIT") were:

1) whether the Respondent was correct in disallowing the deductions being withholding tax deduction and remitted to the Respondent and bringing this amount to charge as additional income ("Issue 1");
2) whether the Respondent is correct in treating all service charges paid by the taxpayer to its affiliates as falling/ within sec. 4A of the *Income Tax Act 1967* ("the Act") ("Issue 2");
3) whether the restructuring costs are deductible in the taxpayer's computation of the adjusted income pursuant to sec. 15(1) of the PITA ("Issue 3"); and
4) whether the Respondent is debarred from raising the assessments for Years of Assessment 1984 and 1985 by reason of sec. 39 of PITA ("Issue 4").

ISSUE 1 - Regrossing

Brief facts:

As outlined above, pursuant to contracts for services rendered by the taxpayer's overseas affiliates, payments made to affiliates for services rendered were paid in full to the affiliates, i.e. the total amount by which the taxpayer is invoiced was required to be increased so that the net amount payable was equal to what the affiliate would have invoiced the taxpayer had there been no requirement to withhold tax.

Accordingly, where, for example, the quantum of the charge rendered is RM100.00, the affiliate would bill RM117.60 in settlement of the bill; the taxpayer would pay RM100.00 to the affiliate and withhold and remit RM17.60 (15% of RM117.60, assuming that the rate of withholding tax is 15%) to the Respondent.

Subsequently, the taxpayer would claim the RM17.60 as deduction for out-goings and expenses in addition to the RM100.00 as cost for the services received by the taxpayer under sec. 15(1) of *PITA*.

Decision of SCIT:

The SCIT distinguished *Commissioner of Taxation v. Century Yuasa Batteries Pty Ltd* (1998) 269 FCA, and applied the Australian High Court case of *David Securities Pty Ltd v. Commonwealth Bank of Australia* (1992) 175 CLR 353 which declared "grossing-up" to be void and held that:

1) there was a clear breach of sections 107A, 109 and 109B of the Act; and
2) withholding tax does not qualify for deductions under sec. 15(1) of *PITA* by virtue of sec. 18(1)(h) of *PITA*.

The grounds for the SCIT's decision were:

- *PITA* and the Act shows no basis or provision for grossing up;
- A strict interpretation of sections 107A, 109 and 109B of the Act requires that tax be deducted from the "contract payment" the actual amount of "interest" or "royalty" payable under sec. 109 or the "payments" under *sec. 109B of the Act*;
- The analogy of employer paying the employee's tax is distinguishable and irrelevant for the purposes of section 4A of the Act;
- The "Guidelines On Withholding Tax On Interest (Or Gains Or Profits In the Case Of The Interest-Free Banking Scheme) To Individuals Resident In Malaysia" are irrelevant to the period in dispute, are not the final tax and are confined to sec. 109C of the Act, individuals and residents in Malaysia;
- No service was rendered to the taxpayer in respect of the RM17.60 to qualify for deduction under sec. 15(1) of *PITA*;
- The taxpayer had structured the withholding tax for:
  i) tax purposes;
  ii) cost recovery; and
  iii) to keep the taxpayer's non-resident affiliates "whole" against Malaysian taxes;
    - The taxpayer failed to disclose, seek the Respondent's approval for, or declare "grossing-up"; and
    - Tax in whatever form does not qualify for deductions
      – Sections 15(1) and 18(1)(h), (i) and (k) of PITA, and sec. 33(1) of the Act refers.

ISSUE 2 - Affiliate Service Charges

Brief facts:

The taxpayer had split up invoices into technical and non-technical and withheld tax only in respect of the payments which the taxpayer classified as technical or not at all.

Decision of SCIT:

The SCIT rejected the taxpayer's contentions in toto and held that in relation to the keeping of records, though no time limit is specified, it is not unreasonable or irrelevant to expect any taxpayer, more so a multinational company like the taxpayer, to keep the records for at least 12 years (now six years) for the purposes of sec. 78 or 82 of the Act.

In the absence of the information asked for, the Respondent had no choice but to act under sec. 91(1) of the Act/sec. 39(1) of *PITA*, which empowers the D.G. of I.R. to raise an assessment or additional assessment according to the best of his judgement, which he did.

The D.G. of I.R.'s Circular No: 1/1984 issued for internal consumption immediately after the coming into force of the *Finance Act 1983*—Act 293 which introduced sec. 4A of the Act, had obviated all possible ambiguities which are likely to arise with the introduction of sec. 4A of the Act and had expressly provided that sec. 4A was now wider in scope. The Circular covers both technical and non-technical assistance or services and most forms of payments made for management or administrative services, in connection with any industrial or commercial undertaking, venture, project or scheme, and while the D.G. of I.R. is prepared to exclude therefrom the allocation of head office expenses to the branch for ordinary day-to-day or routine administration expenses, any claim for such exclusion should however be scrutinised to ensure that the payments to the head office are in no way related to the performance of any specialised service by the head office for the Malaysian Branch.

Additionally, the Malaysian Association of Certified Public Accountants vide its Circular No. 7/84 dated 1 October 1984 indicated that although the D.G. of I.R. was aware of the divergent views on the meaning of and the the need for specific guidelines from the D.G. of I.R. on the term 'technical', the facts of each case must be considered and that the D.G. of I.R. reserves the right to take a decision in any particular case which may not altogether be in line with the views expressed in this circular.

The SCIT held that the taxpayer's internal guidelines were not relevant as such guidelines are not binding upon the Respondent and that the splitting-up of invoices into technical and non-technical components has no legal basis at all as the law does not allow the splitting up.

The SCIT also held that the law is not concerned with the individual elements of the service charge but rather with the actual pay-out incurred by the payer and nowhere is it mentioned that there be severability or segregation of the various types of services or charges except the three categories mentioned in sec. 4A (i), (ii) and (iii) of the Act.

Therefore, the Respondent was correct in treating all service charges paid to the taxpayer's affiliates as falling within the scope of sec. 4A of the Act, except those service charges relating to service, management and administration agreements provided by Esso Eastern Inc. to the taxpayer.

The SCIT further found no ground which would warrant the intervention of the doctrine of legitimate expectation, as argued by the taxpayer, and held that there was clear evidence that the taxpayer had suppressed information *ab initio* from the Respondent.

