Malaysian Institute Of Taxation

Tax Nasional

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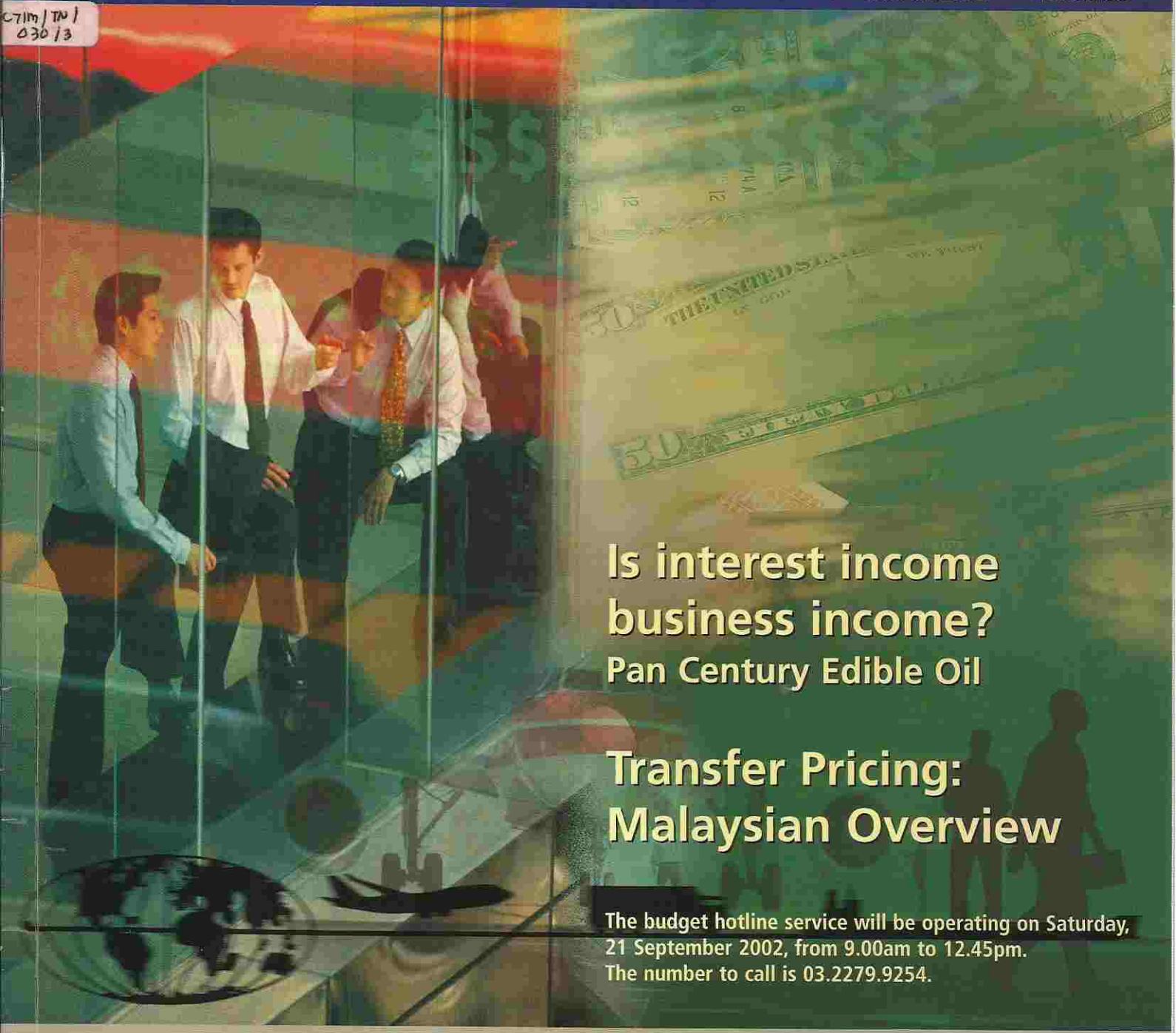

Is interest income business income?
Pan Century Edible Oil

Transfer Pricing: Malaysian Overview

The budget hotline service will be operating on Saturday, 21 September 2002, from 9.00am to 12.45pm. The number to call is 03.2279.9254.

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Creating Value for Professionals

How to become a member of the Malaysian Institute of Taxation

Benefits and Privileges of Membership

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

Fellow Membership

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.
2. Notwithstanding Article 8(1) of the Articles of Association, the First Council Members shall be deemed to be Fellows of the Institute.

Application of Membership

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

1. Certified copies of:
   a) Identity Card
   b) All educational and professional 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 2002 Budget is expected to focus on the need to promote a dynamic and resilient private sector as a means of spurring domestic consumption and ensuring a competitive private sector under globalisation. Strategies for 2002 are targeted to realise the full potential of the services sector, promote development of the small and medium sized industries, further improve productivity levels and to ensure that the incentive structure remains favourable to both foreign and domestic investors.

The Malaysian Institute of Taxation, in its annual pre-budget submission to the Ministry of Finance highlighted certain measures that should be undertaken to ensure that the private sector is able to take advantage of the rapid global changes affecting business and practice .

One of the main issues raised in the Institute's memorandum, was the need for the Government to recognise the Malaysian Institute of Taxation as the main tax body representing and protecting the needs of the domestic tax profession. This issue is indeed significant as the general terms of AFAS [ASEAN Framework Agreement on Services] and GATS [General Agreement on Trade in Services] require a reciprocal recognition of regional qualification and compliance. If there is no single Institution recognised as representing the interest of the Malaysian tax profession, our members may not be in an optimum position to capitalise on the advantages to be gained through the liberalisation of services under AFAS and GATS.

Our memorandum further stressed on the need for a reduction of corporate tax rates, an extension of group relief and other relevant issues. A synopsis of the salient issues raised in the memorandum is published in this issue of the Tax Nasional.

As we approach Budget Day, I wish to take this opportunity to contemplate the advances we have made as a nation.

The 1990's was a decade marked by rapid economic growth and advancements, with the exception of 1998, when the economy was adversely affected by the regional monetary crisis. It was however gratifying to note that the sharp economic contraction in 1998, was largely mitigated by the prudent fiscal policies of the government. In 2001, the economy reverted to the pre-crisis growth rates with relative price stability and low unemployment rates. But as we prepare for the amendments in the Budget, the Malaysian economy will in the coming years face greater challenges as a result of the global movement in the liberalisation of trade and services, as well as, the rapid development of information and communication technology.

We must be forward thinking in our outlook as past boundaries and borders are gradually being erased with liberalisation in the movement of goods, services and people. In the coming years, the Institute will be more pro-active in anticipating the needs of its members and of the profession. To achieve this, the Council is currently reviewing measures to improve the value added services provided to members, as well as to prepare members to embrace the coming changes such as a practising certificate for members, increasing the number of practical tax workshops, reconstituting the composition of committees, and much more.

I wish to reiterate the Council's vision for the Institute to continue to advocating the interest of our members and in endeavouring to improve the services of the secretariat and make the Institute the main tax body of the nation.

On a final note, I am pleased to welcome 2 new members, Mr Andrew Kok and Mr Neoh Chin Wah to the Council. I am confident they will contribute significantly to the activities of the Institute in the coming years.

I would also like to take this opportunity to express my sincere gratitude to all members who took time off to attend the 10th Annual General Meeting of the Institute, in particular, Mr Lee Nee Fook for his invaluable contribution at the AGM.

Lastly, I would like to thank Mr Tony Seah for his invaluable services to the Institute these past years and wish him the best in all his future endeavours.

Ahmad Mustapha Ghazali
President

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The Publisher

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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

Budget 2003 is almost upon us - 20 September 2002. The time between is now rife with projections and expectations of what the budget ought to bring. In light of this, we have included the Malaysian Institute of Taxation's annual pre-budget Memorandum to the Ministry of Finance, highlighting some measures that the budget should incorporate in promoting a strong and active private sector.

In view of the large and increased volume of globalised trade between related entities, transfer pricing rules have become increasingly significant in protecting the local tax base. In this regard, SM Thanneermalai and Jagdev Singh present an overview on some of the more fundamental issues concerning the subject of transfer pricing in Malaysia to enlighten the uninitiated amongst us in their article "Transfer Pricing in Malaysia: An Overview".

In the legal arena, the Court of Appeal in the landmark case of *Pan Century Edible Oils Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* ("PCEOB") has held that interest earned from excess cash (over its daily business) deposited with a bank for such a period until it was needed for the purpose of the business was business income. Hence it is taxable under sec. 4(a) of the *Income Tax Act* and not just as "interest" under sec. 4(c). As such, the Company can utilise interest income to offset brought forward business losses. Dr Arjunan Subramaniam, the lawyer for the taxpayer remarks further on the case issues in his article entitled "*Pan Century Edible Oils Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri: Minding My Own Business*".

Bill Davidson writes his case for judicial review in "Judicial Review as an Alternative to Appeal to the Special Commissioners".

On a more regional note we have the latest on e-commerce from a Hong Kong perspective by Clement Yuen.

The implications of the amended sec. 75 continue to ripple unease in the corporate world. The treasury has responded and is seeking feedback on acceptable amendments to the section in calming the corporate world. We also have further comment on sec. 75 by Gurbachan Singh.

Adding to the discussion on directors' personal liability is the situation under indirect taxes as discussed by Mr Chandran Ramasamy.

Harpal S. Dhillon
Editor of Tax Nasional

Budget Hotline Service

In conjunction with the tabling of Budget 2003 by the Finance Minister this September, the Malaysian Institute of Taxation and the Malaysian Institute of Accountants will conduct a budget hotline centre to handle enquiries, as well as to clarify matters pertaining to the changes proposed in the upcoming budget. The budget hotline service will be operating on Saturday, 21 September 2002, from 9.00am to 12.45pm. The number to call is 03.2279.9254.

MIT holds its 7th Graduation & Prize Giving Luncheon

The Malaysian institute of Taxation (MIT) conducted its professional examinations for the seventh year and has to-date produced 44 graduates.

The Deputy Director General of the Inland Revenue Board, Mr Lim Heng How, officiated the 7th Graduation & Prize Giving Luncheon on 13 July 2002 at Nikko Hotel, Kuala Lumpur. Also present at the ceremony were Y Bhg. Tan Sri Lim Leong Seng, former Director General of the Inland Revenue Department as well as many other representatives of the various government departments, institutions of higher learning and professional bodies. Families and friends of prize winners and graduates were also present to witness the ceremony.

Dr Jeyapalan Kasipillai, Chairman of Examinations Committee in his opening address said that "MIT hopes to produce more graduates by conducting examinations to overcome the current shortage of tax professionals. The subjects in the MIT Professional Examinations were carefully chosen to ensure that graduates would be adequately prepared to meet the rigours of the profession. It is envisaged that the successful completion of the MIT Professional Examinations would build up a pool of qualified taxation personnel with the highest standard of professional competency and ethics to meet the needs of the country".

The candidates in the 2001 examination showed a fairly encouraging performance. To encourage the pursuit of academic excellence, several accounting firms namely, PricewaterhouseCoopers, Ernst & Young Tax Consultants, Deloitte KassimChan, KPMG, Atarek Kamil Ibrahim & Co and individuals such as the President, En Ahmad Mustapha Ghazali and Deputy President, Mr Michael Loh have stepped forward to sponsor the prizes. Prizes were awarded for specific taxation papers and "Best Overall Performance" for each level of the examination. However, prize winners are expected to attain certain standards and criteria before being eligible. In the recent examinations held between 3 to 7 December 2001, Yang Suit Keng, Emily Liew Pei Sew and Hong Mei Lain @ Mei Yan were awarded prizes for Best Overall Performance in the Foundation, Intermediate and Final Levels respectively. Prizes for the best performance in Taxation I, Taxation II, Taxation III and Taxation IV papers were awarded to Yang Suit Keng, Low Fue Cheu, Lee Nyong Phin and Hong Kim Soon respectively.

Student receiving her certificate from Guest of Honour, Mr Lim Heng How

Guest of Honour, Mr Lim Heng How, Deputy Director-General of the Inland Revenue Board delivering his official address

Dialogue with Ministry of Education

On 6 June 2002, the Ministry of Education organised a dialogue with various professional bodies and associations at the Renaissance Kuala Lumpur Hotel. The Institute was represented by the Honorary Secretary, Mr Chow Kee Kan at the dialogue, which served as a platform on exchanging views and obtaining input on the need for manpower, now and in the future.

The Institute also had the privilege of being invited to a National Seminar on "Malaysia As A Centre of Educational Excellence: The Way Forward" on 23 July 2002 at Holiday Villa, Subang Jaya, Selangor, organised by the Ministry of Education. Vice President, Tuan Haji Abdul Hamid bin Mohd Hassan represented the Institute at the seminar.

Courtesy visit to Special Commissioners

On 4 July 2002, a delegation led by the President, En Ahmad Mustapha Ghazali paid a courtesy visit to the newly appointed Chairman of Special Commissioners of Income Tax, Dato Ahmad Zaki bin Haji Husin, at his office.

The delegation consisting of Vice President, Tuan Haji Abdul Hamid and Council Member, Mr Harpal Singh Dhillon congratulated Dato Ahmad Zaki on his new appointment and briefed the new Chaiman on the new vision and recent developments of the Malaysian Institute of Taxation.

The courtesy visit was of significant benefit to both organisations, as they acknowledged the need for maintaining closer ties and pledged to preserve the goodwill arising from the courtesy visit.

10TH ANNUAL GENERAL MEETING

The Institute held it's 10th Annual General Meeting (AGM) on 13 July 2002 at Nikko Hotel, Kuala Lumpur and was attended by more than 50 members.

Office bearers of the Institute.
From Left: Mr Quah Poh Keat, Mr Michael Loh, En Ahmad Mustapha Ghazali, Mr Chow Kee Kan and Tn Haji Abdul Hamid bin Mohd Hassan

The President, En Ahmad Mustapha Ghazali, in his opening address, informed the members that the year 2001 was indeed a momentous year for the Institute as it has grown in strength and vision by assuming its role as the paramount tax body in Malaysia. He explained further that the rise of the Institute can be seen from the various projects undertaken by the Institute in the year. He also stressed that the Institute will improve its services to members, with the aim of holding onto its current members and attracting new ones to subsequently increase the Institutes membership.