ISSUE 3 - Head Office Restructuring Costs

Brief facts:

The taxpayer contended that it was a subsidiary of, and reported to one of six regional head offices for operations outside North America. Following the 1986 restructuring and consolidation of the said regional head offices, the taxpayer reported directly to a new international head office; i.e. Exxon Company International (ECI), which continued to provide pooled services to the taxpayer.

Expenditure incurred in respect of the restructuring costs was allocated to all Exxon operating companies worldwide, including the taxpayer. The taxpayer's claim for such deductions under sec. 15(1) of *PITA* was disallowed by the Respondent.

Decision of SCIT:

a) The expenditure incurred by the taxpayer was not a deductible expenditure incurred wholly and exclusively in the production of gross income falling under sec. 15(1) of *PITA* and not disallowed by sec. 18(1) of *PITA*;
b) What is wholly and exclusively laid out to produce income is a question of fact (*Ampat Tin Dredging Ltd v DGIR* (1982) 2 MLJ 46 at page 51, (1950-1985) MSTC 429, refers);
c) The mere fact that the expenditure had been incurred and that the expenses are reflected in the Profit and Loss Account of the taxpayer does not, without more, qualify for deductions;
d) The Respondent had been consistent in his policy of allowing ordinary day-to-day administration or management services of a routine nature such as the share of overhead expenses incurred by the head office of a branch or by the parent company of a subsidiary charged to the branch or subsidiary;
e) The Respondent had approved the minutes of the meeting with MACPA with a "right to take a decision in any particular case which may not altogether be in line with the views expressed";
f) *The Malaysian Master Tax Guide 1998* at page 423, para. 1140 states that "where head office expenses include any "specialised services" a withholding tax situation can arise.";
g) The Costs were not reflected as such in the taxpayer's accounts but were classified under Head Office Corporate/ Affiliate charges; and
h) The High Court in *KPHDN v. IF Sdn Bhd* (2001) MSTC 3,835 reversed the decision of the Special Commissioners and decided that the expenditure incurred to increase efficiency, productivity and reduce costs are not expenses to be allowed even though it was incurred by the Respondent (taxpayer) in the case cited. In the present case, the expenses incurred were not even for the taxpayer itself but for the Head Office.

ISSUE 4 - Time Bar

Brief facts:

As the additional assessments for the Years of Assessment 1984 and 1985 were raised more than 12 years after the expiration of those Years of Assessments, the onus lies on the Respondent to bring the case within sec. 39(3) of *PITA*, which allowed such assessments to be raised beyond the 12-year period provided that that any form of fraud or wilful default or negligence appears to have been committed by the taxpayer.

The taxpayer submitted that the Respondent must prove, in respect of the affiliate service charges and the regrossing of withholding tax:

i) fraud, wilful default or negligence by the taxpayer; and
ii) that there was a loss of tax attributable to such fraud, wilful default or negligence.

Decision of SCIT:

As fraud, wilful default or negligence are not defined terms in the *PITA*, the SCIT relied upon the following cases.

In regard to fraud, the SCIT referred to *Barclays Bank v. Cole* (1967) 2 Q.B. 738, *Malaysian Taxation 3rd edition* by Verinderjeet Singh, at page 105, *Ex parte Wilson* (1888) 21 QBD 301, *Lord Advocate v. Mc Laren* 5 TC 110, *Bates v. Bates* (1952) AER 458, *Rosette Franks (King Street) Ltd. v. Dick* 36 TC 100, *UHG v. DGIR* (1974) 2 MLJ 33, *Frederick Lack v. Doggett* 46 TC 524, *Wellington v. Reynolds* (1962) 40 TC 209 and *Derry v. Peek* (1889) 14 App. Cas. 337.

In regard to wilful default, the SCIT considered the cases of *Frederick Lack v. Doggett* 46 TC 524, *Wellington v Reynolds* (1962) 40 TC 209, *Staples on Back Duty* by Percy F. Hughes, at page 122, *In re Young and Harston's Contract* (1885) 31 Ch. D. 168 and *Bennett v. Stone* (1903) 1 Ch. 3,509 and in regard to negligence, reference was made to *Whiteman on Income Tax 3rd edition*, at page 1361.

The SCIT held that the standard of proof for fraud is beyond reasonable doubt and that:

i) each instance of fraud need not be proved separately. It will suffice so long as there was any form of fraud and which "showed the kind of thing which was going on";
ii) fraud and wilful default or negligence need not be proved separately because they are not mutually exclusive and the facts would fit one just as well as the other;
iii) the finding of fraud, wilful default or negligence need not be made in respect of each year of assessment because one incident of fraud or wilful default can colour the whole period of the tax operations;
iv) it is not necessary for the Respondent to prove motive of the taxpayer in the commission of fraud or wilful default;
v) it is not mandatory for the Respondent to establish that the loss of tax was attributable to fraud, wilful default or negligence;
vi) the taxpayer disintegrated further the services provided under the Services and Technical Agreements, i.e. technical into technical and non-technical, with a view to minimising the Malaysian tax for the affiliate service provider. The taxpayer is sub-dividing the services further than what the law has grouped in one and this exceeds the boundaries of tax planning and is in breach of the relevant provisions of *PITA* and the Act (*Merrifield v. The Wallpaper Manufacturers Ltd* 16 TC 40 refers);
vii) apart from the day-to-day routine administration and management expenses, which have been allowed to remain outside the withholding tax net, as conceded by the Respondent in his Circular No: 1/84 as well as in the meeting with MACPA, all other expenses, so long as they are connected with the technical services, come within the same "technical" group and thereby within the scope of sec. 4A of the Act. This is the very purpose for which the Act was amended by bringing in sec. 4A; and
viii) the Explanatory Statement to the Bill presented to Parliament when sec. 4A of the Act was introduced states clearly the purpose of sec. 4A, viz to cover a potential tax loophole in the aftermath of the *Euromedical* case where owing to a conflict arising between the UK/Malaysia tax treaty and the Malaysian Act, the courts decided that the treaty provisions must prevail.

It was held that the Respondent had successfully brought its case within sec. 39(3) of *PITA* and therefore was at liberty to make assessments in respect of the tax lost during the Years of Assessment 1984 and 1985.