"The Membership Affairs Committee has been given the task of preparing a memorandum to the Ministry of Finance, for the Institute to be recognised as the main tax body in Malaysia. The Council has reviewed the first draft of the memorandum and it will soon be ready for submission to the Ministry of Finance. The purpose of the memorandum is to seek government recognition of the Institute as the main tax body representing and safeguarding the interest of the tax profession in Malaysia. From our numerous dialogues with the relevant authorities, we are confident that such a motion will be adopted by the relevant authorities, in light of the ever encroaching effects of globalisation. We have also in year 2001 conducted dialogues with certain parties and institutions in the hope of their members joining the Institute as the Institute is in a better position to service the needs of their members" said the En Ahmad Mustapha in his presidential message to members in the recent AGM.

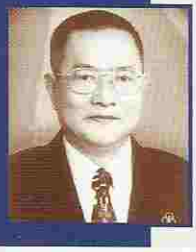
In the 10th AGM of the Institute, besides the three incumbents namely Mr Quah Poh Keat, Mr Lee Yat Kong and Mr Harpal Singh Dhillon being re-elected, Mr Neoh Chin Wah and Mr Andrew Kok Keng Siong were elected as new Council Members. On a sad point, the Institute had to bid farewell to a senior Council Member, Mr Tony Seah who decided not to seek re-election. The Institute will deeply miss his invaluable contributions as he has been with the Institute since it's beginning and has contributed significantly towards the development of the Institute.

The Council has appointed Mr Law Yau Joo as the Chairman of Sarawak Branch, Mr Lam Weng Keat as the Chairman of Ipoh Branch and Mr Ong Eng Choon as the Chairman of Northern Branch, to meet the need for greater representation of members outside the Klang Valley and to help achieve the Institute's vision of providing value added services to it's members. These chairpersons will be entrusted with the duty to serve and assist the members as well as to promote the interest of the Institute in the respective States.

During the closing address, the President extended his appreciation to the Inland Revenue Board and the Royal Customs Department for their invaluable guidance and support towards the Institute throughout the year and reiterated the Institute's resolve in striving harder to provide quality services to its members.

profile

Mr Khor Kay Cham @ Koh Kay Cham, Melaka Branch Chairman



Mr Khor Kay Cham @ Koh Kay Cham holds a Bachelor of Art (Economics) degree from Nanyang University, Singapore. He has over 40 years of experience in the area of company secretarial practice, accounting profession and taxation services and is currently the Managing Partner of K C Koh Tax Accounting & Corporate Services.

Mr Khor is a fellow member of the Malaysian Institute of Taxation and a member of Malaysian Association of Company Secretaries. He also serves in the Audit Committee, Nomination & Remuneration Committee of a public company listed on the KLSE.

Pan Century Edible Oil Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri

Minding my own business

By Dr Arjunan Subramaniam

Tax history was made on 31st July 2002. The Judges pushed the frontiers of knowledge of tax law further and expanded our understanding of the provisions of sec. 4, *Income Tax Act, 1967*. The battle lines were drawn long before 31st July 2002. In the days when there was development tax, the Revenue tended to argue that interest income is business income and so subject to development tax. And the taxpayer, argued interest income is not business income.

The law that repeated transactions can be an adventure in the nature of trade and business was invariably quoted by the Revenue in numerous cases until it came to **Pan Century** where Revenue found that the very law that favoured them in all cases was against them. Such is the uncertainty of case.

Let us begin with the beginning and let the story unfold:

The facts:

i) The Appellant was in the business of refining and processing of palm oil. The price of crude palm oil, the raw material for the Appellant's business fluctuates from time to time;

ii) The volume of cash needed to purchase the raw material, crude palm oil, therefore, varies from time to time;

iii) Certain portions of cash proceeds from the sale of products, therefore, needs to be readily held for the purchase of raw materials, namely, the crude palm oil;

iv) When the price of raw material falls, less cash is needed to fund the purchase;

v) When the price of raw materials rises, more cash is needed to fund the purchase of raw material;

vi) When less cash is needed when the price of raw material falls, the excess cash is placed on short term and long term deposits and on Negotiable Certificate of Deposits, that is, on very short term negotiable deposits;

vii) Certain banks require that the Appellant do place such deposits with the relevant bank where the Appellant has overdraft facilities, however this is not as security;

viii) The short term deposits are all for very short terms, i.e. 30 days or one day call. There was only one deposit for a period of one and half years and this was lifted by assigning it.

ix) The placing of deposits and lifting of deposits continued on a regular and repetitive basis (daily basis, week in and week out in each month) for the relevant Years of Assessment under appeal and still continue to do so up to date;

x) The object of placing on short term deposits is to deal with excess money on hand, to turn over and make profit;

The issue

Whether "interest" income arising from the fixed deposits was business income taxable under sec. 4(a) *Income Tax Act 1967* or sec. 4(c), *Income Tax Act 1967* or is part and parcel of the Respondent's manufacturing business income and taxed under sec. 4(a), *Income Tax Act 1967*.

The tax implications

If the "interest" income is business income, then brought forward business losses can be off set against such interest income and if interest income is taxable under sec. 4(c), *Income Tax Act 1967* then brought forward losses cannot be set-off against interest income. (Sections 43 (1) (a); 43(2); 44(4); 44(5) *Income Tax Act 1967*).

The taxpayer, even though he knew no revenue law, could not believe that business losses could not be set against the interest income. He sought an opinion but was informed, that there was no decided case in Malaysia wherein interest income from fixed deposits was treated as business income. The issue had never been canvassed successfully. The taxpayer was advised that if he started a war with the Special Commissioners, it will proceed all the way to the Court of Appeal. The taxpayer was told that in a war many a battle may be lost, but the war must be won. He was advised not to run at the first sight of loss of a battle at the Special Commissioners. But as it turned out the taxpayer won all battles and the war. A rare case, but it underscores the righteousness of the cause.

The counsel waged the battle on three fronts:

a) the interest income from the fixed deposits and short term deposits was business income within the meaning of sec. 4(a) *Income Tax Act, 1967*.
b) The short term and long term deposits were ancillary to the main trade because the funds for the deposits were from the main business and thus the deposits were tied up with the main business.
c) The repeated placing of deposits on a daily, weekly, monthly basis brought the transactions within the ambit of business from an adventure in the nature of a trade within the meaning of the definition of "business" in sec. 2, *Income Tax Act, 1967*.

The learned Special Commissioners disposed off the argument that the deposits were part and parcel of the main trade as unacceptable because the placing of deposits were in no way allied to its main trade. The battle at this front was lost. In retrospect, the learned Special Commissioners were right. The deposits though arising from the excess funds of the main business were not in the same line as the main business, and therefore, not ancillary.

The learned judge at the High Court held:

> *"It is a case of a company whose purpose is to make as much profit as possible for its shareholders. Having excess cash over it s daily business it diverted the said excess for such period until it is needed for the purpose of business, by putting it in the bank to earn income. Otherwise, those excess fund would remain idle to the disadvantage of its shareholders. It is not a case where a predetermined amount was set aside by the company from time to time for purpose of it being invested in banks to earn interest. Those excess fund in this case together with interest earned would be ploughed back into the company to be used in its business of refining and processing of oil palm in time of need. Those excess funds were in fact the temporary surplus working capital of the Respondent as explained in paragraph 3 of Exhibit "C"."*

When the case was argued before the Court of Appeal, great emphasis was paid to the role of an appellate court in income tax cases. The role of the appellate court is well defined as follows:

i) The Court of Appeal (and the High Court) cannot reverse a decision of the learned Special Commissioners unless the learned Special Commissioners have been positively wrong in law. (Per Lord *Radcliffe* in ***Edwards (H.M Inspector of Taxes) v. Bairstow and Harrison,* 36 TC 207** at page 231 of Report).

ii) The Court of Appeal (and the High Court) **is not a court of second opinion when there are reasons for the first**. (Per Lord *Radcliffe* in ***Edwards (H.M Inspector of Taxes) v. Bairstow and Harrison,* 36 TC 207** at page 231 of Report).

iii) The then Supreme Court in ***Lower Perak Co-operative Housing Society v. Ketua Pengarah Hasil Dalam Negeri* [1994] 2 MLJ 713** (at page 732 of Report) cited and approved the celebrated case of ***Edwards v. Bairstow and Harrison* [1956] AC 14; 3 All ER 48; 36 TC 231,** as follows:

   a) *"If the case contains anything ex facie which is bad law and which bears upon the determination, it is, obviously, erroneous in point of law."*
   b) *"... the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal."*
   c) Unless, there is something **ex facie bad in law or the decision is not supported by the facts found**, the Court of Appeal should not intervene. Mere citation of bad law is not sufficient. It must have a bearing upon the determination of the case.

iv) No judge is entitled to refuse to recognize the force of the Special Commissioners' decision merely because there are one or two points he is not in agreement with. **The decision must be so perverse that it cannot stand.** (See ***Edwards v. Bairstow and Harrison* 36 TC 207**, at page 224 of Report). There is nothing in the Case Stated to be described as "perverse".

v) The question is: are the Special Commissioners **justified by the facts and evidence in arriving at their conclusion.** (See ***Director General of Inland Revenue v. Central Sugars*, [1978] 2 MLJ 71** at page 7 of Report).

vi) The question: **is there sufficient evidence before the Special Commissioners to arrive at their conclusion.** It is not whether a judge should come to the same conclusion. (See ***St. Aubyn Estates, Ltd. v. Strick* 17 TC 412;** at page 419 of Report). The Appellant has not made a case that there was no evidence before the Special Commissioners to come to their conclusion.

vii) It follows that the Court of Appeal and the High Court could only interfere if the case contains anything ex facie which is bad law and which bears upon the determination. Mere citation of bad law is irrelevant. It must bear upon the determination of the case. The Appellant has not shown specifically upon the facts that the case contains bad law, which bears upon the determination of the case. (See ***Director General of Inland Revenue v. Central Sugars Bhd* 2 MLJ 71**, at page 6 of Report).

Datuk Wira Haji Mohd Noor bin Haji Ahmad, J.C.A, considering the role of the Court of Appeal, confirmed the role in the following terms:

> *"An appeal from the decision of the Commissioners is only on a question of law by way of case stated. The court will interfere only if the case contains anything ex facie which is bad in law and which bears upon the determination or if the facts found are such that no person judicially and properly instructed as to the relevant law could have come to the determination under appeal – see* ***Edwards v. Bairstow* [1956] A.C 14; *Director General of Inland Revenue & Central Sugar Bhd* [1978] 2 MLJ 71; *Lower Perak Co-operative Housing Society v. Ketua Pengarah Hasil Dalam Negeri* [1994] 2 MLJ 713 SC."**

Many case law authorities were cited to the court as to why the interest income was business income. The Court of Appeal cited a case of pivotal importance namely, ***American Leaf Blending Co. Sdn Bhd v. Director General of Inland Revenue* [1979] 1 MLJ 1**. In this case, rents, though, they appear in sec. 4(d), nevertheless were considered as falling under business income under sec. 4(a), *Income Tax Act, 1967*.

Datuk Wira Haji Mohd Noor bin Haji Ahmad, J.C.A, citing that case held:

> *"In the same breath, we concluded that the interest despite the fact it was referred to in paragraph (c) of section 4 of the Act nevertheless constitutes income from a source consisting of a business if it was receivable in the course of carrying on a business of putting the Respondent's excess cash to profitable use by placing it on short term and long term deposits."*

The war was closely fought and the principle established that interest, notwithstanding that it falls under sec. 4(c), can nevertheless fall under sec. 4(a) as business income. **Pan Century** created history and stands shoulder to shoulder with **American Leaf Blending (supra)** as a leading case as to what amounts to "business".

The Author

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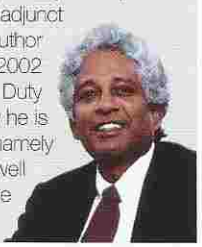
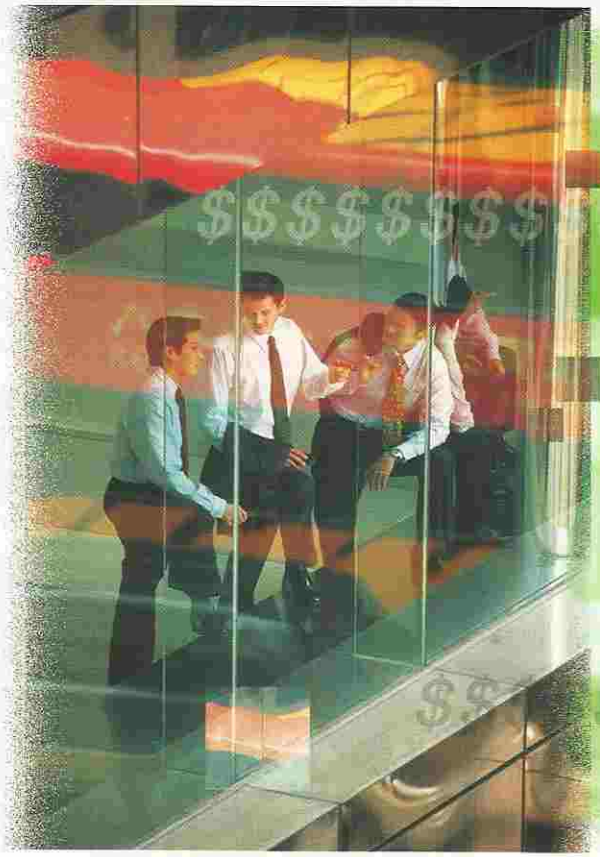




Transfer Pricing: Malaysian Overview

By SM Thanneermalai and Jagdev Singh

Until the 1980s, there were no specific transfer pricing legislation or guidelines in most countries. Transfer pricing practice was characterized by vague references in local tax law dealing with arm's length pricing between related parties.

The government authorities paid close attention to cross-border transactions largely through the customs authorities focusing on the importation of goods while withholding taxes, foreign exchange controls and other requirements for regulatory approvals were often used to limit the overseas royalty, service fees and other payments. Transfer pricing was relatively low on the list of tax issues generally raised by the revenue authorities responsible for direct taxes. In cases where audits were carried out, revenue authorities around the world tended to take an aggressive approach due to the lack of clear understanding and the unavailability of a workable legislative framework. On the other hand, in the absence of a legal requirement, taxpayers were unprepared and unable to produce relevant documentation to support their transfer pricing positions.

As the years passed, increased globalization resulted in most groups of companies being transformed into truly global integrated businesses, consisting of an optimized value chain spread across the world. This naturally resulted in an escalation in volume of cross border transaction between the various entities within a group. Soon enough, tax authorities in the developed countries begun to realize that a significant proportion of their tax base was at stake from the abuse of transfer pricing i.e. outflows from local companies exporting capital and the foreign companies investing in their countries. As such, some of the tax authorities reacted to protect their tax base through the introduction of transfer pricing legislation and rules.

Regional perspective

While the more developed nations recognized the need to introduce transfer pricing rules and regulations much earlier than others, there was much less drive for the developing economies in the Asia Pacific and particularly in the South East Asia region to do the same quickly. Some factors contributing to this include:

- Various forms of tax holidays and tax incentives in many South East Asian countries encouraged Multinational National Enterprises (MNE) to leave larger profits in these countries;

- Many developing nations which were aggressively competing for the inflow of foreign direct investment were of the view that any form of transfer pricing legislation could be viewed as restrictive; and

- There were other forms of controls such as exchange control regulations and other regulatory requirements that were thought to be sufficient in ensuring that a reasonable level of profits were left behind in these countries.

As economies in the Asia Pacific region become more sophisticated, these factors are fast diminishing. There is now a trend in the region for revenue authorities to increase their focus on transfer pricing both in terms of legislation and enforcement. The internal and external push towards this stems from the following factors:

- The tax holidays and tax incentives of many MNEs' have either expired or are about to come to an end soon. This would mean that the profits they leave behind in the countries

they operate in are going to be more closely scrutinized since the tax collected by the revenue authorities are going to be dependent on it.

- There is a belief that MNEs' will be inclined to weigh their profit allocation in favor of countries with more aggressive transfer pricing regime so as to minimize risk of adjustments, consequent penalties and possibility of double taxation in those countries. This would mean that countries without transfer pricing legislation might lose out in collecting their fair share of taxes.

Whilst none of the South East Asian countries (with the exception of Thailand) have introduced any formal transfer pricing legislation or guidelines to date, the following trends seem to be common in most of these countries:

- The revenue authorities have taken steps in enhancing their knowledge on the subject matter through participation in specific training programs conducted by their counterparts overseas who have already been deeply involved in this issue for much longer;

- Some tax authorities have embarked on a data gathering exercise on related party transactions by incorporating such requirements to provide data in the tax returns;

- Transfer pricing has been an important area of focus in tax audits and investigations involving MNEs' and local group companies; and

- Most tax authorities have relied on the OECD Guidelines as a reference in examining transfer prices.

While some countries in the Asia Pacific region that previously introduced legislation and guidelines either fine-tuned or provided additional guidance to taxpayers, others have jumped onto the bandwagon in the last twelve months. India, for instance, has introduced a comprehensive set of legislation requiring not only taxpayer compliance but also requiring an external certification from auditors to that effect. Thailand has taken a relatively simpler approach by introducing guidelines that are very much focused on documentation requirements.

Transfer pricing in Malaysia

Currently, there is no specific transfer pricing legislation or formal guidelines governing transfer pricing practices in Malaysia. However, it appears likely that some form of guidelines will be issued in the near future to provide guidance to taxpayers on the application of the arm's length principle. This much is evident from the draft Transfer Pricing guidelines which were provided to the professional bodies and other affected parties for comments in late 2001.

Although it may not be appropriate to discuss the detailed content of the draft Malaysian transfer pricing guidelines at this stage, given the possibility of changes being made prior to it being finalized, the general thrust of the imminent guidelines is expected to be along the same lines as the OECD Guidelines. As such, the guidelines will not only endorse the various transfer pricing methods used in complying with the arm's length principle but also address specific situations in a Malaysian context as well as lay out the documentation requirements.

Existing legal provisions

The existing anti-avoidance provisions found in sec. 140 and 141 of the *Income Tax Act, 1967* provide sufficient basis in ensuring that transfer prices between related parties are carried out at arm's length.

Section 140(1) states:

The Director General, where he has reason to believe that any transaction has the direct or indirect effect of :

a) altering the incidence of tax which is payable ….. by any person;

b) relieving any person from any liability …..;

c) evading or avoiding any duty or liability which is imposed or would otherwise have been imposed …..;

d) hindering or preventing the operation of this Act …..;

may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustment as he thinks fit with a view to counteracting the whole or any part of any direct or indirect effect of the transaction.

Additionally, Section 140(6) stipulates:

Transactions:

a) between persons one of whom has control over the other;

b) between individuals who are relatives of each other;

c) between persons both of whom are controlled by some other person,

shall be deemed to be transactions of the kind to which subsection (1) applies if in the opinion of the Director General those transactions have not been made on terms which might be fairly be expected to have been made by independent persons engaged in the same or similar activities dealing with one another at arm's length.

The existing anti-avoidance provisions found in sec. 140 and 141 of the *Income Tax Act, 1967* provide sufficient basis in ensuring that transfer prices between related parties are carried out at arm's length.

The key implications of this Section in relation to transfer pricing can be summarized as follows:

- The section is extremely wide and open for application by the tax authorities in a multitude of situations involving both local and cross border transactions;
- Section 140(6) is a deeming section, and consequently, if the Malaysian tax authorities can demonstrate that a transaction falls within the ambit of this section, the anti-avoidance provisions in sec. 140(1) can automatically be invoked;
- Although the burden of proof is on the Malaysian tax authorities, it can easily be shifted to the taxpayer; and
- There is no definition of the term "arm's length" in the Act and although there are informal indications that one can rely on the OECD Guidelines in applying the arm's length principle, there is no formal acceptance of this.

There have been no court cases in Malaysia which have dealt specifically with transfer pricing matters although the courts have considered the interpretation sec. 140 in tax cases involving other forms of tax avoidance.

Administrative issues relating to transfer pricing

Traditionally, the tax administration in Malaysia relied on a system of desk audit of tax returns and accounts submitted by taxpayers. In keeping up with changing times and circumstances, a self assessment system was introduced in year of assessment 2001. Inherent in a self assessment system is the onus on the taxpayer to ensure that there is sufficient documentation to prove that the related party transactions declared in the tax return have been carried out at arm's length.

Another change that occurred even earlier, was the requirement to disclose related party transactions in the tax return in a predetermined format. What was previously required to be disclosed in the statutory accounts depending on materiality, will now be disclosed in full in the tax return. This is a step forward by the revenue authorities in gathering and compiling information on related party transaction for purposes of identifying taxpayers with potential transfer pricing issues.

There are three broad avenues available to the tax authorities in seeking to analyze the transfer prices adopted by taxpayers:

Desk audits

This conventional system involves the tax authorities sitting in their own offices and analyzing the statutory accounts and tax returns submitted to them to identify potential transfer pricing issues. A letter is then issued to the taxpayer requesting additional information or justification for certain related party transactions. Experience indicates that it is difficult for the tax authorities to pursue a transfer pricing issue using this approach, given the limited understanding of the operations of the taxpayer as well as the transactions itself.

Field audits

Field audits, which were introduced to create a system of checks and balances in the self assessment system, involve a visit to the taxpayer's premises to review supporting documents and records which substantiate positions adopted in the tax return. When visiting groups of companies, either multinationals and/or local, significant related party transactions, transfer pricing will inevitably crop up as an issue requiring attention.

Investigations

So far, investigations have been the single most important avenue for transfer pricing "policing" until the introduction of field audits. Again, the opportunity to understand the business of the taxpayer as well as analyze records and transactions provide a good platform for the revenue authorities to raise pertinent issues on transfer pricing.

The arm's length test in practice

Application of the arm's length principle is generally dependent on a comparison of the conditions (e.g. price or profit) in a controlled transaction with the conditions in transactions between independent enterprises. For such comparisons to be of use, the economically relevant characteristics should be sufficiently comparable. Comparable in this case means that none of the differences between the transactions being compared should materially affect the condition being examined in applying the methodology or that reasonably accurate adjustments can be made to eliminate the effect of such differences.

Comparability analysis

In carrying out a comparability analysis, certain factors need to be considered:

- Identifying the functions performed by each of the parties in a controlled transaction as compared to an uncontrolled transaction. Functions would need to take into account risks assumed, assets utilized and contractual terms.

- Comparison of differences in the specific characteristics of the property or services. In general, similarity in the characteristics will matter more when comparing prices and less when comparing profits.

- Arm's length prices may vary across different markets even for transactions involving the same property or services. For example, the price for carrying out contract manufacturing services in a particular industry may vary across countries due to local competitive forces. To achieve comparability, it is necessary to ensure that the markets in which the enterprise operates in is comparable with that of any comparables being used. If there are any differences, they should not have a material impact on prices or appropriate adjustments can reasonably be made.

- The business strategies pursued by the parties in a controlled transaction like market penetration should be taken into consideration when determining comparability of controlled transactions and uncontrolled transactions. For instance, it may not be appropriate to compare profits of a company mainly producing high end technologically advanced products with one in the same industry but focusing on mass market low technology products in an advanced stage of the product development phase.

- The nature and extent of contribution by other members of the group in the controlled transaction of an associated enterprise will also be relevant, as part of the functional analysis to establish comparability. It is not uncommon for groups of companies operating in Malaysia to receive services from their related parties both local and overseas for which no payments are made. In establishing comparability, this must be taken into account.

Selection of transfer pricing methodologies

Transfer pricing methods are the methods which a group or company uses to determine what the price should be when two related parties exchange goods or services.

In general, the methods fall into three categories as set out in the table below:

Transaction Based Methods	Profit Based Methods	Other Methods
Comparable Uncontrolled Price (CUP)	Transactional Net Margin Methos (TNMM)	Global Formulary Apportionment
Resale Price (Resale Minus)	Profit Split	Anything Else
Cost Plus		

Different countries have different approaches but a degree of consistency has been imposed by the OECD Guidelines that accepts the use of the three transaction based methods and two profits based methods. It also specifically rules out the use of any other methods.

The draft Malaysian transfer pricing guidelines indicate that taxpayers can choose any of the five methods prescribed in the OECD Guidelines or a combination of these methods in arriving at an arm's length price. However, the draft guidelines also state a preference for traditional transaction methods, suggesting the use of profit methods as a last resort.

A key issue in deciding which methodology to use is the availability of third party comparables. For the traditional transactional methods to be applied, comparables in the form of like transactions between independent parties must be available. On the other hand, for profit methods to be applied, the appropriate comparables or benchmark is based on profits derived by independent companies carrying out like activities. Many groups of companies simply do not have access to enough information on their competitors to apply the traditional transaction methods. Hence, the reliance on profits methods could become inevitable.

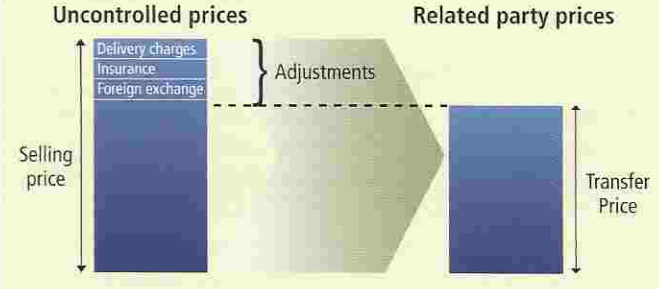
The key features and practical considerations for each of the five methods are as follows:

The comparable uncontrolled price (CUP) method

The CUP method evaluates the arm's length nature of a controlled transaction by comparing the price charged for property or services in a controlled transaction to the price charged for property or services in a comparable uncontrolled transaction under comparable circumstances.

In applying the CUP method, an uncontrolled transaction is considered to be comparable to a controlled transaction if reasonably accurate adjustments can be made to eliminate the effects of any material differences between the controlled and uncontrolled transactions. The extent and reliability of any adjustments will affect the relative reliability of the analysis under the CUP method. Although product comparability is key in the CUP method, consideration should be given to the price effect of all comparability factors. Diagrammatic representation on the application of the CUP method is shown in Figure 1.

Figure 1 Application of CUP



The CUP method is particularly reliable in the following cases:

- Where an independent entity sells the same product as one sold between two related parties; or
- Where an entity sells the same product to a related party as well as to a third party.

When it is possible to locate comparable uncontrolled transactions, the CUP method is the most direct and reliable way to apply the arm's length principle, and is therefore the preferred method. However, in practice, it is generally difficult to apply the CUP method due to difficulty in making reasonable adjustments to eliminate any product or functional differences between the controlled transactions and uncontrolled transactions eg. technological differences embedded into the different products.

Resale price method

The resale price method (RPM) evaluates the arm's length nature of a controlled transaction by employing the gross profit margin realized in comparable uncontrolled transactions. The RPM is most useful when applied in marketing operations such as distributors where the reseller does not add substantial value to the product.

An analysis using the RPM begins with the price at which a product purchased from a related entity is resold to a third party. This price (the resale price) is then reduced by an appropriate gross margin (the resale price margin), which should cover the reseller's selling and other operating expenses as well as provide a profit appropriate to the functions performed, risks assumed and assets utilized by the distributor. The amount remaining after subtracting the gross margin should reflect the arm's length price for the original transfer of property between the related entities. Figure 2 illustrates the application of this method.

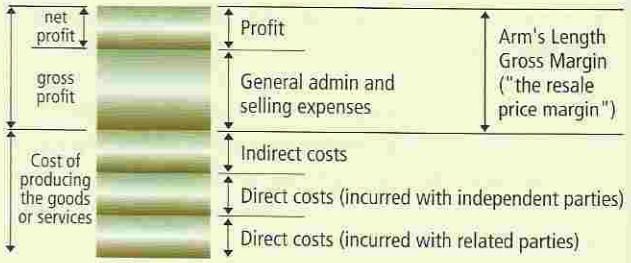
The RPM depends more on the comparability of functions performed by the parties to the transaction and less on the products transacted. As such, the level of activity performed by the reseller will normally influence the resale margin. This level of activity can range widely, from the case where the reseller performs only minimal services as a forwarding agent to the case were the reseller takes on the full risk ownership together with the full responsibility for and risks involved in advertising, marketing, distributing, financing stocks and other connected services. If the reseller in the controlled transaction does not perform a substantial activity and only transfers the goods to a third party, the resale margin could, in the light of the functions performed, be small.

Cost plus method

The cost plus method evaluates the arm's length nature of a controlled transaction by employing the gross profit mark-up realized in comparable uncontrolled transactions. This method is most useful in cases where semi-finished goods are sold between related parties, where related parties have long-term buy/sell arrangements, or where the controlled transaction involves provision of services.