Authors Note:
This is an important case on withholding tax which all tax practitioners should take note of. There are complicated facts and numerous issues involved.

Editorial Note:
This case is cited as follows in Malaysia and Singapore Tax Cases: EPM Inc. v. KPHDN (2001) MSTC 3,306

An appeal against the decision of the Special Commissioners is pending in the High Court.

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A Student's Guide to Tax

Categories & Classes of Income

by Siva Subramanian Nair

The ultimate objective of a tax computation is to determine the tax payable, which is basically the taxable or chargeable income, multiplied by the relevant tax rates. In this module we shall determine how to arrive at the chargeable income figure, which will be subjected to income tax.

Generally, we should start with gross income. However, you will find that for business income, tax computation starts with "*net profit before tax*" and adjusts for differences between accounting and tax treatment. This is because most of the income and expenditure items are the same in arriving at *net profit for accounting* and *adjusted income for tax*; therefore why waste time and energy rewriting the whole list.

So let's start our journey to ascertain chargeable income.

NON-BUSINESS INCOME	BUSINESS INCOME
GROSS INCOME	NET PROFIT
DEDUCTIONS	TAX ADJUSTMENTS*

ADJUSTED INCOME

Add: Balancing charge **

Less: Capital / industrial building** / agricultural / forest / balancing allowances

STATUTORY INCOME
(now add up all business sources together)

Add: Recovered abortive prospecting expenditure/recovered approved agricultural expenditure

Less: Brought forward business losses [Section 43(2) of the *Income Tax Act 1967* (ITA)]

AGGREGATE INCOME
(add all sources of income together)

Less: Section 44(2) ITA	Basis year business losses
Schedule 4 ITA	Abortive prospecting expenditure
Schedule 4A ITA	Approved agricultural expenditure
Schedule 4B ITA	Qualifying pre-operational business expenditure
Schedule 4C ITA	Loss relief for approved food production project

Permitted expenses / annuities

Section 44(6) ITA	Approved donations • Gift of money to Govt./State Govt./ local authority/approved institutions • Restricted to 5% of aggregate income (for companies)
Section 44(6A) ITA	Gift of artefact, manuscript or painting to Government • Value as determined by the Dept. of Museums and Antiques or the National Archives
Section 44(8) ITA	Donation to approved libraries • Section 34(6)(g) is not applicable • Gift of money • Provision of library facilities which are accessible to public • Contributions to public libraries / libraries of schools & institutions of higher education • Maximum RM20,000
Section 44(9) ITA	Gift of money or contribution in kind for disabled persons • Individual • Gift of money • Contribution in kind > value to be determined by the relevant authority • For provision of facilities in public places for the benefit of disabled persons

* These represent items, which have to be adjusted for, in reconciling the net profit as per the accounts and the adjusted income for tax purposes. The adjustments required include:

Income for accounting but NOT for tax.

- E.g. Gain on disposal of fixed assets is reflected as income for accounting purposes but is not taxable as it is capital in nature. Therefore, it has to be deducted from the net profit figure in arriving at the adjusted income.

Section 44(10) ITA Gift of money or medical equipment to healthcare facilities
- Individual
- Gift of money
- Gift of medical equipment
  > cost or value as certified by the Ministry of Health
- To any health care facility approved by that Ministry
- Not exceeding RM20,000

Section 44(11) ITA Gift of painting to the art gallery
- Gift of painting
  > value determined by
  + the National Art Gallery or,
  + any state art gallery
- To the National Art Gallery or any state art gallery

TOTAL INCOME

Less: Personal reliefs
Less: Section 65A ITA special deductions for co-operative societies
Less: Special deduction for executors Section 64(4) ITA

CHARGEABLE INCOME

What is the format for a simple tax computation?

	Business 1	Business 2	Non-business
Gross income	xxx	xxx	xxx
Adjusted income	xxx	xxx	xxx
Less: CA	(**)	(**)	–
Statutory income	xxx	xxx	xxx
	xxxx		
Less B/f loss	(##)		–
	xxxx		xxx
Aggregate income	xxxxx		
Less: Current year losses etc.	@@		
Total income	xxxxx		
Less: Personal reliefs	(***)		
Chargeable income	xxxxx		

Income for tax but NOT for accounting

- E.g. Certain exceptional or extraordinary items such as a huge compensation received may be reflected "below the line" for accounting purposes. However if the compensation is seen as part of the normal course of the business of the enterprise, then it would be taxable. Therefore, it has to be added to the net profit figure in arriving at the adjusted income.

Expenditure for accounting but NOT for tax.

- E.g. Depreciation is not an expenditure which is incurred for the production of income but rather represents an allocation of the capital cost of an asset to the different accounting periods in which the asset is used in the entity, in line with the concept of matching and periodicity in accounting. This also includes expenses, which are required to be deducted at a later stage of the tax computation, for example approved donations. Therefore, it has to be added to the net profit figure to arrive at the adjusted income.

Expenditure for tax but NOT for accounting.

- E.g. Advertising expenditure is incurred in the production of income and is therefore deductible for tax purposes in the year of incurrence although the related income only arises in the future years. However, the accounting practice is to capitalise the expenditure and amortise it over the years in which the benefit from the advertising arises. Therefore, the capitalised portion has to be deducted from the net profit figure in arriving at the adjusted income. Of course, in future years the amount amortised has to be added back since the full claim has already been made in the year of incurrence.

✻✻ As explained earlier, depreciation is not allowed as a deductible expenditure in arriving at the adjusted income since it is NOT incurred in the production of income. However for tax purposes, recognition is still given to the fact that there is a deterioration in the useful life of the asset and accordingly capital allowances, which is basically tax depreciation, is awarded as a deduction in arriving at the statutory income. Also, just as the disposal of assets inaccounting attracts either a gain or loss (assuming the sale price does not equate the net book value), in tax, a disposal will result in a balancing charge or a balancing allowance. The treatment in both tax and accounting is similar except for the difference in the terminology, as reflected below.

	ACCOUNTING	TAX
	Cost of Asset	Qualifying Expenditure
Less:	Accumulated Depreciation	Capital Allowances
	Net Book Value	Residual Expenditure / Tax Written Down Value (TWDV)
Less:	Sales Price	Sales Price
	Loss / (Gain)	Balancing Allowance / (Balancing Charge)

Unlike accounting where the term depreciation is used generally for all assets, in tax, the allowances awarded are as follows:

Capital allowances
- plant and machinery, office equipment, furniture and fittings and motor vehicles

Industrial building allowance
- buildings qualifying as industrial buildings (will be explained in forthcoming articles)

Agricultural allowance
- capital expenditure incurred in agriculture

Forest allowance
- capital expenditure incurred in extraction of timber

The mechanics of computing the figures shown will be dealt with in forthcoming articles.

In the framework presented above, some of the items are self-explanatory whilst others will be discussed in detail in future articles. The different categories are specifically provided under the *ITA 1967* (as amended) and the hierarchy has to be strictly adhered to in arriving at the chargeable income.

FUNDAMENTAL PRINCIPLES IN COMPUTING THE CHARGEABLE INCOME

Where deductions exceed gross income (or if the tax adjustments exceed the net profit as per accounts), the resultant adjusted loss is reflected as Adjusted income = Nil **and the loss is either a permanent loss in the case of non-business income, or carried down as basis year loss in the case of business income.**

E.g. 1: Company A has gross rental income of RM5,000 and allowable deductions of RM5,750. The adjusted income from rental is shown as NIL, and the loss of RM750 becomes a permanent loss. However if it was a business source, then the RM750 becomes current year business loss to be deducted from aggregate income in arriving at the total income.

A balancing charge cannot reduce an adjusted loss

E.g. 2: Company B has profit before taxation of RM800 and the tax adjustments amount to RM1,000, thus resulting in an adjusted loss of RM200. However the company has a balancing charge of RM300. This cannot be used to set off against the adjusted loss of RM200 i.e. the computation should be presented as follows:

	RM
Profit before taxation	800
Add: Tax adjustments	1,000
Adjusted income	NIL
Add: Balancing charge	300
	300

Where capital allowances + balancing allowances exceed adjusted income + balancing charge the resultant is reflected as Statutory income = Nil **and excess is capital allowances c/f in the case of business income**

E.g. 3: Company C has an adjusted income of RM3,200. and a balancing charge of RM900. It also has capital and balancing allowances of RM4,000 and RM1,700 respectively. This cannot be reflected as Statutory loss of RM1,600 but must be shown as follows:

	RM	RM
Adjusted income		3,200
Add: Balancing charge		900
		4,100
Add: Balancing charge	1,700	
Capital allowances	4,000	4,100
Statutory income		NIL
Capital allowances carried forward		1,600

Capital allowances can only be offset against *specific business source*

E.g. 4: Company D has the following details for its hire-purchase and leasing business for year of assessment 2001.

	Leasing	Hire-purchase
	RM	**RM**
Adjusted income	3,000	2,500
Less: Capital allowances	2,500	3,000
Statutory income	500	NIL
Capital allowances c/f	NIL	500

The unabsorbed capital allowances from the hire-purchase business cannot be offset against statutory income of the leasing business

SECTION 43 (2) ITA
Brought forward business losses can be offset against *any business source*

E.g. 5: Mr. E has the following details for his manufacturing and trading business for year of assessment 2001. In addition he has unabsorbed losses from his trading business of RM750 brought forward from year of assessment 2000

	Manufacturing	Trading
	RM	**RM**
Adjusted income	1,000	500
Less: Capital allowances	400	200
Statutory income	600	300
Total statutory income from business	900	
Less: Brought forward business losses	750	
	150	

The unabsorbed business losses can be offset against any business of the taxpayer, irrespective of its source.

SECTION 44 (2) ITA
Current year business losses can be offset against *any source*

E.g. 6: Mr. F is employed as an accountant with Doomsday S/B earning RM5,000 per month, but does personal consultancy business in his spare time. Unfortunately his consultancy resulted in an adjusted loss of RM20,000 for the year of assessment 2001. His tax computation for year of assessment 2001 is as follows:

Consultancy:	**RM**
Adjusted income	NIL
Employment income:	
Adjusted income	60,000 (RM 5,000 X 12)
Less: Current year business loss	20,000
Total income	40,000

Unabsorbed approved donations cannot be carried forward

Amongst the deductions from aggregate income,

- Current year losses - *Section 44(2) ITA*
- Schedule 4 ITA
- Schedule 4A ITA
- Schedule 4B ITA

can be carried forward to the next year in the event there is insufficient income to absorb the full extent of the deductions. However in the case of permitted expenses (which is applicable to investment holding companies, venture capital companies, unit trusts and closed-end funds), annuities and donations under *sec. 44 (6) – (11)*, any unabsorbed portion cannot be carried forward to be offset against aggregate income in future years.

Of course to mitigate the incidence of tax, the taxpayer would wish to deduct those items that cannot be carried forward first, and then those which can, BUT, as stated earlier the order in which the deductions / reliefs are reflected in the *ITA 1967* (as amended) must be strictly adhered to.

In the case of sch. 4C ITA, the question of unabsorbed relief is irrelevant, since only the amount of loss relief required by the claimant company to minimise its tax liability will be transferred by the surrendering company thus nullifying the possibility of ever having an excess relief.

For companies, non-resident individuals, etc.

Total Income = Chargeable Income

The variance between total income and chargeable income is only for:

- Resident individuals
  i.e. personal reliefs.
- Cooperative societies
  i.e. special deduction under sec. 65A ITA.
- Executors
  i.e. special deduction under sec. 64 (4) ITA.

Therefore for all others total income equals chargeable income.

For joint assessments, the income of husband and wife is aggregated at the stage of total income.

Irrespective of whether the income of a married couple is assessed jointly or separately, their tax computations are calculated individually up to the stage of total income. The implications of this are:

- Unabsorbed capital allowances of either party cannot be set off against the income of the other.
- Unabsorbed business losses of either party cannot be set off against the income of the other.
- Current year losses of either party cannot be set off against the income of the other.
- Unabsorbed approved donations made by either party cannot be set off against the income of the other.