Figure 2 Resale Price Method

Figure 3 Cost Plus Method



An analysis using the cost plus method begins with the costs incurred by the supplier of products or services in a controlled transaction. An appropriate mark-up is then added to these costs to make an appropriate profit in light of the functions performed and the prevailing market conditions. What is arrived at after adding the cost, plus gross mark-up on those costs may be regarded as an arm's length price of the controlled transaction.

The cost plus mark-up of the supplier in the controlled transaction should ideally be established by reference to the cost plus mark-up that the same supplier earns in comparable uncontrolled transactions. In the absence or unsuitability of such information, the cost plus mark-up that would have been earned in comparable transactions by an independent entity may also serve as a guide. An illustration of this method is in Figure 3.

Transactional Net Margin Method (TNMM)

The Transactional Net Margin Method (TNMM) examines the net profit margin realized from a controlled transaction or groups of transactions in relation to the net profit margin realized from comparable uncontrolled transactions. Net margins are less affected by transactional differences in the form of price or even functions as used in the traditional transaction method discussed above.

In applying TNMM, the net margin should be first compared to internal comparable uncontrolled transactions (the net margin earned in comparable transactions with third parties) within the company. Where this is not possible, the net margin that would have been earned in comparable transactions by an independent enterprise may serve as a guide (an external comparable uncontrolled transaction). Where an external comparable uncontrolled transaction is used in a TNMM analysis, a high degree of similarity is required in order for the controlled transactions to be comparable.

The introduction of guidelines will assist in filling the gap by providing groups of companies, both MNEs' and Malaysian group companies with more certainty of what is expected of them in complying with the transfer pricing requirements in Malaysia.

Profit split method

Where transactions are very interrelated, it might be that they cannot be evaluated on a separate basis. Under such circumstances, independent entities might decide to set up a form of partnership and agree to split profits. Accordingly, the profit split method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent entities would have expected to realize from engaging on the transaction.

The profit split method first identifies the profit to be split from the controlled transactions in which the related entities are engaged. It then splits those profits between the related entities on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

The combined profit may be the total profit from the transaction or a residual profit (after deducting the routine profits due to the relevant parties) intended to represent the profit that cannot readily be assigned to one of the parties, such as the profits arising from the high value intangibles. The arm's length price is then determined by the relevant contributions of each entity based on a functional analysis (analysis of the functions performed, risks assumed and assets utilized) and valued, if possible by any available external market data.

Documentation

Whilst some countries have specific documentation requirements which taxpayers are expected to comply with in order to avoid penalties, there are no such specific requirements in Malaysia to-date. Taxpayers are however encouraged to maintain proper documentation to ensure that their transfer pricing practices are supportable and defensible in the event of any queries by the revenue authorities.

A typical transfer pricing documentation would consist of the following:

- A functional analysis setting out an overview of the taxpayers business in context of the overall group company's operations, its markets and competitive forces, as well as the functions carried out, risks assumed and assets and intangibles utilized. The functional analysis generally provides a building block for rest of the documentation, and a basis for characterizing the business.
- Selection and application of transfer pricing methodology that is used in determining the arm's length prices. The rationale for selection of a particular method or methods along with any subsequent adjustments and statistical analysis that are required to arrive at an arm's length range of results will be relevant here. Also, it may be appropriate to include the reasons for not choosing the other methods.
- Validation of the arm's length principle, explaining how all the information from the above steps are used in demonstrating that the transactions being analyzed satisfy the arm's length principle. This will generally involve applying the results of the comparable study to the financial data of the company after making and clearly explaining any necessary adjustments.

Moving forward

Although transfer pricing has been an issue that has been on the minds of both taxpayers and the revenue authorities alike in Malaysia in recent years, there has been a marked missing link between the existing legislation and how companies will be evaluated on their transfer pricing practices. The introduction of guidelines will assist in filling the gap by providing groups of companies, both MNEs' and Malaysian group companies with more certainty of what is expected of them in complying with the transfer pricing requirements in Malaysia.

Experience in other parts of the world show that transfer pricing enforcement evolves over time. Once the level of sophistication in the way the tax authorities handle transfer pricing issues increases, it is our belief that they will be more willing to take the next step forward by issuing additional rulings to address specific issues as well as provide avenues for taxpayers to obtain Advance Pricing Agreements (APA).

Whilst ensuring that proper documentation is in place to justify transfer pricing practices, taxpayers should also explore tax planning opportunities which can arise from streamlining the operations of the various entities within a group of companies.

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1. Comments and opinions presented in this article are personal viewpoints of the author(s). As such, they are not reflective of PricewaterhouseCoopers' perspective on the subject matter.
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Letter from Draconia

On assessibility and chargeability, payment of tax and the responsibility for it.

Much debate has taken place about whether the recent amendment to sec. 75 of the Malaysian *Income Tax Act* renders office bearers ultimately liable to pay the taxes of their companies. I had suggested, in a previous issue of this journal, that the new sec. 75 does indeed make office bearers personally liable. In a subsequent issue, this opinion was labeled "draconian." But in light of the recent dialogue between the IRB and professional bodies such a view would be better described as "Revenue." And if I am accused of being Revenue in my thinking, it must be a habit of mind acquired many years ago as a legal officer and state counsel in the Inland Revenue Department in Singapore.

Until the matter is tested in the courts, it will no doubt remain open to debate as to whether the principal officers of a company are jointly and severally "responsible for... the payment of tax," or if they are (still) merely "responsible for doing all acts and things required to be done *by or on behalf of a company* [for] the payment of tax." To be sure, the Jamaican *Income Tax Act* contained a very similar provision. There, the Privy Council[1] held that it would not have been sound to 'collapse' the section so as to make the principal officers responsible for payment of tax, as distinct from being merely answerable for the things required to be done by the company to pay its own tax.

But, even if that decision remains highly persuasive, the issue must surely be whether or not it would be legally untenable for the Malaysian courts to arrive at a different conclusion on a fresh consideration of the issue. What, after all, did Parliament set out to achieve by adding the phrase "**including the payment of tax**" to sec. 75 if not to impose a joint and several liability on a company's office bearers to pay the tax? It seems abundantly clear that sec. 75 need not have been expanded at all were it not Parliament's intention that tax should, if necessary, be recovered from office bearers.

Prior to the amendment, office bearers were already responsible to ensure that their companies complied with the provisions of the Act. They were responsible for doing all acts and things required to be done by or on behalf of a company for the purposes of the Act. This surely included paying out of the company's funds the income tax assessed. Since vicarious responsibility essentially means the performance of the administrative functions in that connection, the unanswered question would be what else would the new sec. 75 require office bearers to do?

It is not easy to see why sec. 75 should have been amended if not to make office bearers liable for their company's taxes in appropriate cases. Tax statutes are construed in accordance with the principle that a person is only to be taxed on clear words, not on "intendment" or on the "equity" of an Act. The courts may only look at what is clearly said. No doubt there are ample authorities to show that the courts have refused to adopt a construction of a taxing Act that imposes liability where doubt exists. See, for example, **National Land Finance Co-op** where the court preferred not to impute to Parliament an intention to make the appellant retroactively taxable. That however, was so as to conform with the provisions requirements of the Interpretation Act as well as to preserve the fundamental constitutional principle that a judicial decision could not be retrospectively nullified by subsequent legislation. However, "clear words" is to be determined on normal principles: these do not confine the courts to adopting a literal interpretation. The context and scheme of an enactment as a whole must be considered, and the court must have regard to its purpose.[3]

Moreover, a court is not at liberty to treat words in a statute as mere tautology or surplusage unless they are wholly meaningless. On the presumption that Parliament does nothing in vain, the court must endeavour to give meaning to every word of an enactment, and it is presumed that if a word or phrase appears in a statute, it was put there for a purpose and must not be disregarded[4]. The word "including" used in sec. 75 is a term of extension and not of restrictive definition. Thus even without overlooking the fact that *in pari materia* does not mean "identical" — it is clear that the Jamaican provision is not in substance the same as or analogous to sec. 75 because the question of what is meant by the words "*including the payment of tax*" was not in issue there at all. The Jamaican Act clearly provided that the manager or other

[1] *Income Tax Commissioner v Chatani* [1983] STC 477
[2] [1994] 1 MLJ 99
[3] *WT Ramsay Ltd v Inland Revenue Commissioners* [1981] STC 174 at 179–180, per Lord *Wilberforce*

Mr Singh would like to thank his associates Ms Ban Su-Mei and Mr Leon Kwong Wing for their assistance in preparing this article.

Until the matter is tested in the courts, it will no doubt remain open to debate as to whether the principal officers of a company are jointly and severally "responsible for... the payment of tax," or if they are (still) merely "responsible for doing all acts and things required to be done *by or on behalf of a company* [for] the payment of tax."

principal officer of every body of persons should be answerable for doing all such acts, matters and things as should be required to be done by virtue of the Act for the assessment of such body and the payment of the tax. "The assessment" and "the payment of the tax" relating, as they did, by virtue of the Jamaican provision, to the body of persons, there was manifestly nothing in the structure of the sentence which subjoined the principal officer to pay the tax for which the body of persons was assessed.

By contrast, sec. 75 uses the word "including." "Payment of tax" here, therefore, stands on a different footing. Here it is linked not with the words "doing all acts and things required to be done by or on behalf of a company... for the purposes of this Act," but with the words "the responsibility for." That is, the office bearers are ultimately responsible for payment of tax on top of doing all the things required to be done by the company for the purposes of the Act.

Under the scheme of the Act, to be responsible for payment is to be liable to pay the tax. A partnership, resident partner or Malaysian agent of a partnership in whose name a non-resident partner is assessable and chargeable to tax is responsible for payment of the tax due from the non-resident partner.[5] Similarly, any attorney, factor, agent, receiver or manager of a non-resident in whose name his principal is assessable and chargeable to tax is responsible for payment of the tax due from his principal.[6] In default of payment, the tax shall be recoverable from the representative.[7] Thus a person may be liable for payment without having being principally assessable and chargeable to tax. Indeed, it is clear that under the Malaysian *Income Tax Act* a person may be liable for payment without having been assessed and charged at all: a trustee is responsible (liable) for the payment of tax notwithstanding that the income of a trust body shall be assessable and chargeable to tax only on the trust body.[8] "Responsible" according to the dictionary means subject to an authority which may exact redress in case of default. The Government may recover by civil proceedings as a debt any tax due and payable under the Act.[9]

This may or may not be a fine thing depending on your point of view but that is quite a separate matter. The imposition of such a liability is commercially insensitive. It is disappointing to note that the discretion has been reserved entirely to the Director-General and there is no statutory requirement of culpability on the part of the office bearers before resort may be had to the new power. Uncertainty of this type is never conducive to encouraging and attracting foreign investment into the country. What with increased competition for foreign investment coming not only from our neighbouring countries but also from the emerging giant that China is proving to be, we can but seek comfort in the nostrum that things must get worse before they get better.

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[4] *Foo Loke Ying v Television Broadcasts Ltd* [1985] 2 MLJ 35

[5] Section 70(2)

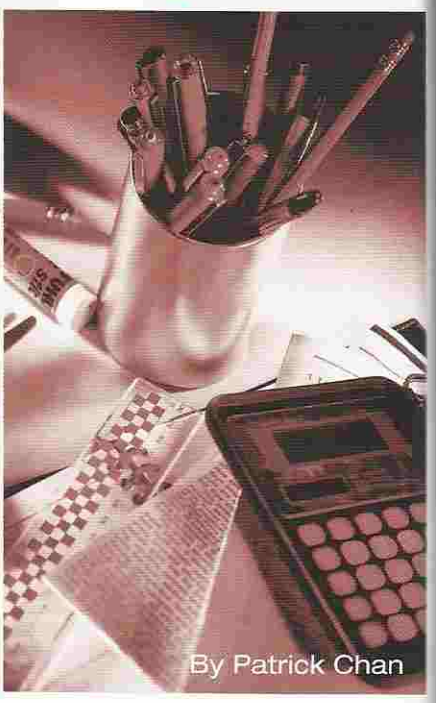
[6] Section 70(1)

[7] Section 67(4)

[8] Section 73

[9] Section 106

The Meaning of "Crediting" for Withholding Tax Purposes – A Synopsis



By Patrick Chan

The *Income Tax Act 1967* (the Act) provides for withholding tax to be remitted to the Director General of Inland Revenue within one month of "paying or crediting" fees that are taxable. "Paying" can be taken to mean when actual funds exchange hands by any means. As such, there is no real need to elaborate upon this term in most situations. However, the Act does not define the meaning of the word "crediting" and the term has caused some confusion over the years as different interpretations may be placed on it by different parties and still be correct in every case. To make matters worse, the word has also not been defined anywhere in statute.

Some dictionaries have defined "crediting" as "entering to the credit in account". If so, does the mere entry in the journal in a company's accounts trigger the need to pay withholding tax within one month of the event? Another dictionary defines "credit" to mean "an amount of money available". Following this, can we therefore conclude that monies must be available to a non-resident before we can say that it is credited? Both definitions are correct in their everyday usage, but are not relevant for withholding tax purposes.

In a Court of Appeal case of ***(The Comptroller of Income Tax v. AB [1960] MLJ 55)***, the shareholders of the XYZ Co Ltd had at a general meeting held on 23 December 1954, passed a resolution as follows: "That a dividend of 250% less income tax at 30% be and is hereby declared for credit to the accounts of shareholders whose names duly appear in the company's share register on 31 December 1954, to pay off any amount any of them may owe to the company and also to pay for the value of the shares which the directors are contemplating issuing to them in the near future."

The respondent owed the company $380 as of 23 December 1954. On 31 December 1954, his account was credited with a dividend of $20,000 less $6,000 income tax at the rate of 30% and also $1,000 being director's fees for the years 1952 and 1953. His credit balance at the end of the year 1954 was $14,620. On 30 June 1955 the directors resolved that shares of $100 each be allotted to certain named persons for payment in cash and the respondent was accordingly allotted 140 shares of $100 each. The company debited his account with $14,000 being the value of the new shares allotted to him. Although this case was about whether the dividend was income or capital, it does give some insight to the meaning of the word "crediting" as well.