CLASSES OF INCOME

Section 4

a) gains or profits from a business for whatever period of time carried on

b) gains or profits from an employment

c) dividends, interest or discounts

d) rents, royalties or premiums

e) pensions, annuities or other periodical payments not falling under any of the foregoing paragraphs

f) gains or profits not falling under any of the foregoing paragraphs

SECTION 4A - Special classes of income
(Applicable to non-resident)

a) amounts received by a non-resident in consideration of services rendered by a non-resident or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, that non-resident

b) amounts received by a non-resident in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme

c) rent or other payments made under any agreement or arrangement for the use of any moveable property

SECTION 11 - Occupation of premises for non-business purposes

If a person occupies premises in Malaysia otherwise than solely for the purposes of a business that person is deemed to have a source of income.

Errata

We wish to apologise for the error appearing at page 43 of the 3rd quarter issue of Tax Nasional. The important information on that page is only applicable for students sitting for the Taxation 4 of the MIT Examination.

PRACTICAL EXERCISE

Gemini Sdn. Bhd. has a mining business and a trading business and closes its accounts on 30th June. The results of its operations together with other tax related information is given below.

Mining Business:

The company performed poorly in 2000, resulting in a tax adjusted loss of RM10,000. Sale of assets resulted in a balancing charge of RM5,000 whilst the claim for capital allowances was RM4,000. In 2001, it managed to reduce its adjusted loss to RM5,000 and had a capital allowances claim of RM1,000. The company had unabsorbed losses brought forward of RM2,200.

Trading Business:

Gross income (all taxable) for 2000 was RM35,000 with an expenditure of RM34,000 inclusive of depreciation and cash donation to an approved institution comprising RM3,500 and RM1,000 respectively. For the year ended 30th June 2001, the profit and loss account showed a net profit of RM3,000, after deducting amongst others, depreciation and cash donation to an approved institution comprising RM4,500 and RM500 respectively.

Other information relating to the company are as follows:

	Year ended 30.6.00 RM	Year ended 30.6.01 RM
Adjusted rental income	4,000	6,000
Interest income	3,200	4,150
Gross Dividends	1,900	–

In 2000, the company was involved in a prospecting venture which was aborted in the same year. The company incurred prospecting expenditure amounting to RM10,000 in 2000 and a further RM12,500 in 2001. In 2001, the company received recoveries of RM20,000 in respect of the aborted prospecting venture.

Required: Calculate the chargeable income of the company for the years of assessment 2000 and 2001 on the basis that the company makes all necessary claims to maximise its deductions.

Solutions to Practical Exercises on Residence Status

Q1

Year of assessment	Status	Section 7(1)
2000	Resident	(a)

Q2

Year of assessment	Status	Section 7(1)
2000	Non-Resident	
2001	Non-Resident	
2002	Non-Resident	
2003	Resident	(c)

Q3

Year of assessment	Status	Section 7(1)
2000	Resident	(a)
2001	Resident	(b)
2002	Non-Resident	
2003	Resident	(c)

Q4

Year of assessment	Status	Section 7(1)
2001	Resident	(b)
2002	Non-Resident	
2003	Non-Resident	
2004	Resident	(c)
2005	Non-Resident	(c)

Q5

Year	No. of days	Status	Section 7(1)
1999	120	Non-resident	
2000	Nil	Non-resident	
2001	245	Resident	(a)
2002	264	Resident	(a)
2003	91	Resident	(c)
2004	Nil	Resident	(d)
2005	92	Resident	(b)
2006	365	Resident	(a)
2007	365	Resident	(a)
2008	121	Resident	(b)

The Author: Siva Subramanian Nair holds an honours degree in accounting and a MBA (Accountancy) from University of Malaya. He is a Chartered Accountant (M) and a Fellow of the Malaysian Institute of Taxation. He acquired extensive experience in taxation whilst being employed in the tax department of one of the Big Five accounting firms and again as a senior finance and tax executive with an established property development company. Currently he is a freelance lecturer preparing students for the professional examinations of the ACCA, ICSA, and AIA and undergraduates of degree programmes in both local and foreign universities.

Highlights of the Income Tax (Amendment) Bill 2001

Amendments to the *Income Tax Act 1967* have been proposed by the *Income Tax (Amendment) Bill 2001* ("the Bill") which was tabled for first reading in Parliament on 29 November 2001. The Bill seeks to extend the self assessment system to individuals, partnerships, trust bodies, co-operative societies and executors of deceased estates. The self-assessment system for these entities will be effective from year of assessment (YA) 2004 onwards.

Some of the major changes introduced affecting the way tax would be assessed for the above stated persons are as follows:

1. Individuals

Basis Period

The basis period for individuals for a YA remains as the basis year (i.e. calendar year).

(sec. 21 amended by cl. 2 of the Bill)

Transitional Provisions (for sec. 21)

Clause 30 of the Bill provides the computation method of tax chargeable for YA 2003 where the basis period for a business source for YA 2003 is more than 12 months.

Tax Returns

Due date for filing of tax returns for any particular YA is 30 April of the following year. The amendment provides that an individual, notwithstanding whether he has chargeable income for a YA or if he does not have chargeable income and he has filed a return in the previous year, is still required to furnish the tax return unless specifically exempted by the tax authorities. For new arrivals in Malaysia, a notice of chargeability must be submitted within two months from arrival date.

(sec. 77 amended by cl. 7 of the Bill)

Notice of Assessment

An individual is deemed to have been served a notice of assessment on the day the return is sent to the Inland Revenue Board.

(sec. 90 substituted by cl. 11 of the Bill)

Payment of Tax

Generally, tax payable for an individual is due and payable by 30 April in the following year of assessment. It further provides that the original tax payable will be increased at the prescribed rate in cases where there is failure to pay on the due date specified.

(sec. 103 substituted by cl. 15 of the Bill)

Payment by Instalments

Individuals are required to pay their taxes on an instalment basis. However, the tax payable here is reduced by tax attributable to any gains or profits from an employment which is to be determined in accordance with a specified formula.

(sec. 107B amended by cl. 19 of the Bill)

Child Relief – Joint Claim

Where a deduction is claimed by two or more individuals for expenses incurred on a child, the claim will be a deduction of 50% of the appropriate deduction.

(sec. 48(4) amended by cl. 5 of the Bill)

Tax Rebate – A Transitional Provision

A tax rebate will be deducted against the tax chargeable on an individual for the YA 2003 if the chargeable income for a period of twelve months is RM35,000 and below.

(Relating to sec. 6A(2) of the Income Tax Act 1967)

2. Partnerships

Basis Period

The basis period for a person other than a company, trust body or co-operative society for a year of assessment is now the basis year (i.e. calendar year).

(sec. 21 amended by cl. 2 of the Bill)

Transitional Provisions (for sec. 21)

Basis year for the YA 2003 for a person other than a company, a trust body or a co-operative society is the basis period for that year of assessment. Where a person becomes a partner in an existing partnership or of a sole proprietor:

- on a day in the basis year 2002 or 2003; and
- that day falls within an accounting period ending in the basis year 2003;

then, that day the person becomes the partner to 31 December 2003 will be the basis period for YA 2003.

Tax Returns

The submission deadline for a particular YA is 30 April of the following YA.

(sec. 86 amended by cl. 10 of the Bill)

3. Trust Bodies and Co-operative Societies

Generally, the amendments proposed by the Bill are to align the tax administrative requirements and

procedures applicable to trust bodies and co-operative societies to that of companies.

Basis Period
The basis period for trust bodies and co-operative societies is the accounting period applicable to these bodies.

(sec. 21A and 44(12) amended by cl. 3 and 4 respectively of the Bill)

Tax Returns
The amendments now require these bodies to file tax returns within six months from the date following the close of the accounting period.

(sec. 77A inserted by cl. 8 of the Bill)

Notice of Assessment
These bodies are deemed to have been served a notice of assessment on the day the return is submitted to the IRB.

(sec. 90 substituted by cl. 11 of the Bill)

Payment of Tax
Tax payable for such bodies is due and payable on the last day of the sixth month from the date following the close of the accounting period.

(sec. 103 amended by cl. 15 of the Bill)

Estimate of Tax Payable for YA 2004
The trust bodies and co-operative societies are required to submit an estimate of tax payable. The estimate for YA 2004 must be:

- equal or more than the amount of tax payable for YA 2002; or
- if the amount for YA 2002 is not yet determined, then the estimated amount of tax payable shall be equal or more than that of YA 2001.

(Special provision inserted by cl. 26 of the Bill)

4. Companies, Trust Bodies and Co-operative Societies

Revised estimate of tax payable
The Bill seeks to extend the application of sec. 107C to trust bodies and co-operative societies.

Currently, the remaining instalments after a revision of the estimate is the difference between:

- the revised estimate of tax payable; and
- the instalment amounts that have been *paid*.

With the proposed amendments, the remaining instalments after revision is the difference between:

- the revised estimate of tax payable; and
- the instalments that are *payable* in the YA prior to the revised estimate.

(sec. 107C amended by cl. 20 of the Bill)

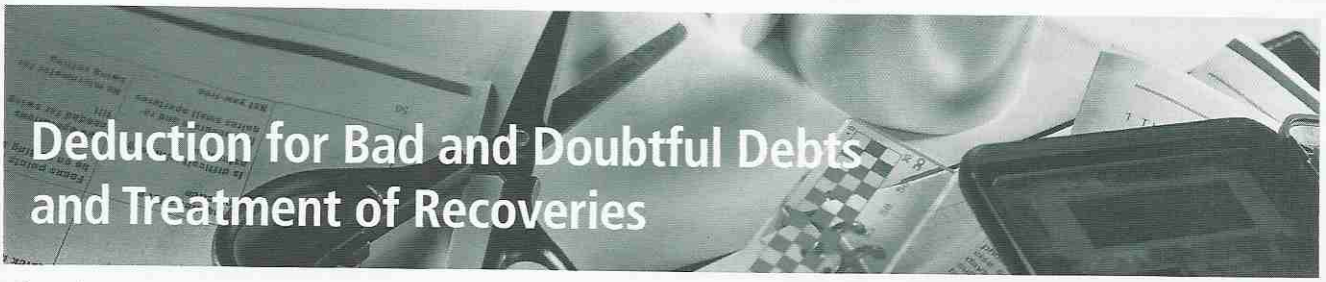
5. Section 108

A definition of "tax refunded" is introduced to mean:

- instalment amounts paid for a particular YA in excess of the tax payable for that YA; or
- amount of tax payable that was discharged due to a reduction or a discharge of a company's tax payable.

The amount mentioned (i.e. tax paid or discharged), *excludes* penalty payments, if any.

(sec. 108(14A) inserted by cl. 21 of the Bill)



Deduction for Bad and Doubtful Debts and Treatment of Recoveries

The Inland Revenue Board Malaysia has proposed to issue a public ruling on the deduction for bad and doubtful debts and treatment of recoveries. This draft public ruling will apply in respect of the deduction for bad and doubtful debts under sec. 34 of the *Income Tax Act 1967* and the treatment of recoveries under sec. 30 of the *Income Tax Act 1967*. It is effective for year of assessment 2001 and subsequent years of assessment.

This ruling will consider the following:

- The deduction for bad debts;
- The deduction for doubtful debts;
- The taxation of any recoveries arising from bad debts which have been given a tax deduction in an earlier year; and
- Other related matters.

The IRB has sought comments on the proposed public ruling. The Malaysian Institute of Taxation (MIT) after reviewing the draft ruling prepared by the Inland Revenue Board forwarded its comments to the Inland Revenue Board. In particular MIT was of the opinion that since some companies have already submitted their tax computations for the year of assessment 2001, it is proposed that the effective date should be 1 January 2002 and not year of assessment 2001 as suggested in the draft ruling.

The draft ruling will be released after the Inland Revenue Board has evaluated all comments.

Draft Transfer Pricing Guidelines

On 29 September 2001, the Ministry of Finance (the Ministry) requested the Malaysian Institute of Taxation (MIT) to review and comment on draft guidelines on transfer pricing. The Ministry, was of the opinion that bearing in mind the changes in the tax regime and the ever encroaching tide of globalisation, it was imperative that Malaysia has a position on the scope and interpretation of transfer pricing arrangements.