In delivering the judgment of the Court of Appeal in this case, the learned *Ambrose J* stated that:

"I hold that the whole of the transaction must be looked at, that is, the resolution passed on 23 December 1954, by the company in general meeting, the crediting of the respondent's account with the sum of $14,000 on 31 December 1954 the resolution of the directors of 30 June 1955, giving effect to the resolution of the company, and the debiting of the respondent's account on 31 December 1955, with the sum of $14,000, being the value of 140 shares of $100 each allotted on 30 June 1955."

"These words, in my opinion, express the determination of the company that the money was not to be paid to the shareholders nor placed at their disposal but to be applied as stated in the resolution. Under the circumstances, the shareholders had no option to receive cash in lieu of shares."

"In my opinion, the resolution did not give to the respondent a right to sue for the dividend in cash, his only right being to have the dividend credited to his account and applied as stated in the resolution."

"It follows from the above case that a dividend is not to be treated as income accruing in the Colony merely because it has accrued as a dividend. The money must accrue as income. In my opinion the dividend in question did not accrue by way of income in view of the terms under which it was credited to the respondent's account."

The dividend was not taxed because it was not available to the respondent to do as he pleased. It thus appears that not all amounts "credited" will attract tax. Only those amounts available to the respondent would attract tax. Therefore, in this case, the term credited (which attracts tax) appears to mean "placing at one's disposal". If not, then the amounts should not be subject to tax.

The Malaysian Inland Revenue Board (IRB) is also of the view that an amount is "credited" only when value for the amount owing has been made available to or for the benefit of a non-resident. However, there have been difficulties in relation to the determination of the date of 'crediting' of the amount due to a non-resident, particularly among assessors from different branches of the IRB. The disagreement usually centres on when the amount is "made available" to or for the benefit of the non-resident recipient. Sometimes, officers have taken the word to mean "when a liability has crystallised", i.e. when an entry is made in the books of the payer company even though the recipient cannot utilise the funds in any way. On the other hand, some officers have advised taxpayers to deduct withholding tax on the making of actual payments only. Therefore, it was obvious that some form of clarification of the term was necessary.

Subsequently, through recent communications, the IRB clarified that their interpretation of the term 'crediting' in the Act means something more than a mere journal entry or the accrual of a liability in the accounts of the payer company. The IRB has interpreted "crediting" an amount to mean that the amount has been made available to or for the use of the non-resident. Therefore, the date of "paying or crediting" is the date on which the amount is paid, credited into the bank account of a non-resident recipient, or the date on which the amount is applied against an amount owing by the non-resident recipient in the records of the company i.e. a contra entry. That means the non-resident recipient will have to be able to benefit from the amount in some manner. Therefore, "paying or crediting" means that whichever of the earliest date on which the above actions are taken is to be regarded as the date from which the period of one month for remitting withholding tax is to be computed. If the non-resident recipient cannot apply the amount in any way, then there should be no case to say that the amount is "paid or credited". However, the IRB has mentioned that they will come up with some guidelines on this issue in the near future.

Finally, it's to be noted that the IRB may invoke the anti-avoidance provisions under sec. 140 of the Act against the payer in situations where the amounts are merely credited to an inter-company account, without payments (by cash or credit to bank account or offset of inter-company debt, or by any other means) ever being made, in negating the impact of such tax planning opportunities.

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Judicial Review as an Alternative to Appeal to the Special Commissioners

by W.S.W. Davidson

Until fairly recently, it was assumed that estoppel by representation could not be pleaded against the Government where the Government officer was under a statutory duty to act.

An application of this now outdated principle can be seen in the often quoted Federal Court case of ***Public Textiles Bhd v. Lembaga Letrik Negara*** **(1976) 2 MLJ 58**. In that case the Defendant, Public Textiles Bhd had contracted with the LLN for the supply of electricity to its factory at a rate which was below the prescribed tariff rates under the *Electricity Act 1949*, and had on the faith of the contracted rates costed their products. The Board then sued for payment on the basis of the higher rates specified in the tariff.

In the private sector, these are undoubtedly circumstances which would give rise to an estoppel by representation. The Defendant did plead estoppel. The Board however succeeded in their claim by defeating the plea of estoppel, it being held that estoppel by representation cannot be pleaded against a public corporation on which there is imposed a statutory duty to carry out certain acts in the interest of the public.

For many years, public officials were able to ride comfortably on the basis of this and other similar decisions.

But in recent years, heavy inroads have been made into this principle, through the process of judicial review of administrative action and the development of the related doctrine of legitimate expectation.

It is clear that officials of the Inland Revenue Board as public officers or officers of a statutory corporation, are in no different position to officers in other Government departments or statutory corporations.

The first major tax case where this issue arose was in ***re Preston*** **(1985) 1 AC 835**, a House of Lords case. In that case, the taxpayer had applied for judicial review on the grounds that an inspector in the special investigation section of the Inland Revenue had informed him that he did not intend to raise further queries on his tax affairs if the taxpayer withdrew certain claims for interest relief and capital loss, after which the taxpayer had withdrawn the claims and paid the capital gains tax. The Inland Revenue then after receipt of new information, took steps under sec. 460 of the relevant act to cancel a tax advantage which they claimed he had obtained. The taxpayer failed on the facts as it was held that he had not made full disclosure of the facts; but the importance of the case lies in the fact that it confirmed that the Inland Revenue Commissioners were not immune from the process of judicial review where the taxpayer could show that there has been a failure to discharge the statutory duty or an abuse of power. Unfairness in the purported exercise of the power could amount to an abuse of process. A remedy by way of judicial review is not normally to be made available where an alternative remedy exists, but nevertheless in exceptional cases, judicial review can be entertained where appeal procedures are provided by statute.

Not long after the ***Preston*** case, the case of ***Government of Malaysia v. Jagdis Singh*** **(1987) 2 MLJ 185** came before the Malaysian Supreme Court. The applicant Jagdis Singh had succeeded in the High Court on judicial review in quashing an assessment which had been raised against him on the grounds that it had been issued maliciously and as a vindictive act. The Government's appeal was allowed on two grounds:

a) that following ***Preston***, the Inland Revenue were not immune from judicial process but the remedy should not be made available where an alternative remedy exists save in exceptional cases. Hence in the absence of such circumstances, the applicant should have pursued his remedies through the usual channel of the Special Commissioners;

b) the applicant had not discharged the burden of proving malice and vindictiveness.

The next important case which came before the English Court of Appeal was ***R v. Inland Revenue Commissioners ex parte MFK Underwriting Agents Ltd*** **1990, 1 WLR 1545**. In that case, approaches were made to the Inland Revenue by financial institutions proposing to issue certain bonds, seeking assurances concerning the prospective tax treatment of the proposed bonds and that the amount by which the securities rose in value was taxable as capital and not income. About 62 index linked funds were involved. The particularity of the proposals put to the Revenue varied widely. It was submitted by the taxpayers that the Revenue's policy not to claim the uplift in value as income was made known in the course of the correspondence and their statements were an effective inducement to the applicants to buy the bonds. Subsequently, the Inland Revenue resolved that the taxation element involved would be assessed as income and not capital gain. The taxpayers applied for judicial review on the basis that it would be grossly unfair to the applicants and an abuse of the Revenue's statutory powers if the Revenue were now free to alter its position with retrospective effect to the prejudice of the applicants.

Again the taxpayer failed on the facts, it being held that there were no clear or ambiguous and unqualified representation made and the assurances given did not amount to a general assurance to the market as a whole as to the future tax treatment of other bond issues on different terms.

But the importance of this case lies in the lucid comments of Bingham LJ, the soon-to-be Chief Justice of England. Distinguished counsel for the Revenue, Michael Beloff QC again made the concession (by now inevitable) that the Revenue was not exempt from judicial review. He however argued that judicial review could not lie to oblige the Revenue to act contrary to its statutory duty. To put it simply the Revenue could not be prevented by its previous representations or conduct from collecting tax which they considered to be lawfully due because it was their plain and simple duty to collect the tax.

Bingham L.J. did not accept that the Revenue's discretion was so limited, and he dealt with the Revenue's argument by explaining the principle of 'managerial discretion'. The following are extracts from this important judgment:

> *"I cannot for my part accept that the revenue's discretion is as limited as Mr. Beloff submitted. In the Fleet Street Casuals case [1982] A.C. 617 the revenue agreed to cut past (irrecoverable) losses in order to facilitate collection of tax in future. In Ex parte Preston [1985] A.C. 835 the revenue cut short an argument with the taxpayer to obtain an immediate payment of tax. In both cases the revenue acted within its managerial discretion. The present case is less obvious. But the revenue's judgment on the best way of collecting tax should not lightly be cast aside. The revenue might stick to the letter of its statutory duty, declining to answer any question when not statutorily obliged to do so (as it sometimes is: see, for example, sections 464 and 488 (11) of the Income and Corporation Taxes Act 1970) and maintaining a strictly arm's length relationship with the taxpayer. It is, however, understandable if the revenue has not in practice found this to be the best way of facilitating collection of the public revenue. That this has been the revenue's experience is, I think, made clear by Mr. Beighton who, having described the machinery for assessment and appeal, continues:*
>
> > *"Notwithstanding this general approach in administering the tax system, the board see it as a proper part of their function and contributing to the achievement of their primary role of assessing and collecting the proper amounts of tax and to detect and deter evasion, that they should when possible advise the public of their rights as well as their duties, and generally encourage co-operation between the Inland Revenue and the public."*
>
> *I do not think that we, sitting in this court, have any reason to dissent from this judgment. It follows that I do not think the assurances the revenue are here said to have given are in themselves inconsistent with the revenue's statutory duty.*
>
> *I am, however, of the opinion that in assessing the meaning, weight and effect reasonably to be given to statements of the revenue the factual context, including the position of the revenue itself, is all important. Every ordinarily sophisticated taxpayer knows that the revenue is a tax-collecting agency, not a tax-imposing authority. The taxpayers' only legitimate expectation is, prima facie, that he will be taxed according to statute, not concession or a wrong view of the law: Rev. v. Attorney-General, Ex parte Imperial Chemical Industries Plc. (1986) 60 T.C.I. 64G, per Lord Oliver of Aylmerton. Such taxpayers would appreciate, if they could not so pithily express, the truth of the aphorism of "One should be taxed by law, and not be untaxed by concession:" Vestey v. Inland Revenue Commissioners [1979] Ch. 177, 197 per Walton J. No doubt a statement formally published by the Inland Revenue to the world might safely be regarded as binding, subject to its terms, in any case falling clearly within them. But where the approach to the revenue is of a less formal nature a more detailed inquiry is in my view necessary. If it is to be successfully said that as a result of such an approach the revenue has agreed to forgo, or has represented that it will forgo, tax which might arguably be payable on a proper construction of the relevant legislation it would in my judgment be ordinarily necessary for the taxpayer to show that certain conditions had been fulfilled. I say "ordinarily" to allow for the exceptional case where different rules might be appropriate, but the necessity in my view exists here. First, it is necessary that the taxpayer should have put all his cards face upwards on the table. This means that he must give full details of the specific transaction on which he seeks the revenue's ruling, unless it is the same as an earlier transaction on which a ruling has already been given. It means that he must indicate to the revenue the ruling sought. It is one thing to ask an official of the revenue whether he shares the taxpayer's view of a legislative provision, quite another to ask whether the revenue will forgo any claim to tax on any other basis. It means that the taxpayer must make plain that a fully considered ruling is sought. It means, I think, that the taxpayer should indicate the use he intends to make of any ruling given. This is not because the revenue would wish to favour one class of taxpayers at the expense of another but because knowledge that a ruling is to be publicised and a large and important market could affect the person by whom and the level at which a problem is considered and, indeed, whether it is appropriate to give a ruling at all. Secondly, it is necessary that the ruling or statement relied upon should be clear, unambiguous and devoid of relevant qualification.*
>
> *In so stating these requirements I do not, I hope, diminish or emasculate the valuable, developing doctrine of legitimate expectation. If a public authority so conducts itself as to create a legitimate expectation that a certain course will be followed it would often be unfair if the authority were permitted to follow a different course to*

the detriment of one who entertained the expectation, particularly if he acted on it. If in private law a body would be in breach of contract in so acting or estopped from so acting a public authority should generally be in no better position. The doctrine of legitimate expectation is rooted in fairness. But fairness is not a one-way street, it imports the notion of equitableness, of fair and open dealing, to which the authority is as much entitled as the citizen. The revenue's discretion, while it exists, is limited. Fairness requires that its exercise should be on a basis of full disclosure. Mr. Sumption accepted that it would not be reasonable for a representee to rely on an unclear or equivocal representation. Nor, I think, on facts such as the present, would it be fair to hold the revenue bound by anything less than a clear, unambiguous and unqualified representation."

From this time onwards, it would only be a matter of time before the right case came along and the taxpayer would succeed.

The next major tax case was ***R v. Inland Revenue Commissioners ex parte Matrix-Securities Ltd*** **(1994) 1 WLR 334**, another House of Lords case. I will not deal with this case in detail, since the decision substantially turned on the facts and was decided against the taxpayer on the grounds that the taxpayer's communications had been inaccurate and misleading and there had been no full disclosure. It was another example of the maxim 'fairness is not a one way street'.

With the Court of Appeal case of ***R v. Inland Revenue Commissioners ex parte Unilever*** **(1996) STC 681**, the tide finally turned in favour of the taxpayer. ***Unilever*** was considered to be a model taxpayer and there was no hint of any non-disclosure or misleading statements by them. In short they had put all their cards on the table.