The MIT in its memorandum to the Ministry on the draft transfer pricing guidelines stated that it certainly welcomed the initiative by the Ministry of Finance to introduce the Inland Revenue Board's (IRB) Transfer Pricing Guidelines (guidelines); which was timely as Multinational Enterprises (MNEs) and Malaysian group companies have in the past sought such guidance on their transfer pricing arrangements. The MIT is of the opinion that transfer pricing is an issue of great concern to taxpayers in Malaysia, especially in respect to transactions with related parties. In the absence of specific guidelines, taxpayers are unable to operate with certainty as they are unsure how their pricing policies are likely to be evaluated for Malaysian tax purposes.

The draft guidelines will definitely provide a clearer direction for determining transfer pricing whilst providing the IRB with a consistent approach to review transfer pricing arrangements.

The draft guidelines have sought to provide all MNE's, methodologies acceptable to IRB that can be used in determining arm's length price and administrative regulations including the types of records and documentation expected from taxpayers involved in transfer pricing arrangements. The draft guidelines state that it is the prerogative of the taxpayer to choose from the various methodologies mentioned in the draft guidelines, with the ultimate aim of arriving at an arm's length transfer price. It is also intended that the draft guidelines (which may be reviewed from time to time) will assist MNE's in their efforts to determined transfer prices which are consistent with the arm's length principle and at the same time comply with Malaysian tax law as well as administrative requirements of the IRB.

The draft guidelines specify that the following methodologies can be used in the determining arm's length price:

1. Comparable uncontrolled price method;
2. Resale price method;
3. Cost plus method;
4. Profit split method; or
5. Transactional net margin method.

The acceptability of all the above five methods (which are also prescribed in the OECD Guidelines), will provide MNEs sufficient flexibility in choosing a basis that best fits their particular facts and circumstances. In light of the inherent difficulty in applying the three traditional transactional methods in certain situations, it is comforting to note that the draft guidelines has indicated that a profit based method is also acceptable. This would not preclude MNEs which have adopted a particular method prescribed by the OECD Guidelines on a global basis from applying the same basis in Malaysia.

Overall, the MIT is of the consensus that the issuance of a guideline on transfer pricing is a good start and taxpayers will definitely look forward to further progress on the issue of transfer pricing. However, the MIT has stressed in the memorandum that just like the development of the OECD Guidelines which is a continuous process, these draft guidelines should also be viewed in a similar fashion, as taxpayers would like to see further guidance and clarifications provided from time to time. It would also be extremely helpful if the IRB could provide an avenue for taxpayers and tax practitioners to seek and obtain clarifications on transfer pricing, without which, the smooth implementation of the draft guidelines would be affected.

The draft transfer pricing guidelines are currently being finalised by the Ministry, after having received feedback and comments from the numerous bodies/ associations.

The MIT will inform members of any changes, in due course.

Notis Perlaksanaan Cukai Perkhidmatan seperti dalam Cadangan Belanjawan 2002

Mulai 1 Januari 2002, nilai perolehan tahunan (threshold) bagi perkhidmatan tertentu telah dikurangkan seperti Jadual dibawah.

Sekiranya nilai perolehan tahunan syarikat pada 1 Januari 2002 telah melebihi 'threshold' yang berkenaan, dinasihatkan untuk hadir dengan segera ke Pusat Pelesenan Bersetempat Kastam beralamat di Aras 3, Blok I Selatan, Pusat Bandar Damansara atau di stesen kastam yang mana berkenaan untuk memohon lesen Cukai Perkhidmatan. Bersama-sama ini disertakan senarai semakan (checklist) dokumen-dokumen yang perlu dikemukakan untuk permohonan lesen tersebut. Sila pastikan orang yang bertanggungjawab (responsible person) sahaja yang menghadiri urusan permohonan lesen bagi mengelakkan sebarang kesulitan dan kelewatan semasa memproses permohonan.

Sila lihat Seksyen 8(1), *Akta Cukai Perkhidmatan 1975* yang bermaksud:

"Every taxable person who carries on a business of providing taxable service shall apply to the senior officer of customs in the prescribed form for a licence, and no taxable person shall carry on such a business unless he is in possession of a licence issued under subsection (2).

Kegagalan mematuhi kehendak Seksyen 8(1), *Akta Cukai Perkhidmatan 1975* adalah merupakan kesalahan di bawah Seksyen 29(a), yang membawa hukuman denda tidak lebih dari RM5,000.00 atau penjara tidak lebih dari dua (2) tahun atau kedua-duanya sekali.

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50596 Kuala Lumpur

sekiranya memerlukan keterangan lanjut tentang perkara di atas.

Jadual

Bil	Kod orang yang kena bayar cukai	Jenis Perkhidmatan	Nilai perolehan lama	Nilai perolehan mulai 1 Januari 2002 (RM)
1	003	Restoran, bar, snek bar, rumah kopi terletak dalam hotel yang mengandungi 25 bilik atau kurang	500,000.00	300,000.00
2	004	Restoran, bar, snek bar, rumah kopi terletak di luar hotel dan medan selera	500,000.00	300,000.00
3	009	Kelab persendirian	500,000.00	300,000.00
4	029	Syarikat Pengiklanan	500,000.00	300,000.00
5	020	Akauntan Awam	300,000.00	150,000.00
6	021	Guaman	300,000.00	150,000.00
7	022	Jurutera	300,000.00	150,000.00
8	023	Arkitek	300,000.00	150,000.00
9	024	Jurukur / Penilai / Penaksir / Agen Hartanah	300,000.00	150,000.00
10	025	Juruperunding	300,000.00	150,000.00
11	028	Penyedia Perkhidmatan Pengurusan termasuk Pengurusan Projek / Koordinasi	300,000.00	150,000.00

Senarai Semakan

Permohonan untuk Lesen Cukai Perkhidmatan

Seksyen 8, Akta Cukai Perkhidmatan 1975

(Semua dokumen dikehendaki bertaip)

Dokumen-dokumen yang diperlukan:

1. Surat permohonan pemohon / syarikat
2. Borang JKED 1 - 2 salinan
3. Gambar - 2 keping (Perseorangan / semua pekongsi / pengarah syarikat/pemohon)
4. Salinan Kad Pengenalan - 2 salinan (Perseorangan / semua pekongsi / pengarah syarikat/pemohon)
5. Memorandum and Articles of Association (M&A)*
6. Borang 24* - Return of allotments of shares
7. Borang 44* - Registered office
8. Borang 49* - Nama ahli Lembaga Pengarah
9. Borang A dan D (jika ada)
10. Pelan lokasi
11. *Perjanjian sewa premis*
12. Lesen Rumah Awam (L.R.A) Kelas 1
13. Permit Dewan Tari / Lesen Rumah Urut
14. Penyata jualan / nilai perkhidmatan
15. Surat Kuasa* (dari pemohon)
16. Lain-lain sijil yang relevan

(* untuk syarikat)

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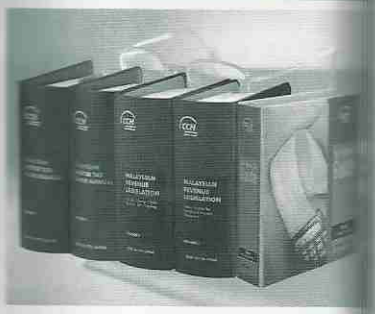

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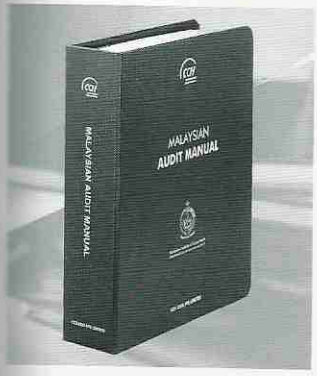

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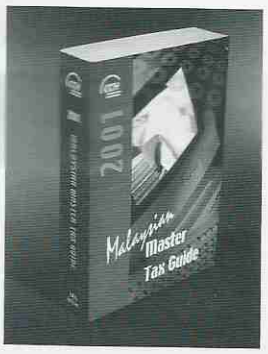
Some of the practical forms throughout the publication includes Audit Programme, Audit Workpapers, Questionnaire for Analysing Risk, Audit Approach Flowchart, Questionnaire for Other Auditors, Audit File Completion Checklist, Accounts Disclosure Checklists, Step-by-step Procedures and Management, Representatives & Engagement Letter, etc.

Topics covered in this manual includes: Audit Philosophy, Planning, Administration, Internal Control Evaluation, Trial Balance and Equity, Assets, Liabilities, Income Statement and Others.



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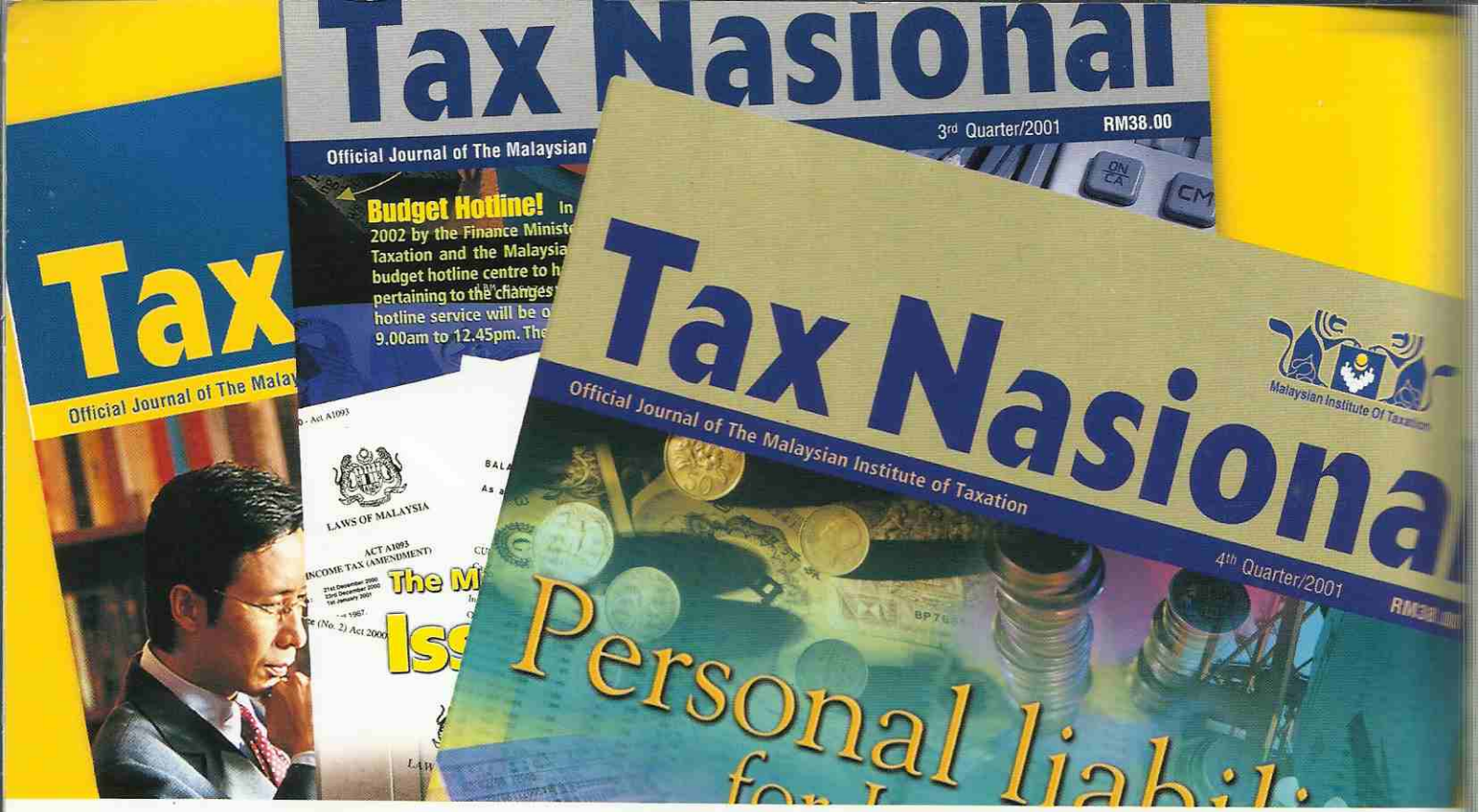

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