The facts of this case are set out in the headnote to the report which reads as follows:

"The first applicant was the parent company of a large group of companies worldwide. In recognition of the complexity of its tax affairs, an administrative procedure was adopted whereby the Revenue sent a schedule to the applicant seeking an estimate of its likely taxable profits. The schedule was laid out in four columns headed (1) company tax reference; (2) company name; (3) date of year end and (4) amount/notes. The first three columns were completed by the Revenue and in column (4) the applicant would record either 'nil profits', 'loss' or the amount of the profit. It was the group's practice to deduct trading losses from profits of the current year. However, while the schedule was amended in 1987 to incorporate columns headed group relief, double tax relief and advance corporation tax, at no time was there a column headed loss relief. Hence in giving its estimate of taxable profits for column (4) the applicant deducted from estimated total profits the amount of expected trading losses. However, it did not state explicitly that such losses had been so deducted nor did it make an express claim to loss relief pursuant to s. 393 of the Income and Corporation Taxes Act 1988. An assessment based on the information contained in the schedule would be raised and then appealed to keep the position open. Tax was paid in accordance with the estimated assessment and after the applicant's accounts had been finalised, tax computations containing express indications that loss relief was to be claimed, would be prepared and sent to the Revenue. The appeals would be determined by agreement by reference to the finalised tax computations and any outstanding tax paid (or repaid). On thirty occasions over a period of more than 20 years (which represented a quarter of all loss relief claims) the tax computations had been submitted more than two years after the end of the accounting period to which they related but the Revenue had not refused the applicant's claims to loss relief against profits of the current year on those occasions. However, for the three accounting periods ended 31 December 1986, 1987 and 1988 the Revenue did so refuse to allow the applicant loss relief against profits of the current year on the ground that its claims were not made within the statutory time limit required by s. 393(11) since the tax computations for those accounting periods had been submitted more than two years after the end of each respective accounting period. The applicant sought judicial review of the Revenue's decision to refuse its claims on the grounds, inter alia: (i) that, as the applicant had submitted the schedules timeously, valid claims had been made within the two-year time limit; alternatively, (ii) that the Revenue could not in fairness, having regard to its conduct in the past, treat the claim as time-barred; or (iii) that the Revenue ought to have exercised their discretion to allow late claims in the applicant's favour. Macpherson of Cluny J held that the applicant had not made a valid claim within the time limit but granted the relief sought on the grounds that the Revenue could not in fairness, having regard to their past conduct, treat the claim as time-barred and that the Revenue should have exercised their discretion in the applicant's favour. The Crown appealed and by a respondent's notice the applicants cross-appealed against the judge's decision on the first point. (The facts and issues of the second application relating to a subsidiary company of the first applicant were not materially different.)

On the facts it was held on the second issue that:

"While, in the instant case, there had been no clear unambiguous and unqualified representation by the Revenue, such as had been held previously to be necessary before it could be decided that it would be unfair to permit the Revenue to discharge their duty of collecting taxes, the following points led cumulatively to the conclusion that on the unique facts of the instant case to reject the applicant's claims in reliance on the time limit, without clear and general advance notice, was so unfair as to amount to an abuse of power. (i) The categories of unfairness were not closed, and precedent should act as a guide not a cage. Each case had to be judged on its own facts, bearing in mind the Revenue's unqualified acceptance of a duty to

act fairly and in accordance with the highest public standards. (ii) The taxpayer's entitlement to deduct trading losses from other profits in the same year, although provided by statute, gave effect to a very basic principle. A tax regime which did not provide such an entitlement could scarcely be regarded as equitable. (iii) While a statutory provision was not to be overridden or disregarded simply because it was regulatory, it was not irrelevant in considering the overall picture that the time limit provision under consideration in the instant case was regulatory. (iv) While the Revenue had not formally exercised their power to determine the form in which a claim for loss relief had to be made, they had (by sending the applicant blank profit estimate schedules over the 20-year period) indicated the basic information they required at the first stage. Moreover, when amended in 1987, information was thenceforth sought on other reliefs but not on loss relief. (v) Had the Revenue indicated a wish to be told when trading losses were being deducted from profit in the estimated profit schedules the applicant could have complied without difficulty, cost or inconvenience. Giving that information would have involved no disadvantage to the applicant and no advantage to the Revenue. (vi) The consensual procedure adopted by the Revenue and the applicant operated harmoniously for years, to the benefit of both the applicant and the public. (vii) The applicant's almost invariable practice was to set off trading losses against other profits in the same year and therefore would not have been unexpected to the Revenue. (viii) The evidence did not suggest that either the applicant or the Revenue consciously disregarded the time limit rather that there had been a mutual oversight. (ix) If the Revenue's argument was correct, the applicant was seriously prejudiced by the fact that the point was taken now and not before. (x) On an objective but untechnical view, it would be hard to regard the applicant as owing £17m additional tax to the Crown. If that tax was due it could fairly be regarded as an adventitious windfall, accruing to the Crown through the understandable error of an honest and compliant taxpayer, shared over many years by the Revenue. The judge's conclusion had therefore been correct and the appeal would be dismissed. R v IRC, ex p MFK Underwriting Agencies Ltd [1989] STC 873 and Preston v IRC [1985] STC 282 considered.

The threshold of public law irrationality was notoriously high. Moreover, what might seem fair treatment of one taxpayer might be unfair if other taxpayers similarly placed had been treated differently. And in all save exceptional circumstances the Revenue were the best judge of what was fair. It had not, however, been suggested that the detailed history of the instant case had any parallel. The circumstances were, literally, exceptional. It was inconceivable that any decision-maker fully and fairly applying his mind to that history could have concluded that the legitimate interests of the public were advanced, or that the Revenue's acknowledged duty to act fairly and in accordance with the highest public standards was vindicated, by a refusal to exercise discretion in favour of the applicant. That refusal, if fully informed, was so unreasonable as to be, in public law terms, irrational. Council of Civil Service Unions v Minister for the Civil Service [1985] 1 AC 374 applied. Preston v IRC [1985] STC 282 considered."

The importance of this case lies in the fact that the taxpayer was granted judicial review notwithstanding that there was no unqualified representation but only a course of conduct consensually adopted over a course of many years. In this sense the doctrine of legitimate expectation may be considered as even wider than the sister doctrine of estoppel.

In Malaysia, I am not aware of any tax case where judicial review has been granted to quash an assessment on 'legitimate expectation' grounds, but the recent Federal Court case of ***Majlis Perbandaran Pulau Pinang v. Sy Berkerjasama-sama Serbaguna Sungei Gelugor*** **(1999) 3 MLJ 1** has applied legitimate expectation principles to grant judicial review in a planning case. The principles are widely stated and there is no logical reason why the English precedents should not be followed by the Malaysian Courts against the Revenue in tax cases where the circumstances justify it. In fact the tax cases of ***Preston*** and **MFK** are referred to in the judgment.

This case is also of importance in clarifying the applicants right to opt for judicial review in lieu of statutory appeal procedures, in appropriate circumstances particularly where generalized principles of public law are involved. In tax cases, this means that the taxpayer is unlikely to be penalized, as he was in the ***Jagdis Singh*** case, for chosing to take the issue direct to the High Court rather than to take the issue to the Special Commissioners. In answer to the submission that the Respondent should first have exhausted its domestic statutory remedies, Edgar Joseph FC.J gave guidelines which are summarized in the headnote as follows:

"There are certain classes of cases such as planning, employment and tax cases whereby a statute provides for a specialised appeal procedure, and so the courts understandably may not grant judicial review. However, this is always subject to the grant of review in certain cases, for example, where an applicant is able to demonstrate excess or abuse of power, or breach of the rules of natural justice. Though planning cases come under an extensive appellate structure provided for by the Town and Country Planning Act 1976, this does not prevent the Court in appropriate cases from entertaining an application for judicial review in a planning case where the statutory scheme provides no equally convenient remedy (see pp 40B-F).

In the present case, main grounds on which the Society sought judicial review were based on distinct principles of public law or general issues of law, in particular, the Society had clearly raised an arguable case that the Council, a public body, had acted unfairly, abused its powers and had raised the general question of the extent to which representations can bind public bodies. These grounds involve a consideration of generalised principles of public

> *law developed by the Courts to control the exercise of power by public authorities, and as such, judicial review would be the appropriate route to follow rather than appeal. Judicial review in this case, rather than appeal, would be the appropriate route to follow, because by their application, the Society had raised issues of law of public importance, going beyond the significance of the case itself (see pp 40H-41B).*
>
> *The issues which arose for decision were based substantially, if not wholly, on established or admitted facts, and so the only question was their legal significance. The greater speed of judicial review as compared to appellate procedures is a factor which can rightly be put in the balance and weighed and tip the balance in favour of judicial review. The Court is concerned here with a planning case involving a housing project, the object of which, was to provide homes for members of a co-operative society belonging to the less affluent section of society. It was not disputed that many of the flats to be erected had been sold. In such a situation, a swift means of redress was indicated and judicial review would be the natural choice of remedy rather than appeal (see pp 41E-G)."*

The conclusion is now clear. The way is now open for tax practitioners to consider in appropriate cases advising clients to consider the judicial review option to quash an assessment on the grounds that the Revenue has acted in a manner which is so unfair as to amount to an abuse of power. The circumstances which may give rise to this remedy are many and various and cannot be straight jacketed into fixed categories. At least since the ***Unilever*** case, there is no absolute requirement to rely on a representation and a course of conduct acquiesced in over a period of years may be sufficient.

But it is always necessary to bear in mind Bingham LJ's warning that fairness is not a one way street. The obligation of fair dealing and full disclosure applies both ways; and a concession obtained from the Revenue on a set of incomplete facts will not be worth the paper it is written on.

It is suggested that the Court will normally be more inclined to grant judicial review in cases where additional assessments have been raised retrospectively. In recent years, I have come across several cases where tax has been assessed for a number of years on the basis of an established practice, when a 'new broom' on the Revenue side has come in and disagreed with the practice. In my view it is one thing to notify the taxpayer that the established practice will be discontinued for the future although even then it is certainly arguable that an opportunity should be given to the taxpayer for further discussion. However, it is quite another matter for the 'new broom' to take the matter into his own hands by reopening the past years assessments based on the existing practice by raising retrospective assessments for these years. Such a practice undoubtedly smacks of unfair practice, especially where there is an oblique motive for so acting.

In the light of the ***Majlis Perbandaran Pulau Pinang*** case referred to above, the way is now clear to go straight to the High Court. There are several advantages for this course; viz:

a) an early hearing will normally be obtained;

b) the matter will come before a High Court Judge, who will normally be more attuned to dealing with detailed legal arguments rather than the Special Commissioners who are accustomed more to dealing with the technicalities of tax;

c) most importantly, Order 53 of the Rules of the High Court, which deals with judicial review, empowers the High Court at the ex-parte leave stage to grant a stay on the assessments objected to, giving an important form of relief, which is scarcely allowable under the Income Tax Act.

But it is not suggested that the Special Commissioners lack the jurisdiction to quash assessments appealed against on legitimate expectation grounds, and it is my considered view that they do have powers to quash assessments on any grounds which are available under the law. In the ***Hong Kong Privy Council case of Harley Development Inc v. CIR*** (1996) 1 WLR 727, it was held that Hong Kong Board of Revenue with similar statutory powers were entitled to quash assessments on ultra vires grounds.

One disadvantage of opting for the direct High Court route becomes apparent where the taxpayer, in addition to the judicial review grounds of challenge also wishes to attack the assessment on the technical application of the Income Tax and Revenue law, which issues must necessarily go before the Special Commissioners, resulting in a split hearing.

So far I have been discussing judicial review only in the context of quashing assessments, but the remedies available are in no way so limited.

In the case of High Court of Sabah and Sarawak OM No. K7 of 1991, ***Board of Trustees of Sabah Foundation v. DGIR*** judicial review was granted to the Applicant to quash the decision of the Commissioner refusing approval for exemption from income tax as a charitable institution pursuant to item 13(2) of Schedule 6 of the Income Tax (which has since been amended) on erroneous and/or irrelevant grounds.

I will like to conclude this paper by acknowledging the assistance I have received from James Loh, who first introduced me to the legitimate expectation line of tax cases, and my colleague Yatis Ramachandran for their contributions.

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Stay of proceedings in income tax cases: - The silver lining in the dark tax cloud

By Dr Arjunan Subramaniam

The legislation: to pay first

Taxpayers must pay tax on service of a notice of assessment. [Section 103 (1), *Income Tax Act, 1967*]. Where the tax is not paid within 30 days after the service of the notice, the tax is increased by a sum equal to ten per cent [Section 103 (4)] and by a further 5% if the tax or balance of tax remains unpaid upon expiration of sixty days from the date of increase. [section 103 (5A)]. Tax must be paid notwithstanding an appeal to the Special Commissioners [section 103 (1), *Income Tax Act, 1967*]. Tax due and payable, if not paid can be recovered by civil proceedings as a debt due to the Government [Section 106 (3)].

The taxpayer's dilemma

Where a taxpayer is aggrieved with an assessment, he must generally appeal within 30 days of the assessment [Section 99 (1) *Income Tax Act, 1967*]. However, should an aggrieved taxpayer with sound grounds for an appeal pay the tax first? The law provides that he should pay first (Section 103 (1)], and if he succeeds in his appeal, his tax would be refunded. This is sound collection policy. But what are its limits? That is the question addressed in this brief opinion.

The defence against civil proceedings?

In a civil suit under sec. 106, the production of a certificate under sec. 142 (1) is sufficient authority for the court to give judgment for the tax due. Consequently and generally, it is an uphill task to defend a suit for tax payable. Not that it is impossible but that it is improbable. It is not impossible, if it can be shown that the certificate produced is in error as to the due taxes. The certificate is only **evidential** and if it can be contradicted or shown to be inaccurate, it cannot have the effect it was designed for. In ***Government of Malaysia v. Lee Tain Tshung*** **[1992] 1 MLJ 429** the Court held that such certificate is neither genuine nor true. Thus, there is the possibility of rebutting such a certificate where the taxes shown are not correct. The certificate is merely prima facie evidence and like all prima facie evidence, is subject to rebuttal.

Remedies of a taxpayer

Where the Government has applied for summary judgment under Order 014 of the Rules of the High Court 1980 for taxes due supported by a certificate under sec. 142 (1), *Income Tax Act, 1967*, what are the remedies of an aggrieved taxpayer who is of the opinion that the taxes claimed are not due in law?

The first possible remedy is to apply for a stay of proceedings of the civil action claiming the taxes. In the event that judgment has already been obtained, the second remedy, would be to apply for a stay of execution. The principles applicable for a stay in both circumstances are generally the same.

Limits of section 103 (1) and 106 (3), Income Tax Act, 1967

Notwithstanding the provisions of sec. 103 (1) and 106 (3), *Income Tax Act, 1967*, that is, tax is payable notwithstanding an appeal, a court can grant a stay of proceedings or a stay of execution as the case may be: In ***Kerajaan Malaysia v. Jasanusa Sdn Bhd*** **[1995] 2 AMR 1477**, Edgar Joseph, Jr, FCJ said:

"With respect in our view, neither section 103 (1) nor section 106 (3) bars a court in appropriate circumstances from exercising its inherent powers of granting a stay, even in a tax case (see the Supreme Court decision in ***Chong Woo Yit v. Government of Malaysia*** **[1989] 1 MLJ 473** *at page 475 Col. 2 last paragraph per Gunn Chit Tun CJ."* (At page 1493 of the Report).

Even in income tax cases, both a stay of proceedings or a stay of execution may be applied for where there is evidence of special circumstances.

The special circumstances test

The special circumstances test may be summarized as follows:

a) the parameters of the words "special circumstances" are wide. (***Leong Chee Kong & Anor v. Tan Leng Kee (No. 2)*** **[2001] 5 CLJ 408 at page 423**);
b) A factor that needs to be considered is whether by not making an order to stay the execution or proceedings, it would render a successful appeal nugatory, **(Leong, (supra) at page 423),** and therefore the *status quo* ought to be maintained. The fact that the taxpayer may go into bankruptcy if not for a stay must be demonstrated;
c) That fact that the Form Q, appeal form, has not been forwarded to the Special Commissioners through no fault of the taxpayer; and
d) The merits of the appeal is a factor but not a dominant factor (see ***Serangoon Garden Ltd. v. Ang Keng*** **[1953] MLJ 116**).

The Nugatory Test

The nugatory test, that is, if a stay is not granted a successful appeal would be rendered nugatory, is not really a test by itself but part and parcel of the special circumstances test. There are however some judges who are of the view that they are separate tests.

Application of the special circumstances test – *Kerajaan Malaysia v. Jasanusa Sdn Bhd* [1995] 2 AMR 1477

Jasanusa (supra) is a tax case where a stay of execution was granted. Briefly, the facts were:

a) the Inland Revenue obtained summary judgment against the taxpayer;
b) the taxpayer filed Form Q, appeal on 17.2.1992 and
c) the Inland Revenue requested for some information.

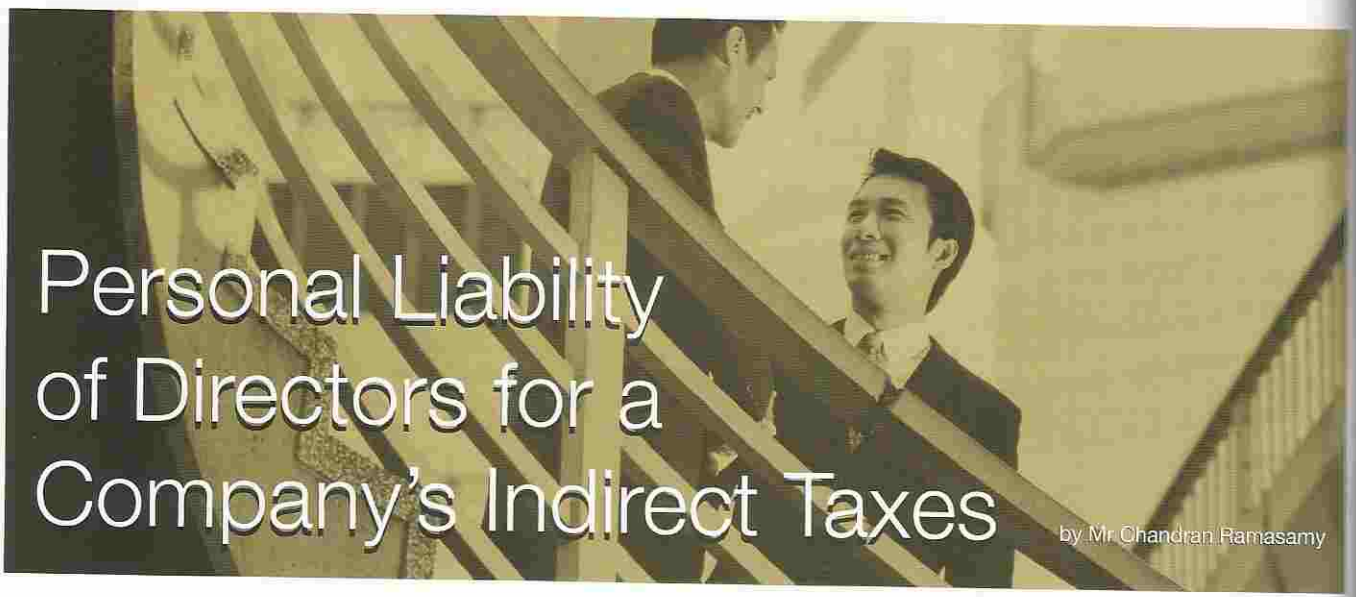
The Court held:

"Matters of this nature involve, inter alia, balancing the need of the Government to realise the taxes and the need of the taxpayer to be protected against arbitrary or incorrect assessments. The court should be ever vigilant against taxpayers who may use the procedure of the court, like applying for a stay of execution, to defer or postpone payment of his just dues or to abscond by migration or to dissipate the assets to defeat the judgment. The court should also bear in mind the possibility of arbitrary or incorrect assessments, brought about by fallible officers who have to fulfill the collection of a certain publicly declared targeted amount of taxes and whose assessments, as a result, may be influenced by the target to be achieved rather than the correctness of the assessment. It should not be much of a difficulty for the court to see the genuineness of an appeal or the willingness of the taxpayer to comply with all reasonable requests of the Director, if they exist and thus move the court to stay the execution. Having so apprised myself of the legal principles, I will now apply them to the facts and deliver my decisions."

A stay was granted.

Conclusion

In very special cases, where special circumstances can be proved, there is still hope to talk first and pay later if the appeal fails in the Courts.



Personal Liability of Directors for a Company's Indirect Taxes

by Mr Chandran Ramasamy

The amendments made by the *Finance Act 2002* to sec. 75 of the *Income Tax Act 1967 (Act 53)* ("ITA"), have raised, by what has been termed a "draconian interpretation" of the amended section, the risk of the Revenue holding inter alia directors of a company personally liable for a company's income tax.

Prior to the amended sec. 75 of the ITA, certain indirect tax laws administered by the Royal Customs Department ("Customs") already had specific provisions on the personal liability of inter alia company directors[1], for the company's indirect taxes and certain other sums payable under the indirect tax laws (also collectively referred to herein as "indirect taxes").

The indirect tax laws in question are those relating to customs duty, sales tax and service tax, namely:

- *Customs Act 1967* (Act 235) ("CA 1967")
- *Sales Tax Act 1972* (Act 64) ("STA 1972")
- *Service Tax Act* 1975 (Act 151) ("STA 1975")

Coupled with the provision on the personal liability of directors, the said indirect tax laws also contain provisions for preventing persons with outstanding indirect taxes from leaving Malaysia[2].

In Table A, a checklist is provided on the indirect taxes and other sums payable under the above indirect tax laws, the provisions on personal liability of directors for the indirect taxes and other sums payable by the company and the provisions on the prevention of persons from leaving Malaysia.

Table A:

Indirect tax law	Indirect tax and other sums, if any, payable	Provision in indirect tax law	
		Personal liability of directors	Prevention from leaving Malaysia
CA 1967	Customs duty	Section 22C	Section 17A
STA 1972	Sales tax, penalty[3], surcharge[4]	Section 26	Section 27A
STA 1975	*Service tax, penalty[3], surcharge[4]*	*Section 17*	Section 18A

The statutory wording imposing liability on directors of a company is largely the same for the CA 1967, the STA 1972 and the STA 1975 and as an example, we quote below the relevant provision in the CA 1967 i.e. sec. 22C:

> *"Where any customs duty is payable by -*
> *a) a company;*
> *b) a firm; or*
> *c) a society, an association or other body of persons,*
>
> *then notwithstanding anything to the contrary in this Act or in any other written law, the directors of such company or the partners of such firm or the members of such society, association or other body of persons, as the case may be, shall, together with such company, firm, society, association or other body of persons, be jointly and severally liable for the customs duty payable:*
>
> *Provided that in relation to a company that is being wound up, the directors of such company shall only be so liable where the assets of the company are insufficient to meet the amount due, after paying any sums having priority over the customs duty under the Companies Act 1965 in relation to the application of the assets of the company in such winding up."*

[1] Whilst this article's focus is on the liability of directors of a company for the company's indirect taxes, it is to be noted that the concept of personal liability under the indirect tax laws extends to partners of a firm (for the firm's indirect taxes), and even members of a society, an association or other body of persons (for the indirect taxes payable by the society, association or other body of person, as the case may be).

[2] The law relating to excise duty (i.e. the Excise Act 1976 (Act 176)) does not have any provision which imposes personal liability on directors of a company for the company's excise duty, though there is a provision for preventing persons who owe excise duty to Customs, from leaving Malaysia.

[3] The penalty is payable under the STA 1972 and STA 1975 respectively, where there is a late-payment of sales tax and service tax. The rate of penalty ranges from 10% to a maximum of 50% of the unpaid sales tax and service tax, depending on how late the payment of sales tax and service tax is.

[4] The surcharge is payable under the STA 1972 and STA 1975 upon default in the payment of sales/service tax and penalty, under any instalment scheme for the payment of sales/service tax and penalty, as approved by Customs. The rate of surcharge is 10% of the outstanding balance of sales/service tax and penalty as at the date of default.

In relation to the provisions of the STA 1972 and the STA 1975, besides the relevant indirect tax being payable i.e. sales tax and service tax respectively, the penalty and surcharge imposed under the STA 1972 and the STA 1975 are also payable.

It is to be noted that the provisions of the STA 1972 and the STA 1975 have undergone amendments in 1999 and 2001 purportedly to make them more onerous. To compare the varying extent of liability of company directors, especially as a result of amendments made in 1999 and 2001, Tables B, C and D set out a summary of the provisions before and after the relevant amendments to the CA 1967, STA 1972 and the STA 1975.

In short, the provisions of sec. 22C of the CA 1967, sec. 26 of the STA 1972 and sec. 17 of the STA 1975, hold directors of a company jointly and severally liable, together with the company, for the company's indirect taxes, with the single exception being found in the respective proviso to the aforesaid sections, which stipulate that, in the case of a company being wound up, the directors of such a company would only be liable where the company's assets are insufficient to cover the indirect taxes, after the payment of sums having priority over the indirect taxes under the *Companies Act 1965*[5].

Table B: Section 22C of the CA 1967

Before amendments in 2001 (w.e.f 6.7.2001)	After amendments in 2001 (w.e.f 6.7.2001)
No provision in the CA 1967 to hold directors personally liable for the customs duty payable by the company.	Section 22C inserted into the CA 1967. - Directors together with the company are jointly and severally liable for the customs duty payable by the company. Proviso: Provided for companies being wound up, the directors are only liable where the company's assets are insufficient to meet the amount due after distribution in accordance with the order of priorities under the Companies Act 1965.

Table C: Section 26 of the STA 1972

Before amendments in 1999 (w.e.f 1.1.2000)	After amendments in 1999 (w.e.f 1.1. 2000)	After amendments in 2001 (w.e.f 6.7. 2001)
Directors, including persons who were directors of a company during any taxable period shall, together with the company, be jointly and severally liable for the sales tax liability incurred by the company for any such taxable period.	Directors, including persons who were directors of a company shall, together with the company, be jointly and severally liable for the sales tax, penalty or surcharge due and payable by the company. (Note: "taxable period" deleted)	(Same as position after amendments in 1999, except for insertion of proviso for companies being wound up, similar to the proviso to section 22C, CA 1967.)

Table D: Section 17 of the STA 1975

Before amendments in 1999 (w.e.f 1.1.2000)	After amendments in 1999 (w.e.f 1.1. 2000)	After amendments in 2001 (w.e.f 6.7. 2001)
Directors of a company shall, together with the company, be jointly and severally liable for the service tax or penalty due and payable by the company.	Directors of a company shall, together with the company, be jointly and severally liable for the service tax, penalty or surcharge due and payable by the company.	(Same as position after amendments in 1999, except for insertion of proviso for companies being wound up, similar to the proviso to section 22C, CA 1967.)

Set out below, is a brief discussion on some of the pertinent issues arising from the imposition of personal liability on company directors for a company's indirect taxes.

When would the tax authorities exercise the power to recover indirect taxes from directors of a company?

There is evidence of a statement being made by Customs on self-imposed limits as to when it would exercise its power to recover a company's indirect taxes from the company's directors. The statement was made by the Deputy Minister of Finance (the Minister of Finance has jurisdiction over Customs) when he tabled the *Customs (Amendment) Bill 2001* in Parliament, which proposed the introduction of sec. 22C of the CA 1967. (The statement was made in the context of the CA 1967, but as it relates to the concept of recovery of indirect taxes of a company from a company's directors, it is the writer's view that it would be equally applicable to the STA 1972 and the STA 1975). Extracted below is the statement by the Deputy Minister of Finance from Hansard (Dewan Negara, 5 June 2001), as it appears on the website of Parliament (www.parlimen.gov.my):

> "...Sebelum tindakan yang disebutkan dalam seksyen 22C [diambil] ... tindakan-tindakan untuk mendapat balik wang kerajaan harus dilakukan dahulu ... termasuk tuntutan melalui cagaran ataupun jaminan bank, tindakan tahan dagangan, tindakan untuk mendapat bantuan daripada agensi-agensi kerajaan yang lain seperti pejabat pendaftar syarikat dan perniagaan dan sebagainya, senarai hitam penama si penghutang di Jabatan Imigresen, kaviet pendaftaran atas tanah kepunyaan si penghutang dan sebagainya. *Maka setelah semua tindakan diambil dan duti kastam yang harus diterima tidak juga diperolehi oleh pihak kastam, maka tindakan di bawah seksyen ini akan diambil oleh pihak kastam.*" (Emphasis added.)

From the above statement, it appears that the power under sec. 22C of the CA 1967 (and the other equivalent provisions of the STA 1972 and the STA 1975) would only be exercised as a matter of last resort, after Customs has exhausted all other avenues to recover the indirect taxes.

[5] As the indirect taxes are federal taxes, they are unsecured preferential debts which would rank sixth in line of the preferential payments listed under section 292(1) of the Companies Act 1965.

However, this has not been the case in reality as Customs has been known to issue notices of demand to company directors to pay up their company's indirect taxes, without first exhausting the other avenues available to recover the indirect taxes directly from the company.

Indeed, one of the means to recover the indirect taxes, as mentioned in the above-quoted statement by the Deputy Minister, i.e. "Immigration `blacklisting'" (which means basically preventing a person from leaving Malaysia under sec. 17A of the CA 1967, sec. 27A of the STA 1972 and sec. 18A of the STA 1975), seems to be premised upon the exercise of the power to recover the indirect taxes from the directors, rather than a step taken prior to the exercise of the said power. This is because it seems obvious that only individuals can be prevented from leaving Malaysia and it only seems logical that, in the context of personal liability of directors for a company's indirect taxes, the directors of the company would only be prevented from leaving Malaysia due to non-settlement of a notice of demand raised by Customs against them, in their personal capacity, for the company's indirect taxes.

Thus, the seemingly ambiguous and equivocal statement by the Deputy Minister does not appear to be capable of instilling a legitimate expectation on the part of anxious directors, that they would only be held to account for their company's indirect taxes as a matter of last resort.

The lack of statutory safeguards for directors against incurring personal liability for a company's indirect taxes

The lack of safeguards or defences against directors' incurring personal liability is an issue that was highlighted during the debate in the Dewan Negara on the proposed insertion of sec. 22C of the CA 1967. (Once again, though the debate centred on the CA 1967, in the writer's view it ought to be equally relevant to the STA 1972 and the STA 1975.)

A senator in the Dewan Negara had proposed a proviso to sec. 22C of the CA 1967 as a defence or safeguard for directors who do not actively participate in a company's affairs, in particular so-called "independent directors" who are required to be appointed as directors of companies listed on the Kuala Lumpur Stock Exchange ("KLSE").

Below is an extract from the statement by Senator Datuk William Lau Kung Hui, in *Hansard* (Dewan Negara, 5 June 2001), as it appears on Parliament's website:

"... saya berasa pihak kementerian mungkin bersikap sedikit keras, dengan izin, *a little too strict* kepada pengarah syarikat kerana saya tidak nampak apa-apa atau mana -mana pembelaan atau defence, dengan izin, diberikan kepada pengarah yang tidak mengambil bahagian dalam pengurusan syarikat mereka...

Tuan Yang di-Pertua, dalam syarikat khususnya dipaparkan dalam Bursa Saham Kuala Lumpur (BSKL) kerajaan telah selama ini memperkenalkan sebagai pengarah bebas atau bukan mempengaruhi, dengan izin, *independent director*. Pengarah bebas, dengan izin, *is required by the KLSE Listing Requirement, as a matter of law for all public listed companies.*

Tuan Yang di-Pertua, ciri-ciri yang ada pada pengarah bebas ialah tidak terdiri daripada kalangan pegawai syarikat, tidak ada hubungan dengan pegawai syarikat atau mewakili pegangan saham keluarga, tidak mewakili kepentingan –kepentingan saham awam, ... bebas daripada sebarang ikatan yang boleh mempengaruhi keputusannya.

Tuan Yang di-Pertua, saya merasa pihak berkenaan tidak menunjukkan apa-apa keadilan kepada pengarah bebas kerana mereka tidak diberikan apa-apa peluang supaya boleh membela diri.

Tuan Yang di-Pertua, saya mencadangkan supaya pihak kementerian sepatutnya memasukkan satu *proviso*, contohnya seperti berikut. Jika pertubuhan berkenaan gagal membayar duti kastam yang kena dibayar, mana-mana orang yang merupakan pengarah, pengurus, setiausaha atau pegawai serupa itu yang lain bagi pertubuhan perbadanan itu hendaklah disifatkan bertanggungjawab melainkan jika dia membuktikan bahawa;

a) kegagalan atau kesalahan itu telah dilakukan tanpa pengetahuannya, keizinannya atau pemberiannya; dan

b) bahawa dia telah mengambil segala langkah berjaga-jaga yang munasabah dan menjalankan segala usaha yang sewajarnya untuk mengelakkan perlakuan kesalahan itu.

Tuan Yang di-Pertua, saya memang merasa bimbang jikalau pihak kementerian akan melaksanakan pindaan berkenaan tanpa mengambil kepentingan tentang pengarah bebas yang dikenali sebagai, dengan izin, *independent directors*."

The proviso suggested by the Senator is similar to the existing defence found in the CA 1967, the STA 1972 and the STA 1975, whereby directors would not incur

criminal liability for offences committed by a company, if they can prove the following:

a) that the offences were committed without their consent or connivance; and
b) that they exercised all such diligence to prevent the commission of the offences as they ought to have exercised, having regard to the nature of their functions in that capacity and to all the circumstances.

In reply, the Deputy Minister of Finance made this statement, per *Hansard* (Dewan Negara, 5 June 2001), as it appears on Parliament's website:

"... individu-individu yang bersedia memegang jawatan pengarah ataupun berkongsi dalam mana-mana syarikat perlu memainkan peranan aktif dan tidak wujud sebagai *sleeping partner* dalam aktiviti syarikat dan dengan ini sama-sama dapat membangun dan menjayakan sesuatu syarikat dan seterusnya negara ini di samping menambahkan kualiti *entrepreneurship* Malaysia. Maka pengarah yang memberi alasan bahawa mereka tidak memainkan peranan dalam sesuatu syarikat ini memang tidak boleh diterima oleh pihak kerajaan khususnya pihak kastam."

Although the Deputy Minister did not directly address the Senator's proposed defence for directors against incurring personal liability for a company's indirect taxes, nevertheless, from the Deputy Minister's emphasis of the Government's position of not accepting any excuse that directors are not active in a company, it is quite obvious as to why such a defence was not given any consideration by the Government.

In practice, it is known that Customs has issued notices of demand for indirect taxes against directors of a company who do not play any role in the company's affairs (apart from being 'titular' directors).

Is personal liability to be restricted to directors who hold office at the time the company incurs the liability for the indirect taxes?

Section 22C of the CA 1967 does not give any explicit indication as to whether the personal liability of directors is to be restricted to individuals who hold office as directors during the time when the company incurs the liability for the customs duty.

In the STA 1972, prior to the amendments in 1999, sec. 26 of the STA 1972 made it very clear that liability for sales tax incurred for a "taxable period" is to be attributed to directors of a company *during the taxable period*. (The term "taxable period" refers to the period of two months or permitted accounting period in respect of which a licensed manufacturer under the STA 1972 is required to submit sales tax returns to Customs to account for any sales tax which falls due – in other words, "incurred" - in that taxable period.)

Amendments were made in 1999 to remove the reference to "taxable period" from sec. 26 of the STA 1972, which raises the issue whether a person who is not a director during the relevant taxable period (of the company) in which the sales tax falls due, or, when the penalty or surcharge is incurred by the company, would be liable for the sales tax, penalty or surcharge. It is the writer's view that since the intention of removing the reference to "taxable period" was not made expressly clear, the position before the amendments ought not to be said to have been altered. This view is based on a cardinal principle of statutory interpretation as re-emphasised in the following passage in the judgment of *Peh Swee Chin* SCJ in *Chan Chin Min & Anor v Lim Yok Eng* [1994] 3 MLJ 233:

> *"There is one important principle of statutory interpretation which has been applied repeatedly over the years. It is this, that it is in the highest degree improbable that Parliament would depart from the general system of law without expressing its intention with irresistible clearness ... I would also agree 'that interpretation should be chosen which involves the least alteration of existing law'..."*.

In relation to service tax, from the inception of sec. 17 of the STA 1975 there is no reference therein to the service tax liability being restricted to directors of a company who hold office during the taxable period (of the company) in which the service tax is incurred (in other words, falls due).

In the writer's view, notwithstanding the absence of any explicit reference in the CA 1967 or the STA 1975 on the restriction of personal liability to individuals who hold office as directors during the time when the company incurs the liability for the indirect taxes, such a restriction is to be necessarily implied in the said provisions. It would be repugnant to the principles of justice to leave the provisions on personal liability of directors 'open-ended', in the sense that future directors would have to suffer the 'sins' of their predecessors!

The Author

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"To penalise or not to penalise ...that's not the question"

By En. Mokhtar Mahmud

From time immemorial, the enforcement of laws and regulations has always been dependent on man's basic weakness, fear. In certain societies, we were brought up to fear the law, which ironically were meant to protect us in the first place. We fear the policeman, we fear the municipal council's enforcement officers, and we fear just about anybody in uniform. Why we fear is anybody's guess, but basically I think we are afraid of the reprisals that come with not toeing the line. Anybody who does not toe the line will be punished. Yes, we are afraid of being punished, we are afraid of being penalized.

Generally, any tax laws in any country will incorporate provisions for some form of penalty as punishment for a failure to perform a required act, for example, the failure to submit tax returns or the failure to pay tax. In taxation, a penalty is both a deterrent and is meant to deter non-compliance and indirectly encourage compliance on the part of taxpayers. In this regard, both the *Sales Tax Act, 1972* and the *Service Tax Act, 1975* have such provisions. Section 24 of the *Sales Tax Act, 1972* (prior to its amendment) reads:

"Where any amount of sales tax remains unpaid after the last day on which it was payable under section 2 of section 22 -

a) a penalty equal to ten per cent of such unpaid amount shall thereupon be payable;

b) if the sales tax due and payable remains unpaid for more than thirty days after the last day on which it was so payable the rate of penalty under paragraph (a) on such unpaid sales tax shall be increased by two per cent for the second period of thirty days after such last day and for every succeeding period of thirty days or part thereof during which such amount remains unpaid to a maximum of fifty percent."

Likewise, the *Service Tax Act, 1975* has a similar penalty provision in sec. 16. These provisions were later amended to provide for more punitive action against recalcitrant taxpayers. Section 24 of the *Sales Tax Act, 1972* was amended and came into force on 1 January, 2000. The amended sec. 24 reads:

" Where any amount of sales tax remains unpaid after the last day on which it was payable under subsection (2) of section 22 -

a) a penalty equal to ten per cent of such unpaid amount shall thereupon be payable;

b) if the sales tax due and payable remains unpaid for more than thirty days after the last day on which it was so payable the rate of penalty under paragraph (a) on such unpaid sales tax shall be increased by ten per cent for the second period of thirty days after such last day and for every succeeding period of thirty days or part thereof during which such last amount remains unpaid to a maximum of fifty per cent"

Section 16 of the *Service Tax Act, 1975* was also amended and came into force on 1 January, 2000. The rate of penalty was also raised from 2% to 10% just as in sec. 24 of the *Sales Tax Act, 1972*.

The amended sec. 16 now reads:

"Where any amount of service tax deemed payable remains unpaid after the last day on which it is payable under section 14-

a) a penalty equal to ten per cent of such unpaid amount shall thereupon be payable;

b) if the service tax due and payable remains unpaid for more than thirty days after the last day on which it was so payable the rate of penalty under paragraph (a) on such unpaid service tax shall be increased by ten per cent for the second period of thirty days after such last day and for every succeeding period of thirty days or part thereof during which such amount remains unpaid to a maximum of fifty per cent."

To ensure compliance, it is not enough to just have the penalty provisions for the respective Acts, there must be corresponding provisions that empower the tax authorities to recover such penalty. This is provided for by sec. 30 of the *Sales Tax Act 1972* and sec. 20 of the *Service Tax Act 1975*. Under sec. 30, the tax authorities may issue of Bills of Demands to an errant taxpayer. Prior to its amendment, sec. 30(1) read:

"30(1) Where

a) the whole or any part of any sales tax, or other moneys payable under this Act has not been paid; or

b) .....

then, provided a demand is made within three years from the date on which such sales tax or other moneys were payable, or the deficient sales tax or other moneys were paid, or refund was made, as the case may be, the person liable to pay such sales tax or other moneys .....shall pay the deficiency ....."

The amended sec. 30(1) which came into force on 1 January 2000 reads

> *"30(1) Where –*
>
> *a) the whole or any part of any sales tax, penalty or other moneys payable under this Act has not been paid; or*
>
> *b) .....*
> *then, provided a demand is made within three years from the date on which the sales tax, penalty or other moneys were payable, or the deficient sales tax, penalty or other moneys were paid, or refund was made, as the case may be, the person—*
>
> *aa) liable to pay—*
> *i) the sales tax, penalty or other moneys; or*
> *ii) the deficient sales tax, penalty or other moneys; or*
>
> *bb) .....*
> *shall pay the sales tax, penalty or other moneys, or the deficient sales tax, penalty or other moneys, or repay the refund erroneously paid to him, as the case may be."*

The *Service Tax Act, 1975* prior to the amendments to sec. 15 and 20 which came into force on 1 January 2000, on the other hand, have a provision for the recovery of penalty accrued for late payment of tax in sec. 15. Such a penalty however, may only be recovered as a civil debt due to the Government.

Looking at the respective provisions prior to their amendments, it would appear that any claim for penalty accrued then by the tax authorities under the old sec. 30(1) of the *Sales Tax Act, 1972* or sec. 15 of the *Service Tax Act, 1975* is questionable. Firstly, sec. 30(1) of the *Sales Tax Act, 1972* did not provide for the "penalty". Secondly, a penalty under the *Service Tax Act, 1975* must be recovered as a civil debt and therefore go through the due process of law before it can be recovered.

Since the claims for penalties for late payment of tax were made by invoking sec. 30(1) of the *Sales Tax Act 1972* and sec. 20 of the *Service Tax Act 1975*, this raises questions as to the validity of the claims made of penalties by the tax authorities for "penalties accrued" prior to the amendments to sec. 23 and 30(1) of the *Sales Tax Act 1972* and sec. 15 and 20 of the *Service Tax Act 1975* respectively.

Prior to the amendment, sec. 30(1) of the *Sales Tax Act 1972* did not specifically mention the word "penalty" but rather the words "other moneys" and this was presumed to include penalty. This being the case, it seemed correct to frame claims under this provision (though it was never challenged then). However, since the amendment to sec. 30(1) makes specific provision for "penalty" (as explained in Fasal 13, Rang Undang-Undang Akta Cukai Jualan 1972 (Pindaan) 1999) and came into effect on

" ...tax administrators not only owe a duty to the Government but also the taxpayers to ensure the taxpayers are not wrongly assessed."

1 January 2000, it is arguable that claims made previously under sec. 30(1) for penalties are invalid. Simply put, there was no legal provision under sec. 30(1) to allow for such claims then.

Fasal 13 presented in Parliament proposed to amend sec. 30(1) reads:

> *"Fasal 13 bertujuan untuk meminda subseksyen 30(1) Akta 64 (Akta Cukai Jualan 1972) untuk mengadakan peruntukan bagi mendapatkan penalti yang tidak dibayar, terkurang bayar atau tersilap dipulangkan balik."*

Literally translated, Fasal 13 seeks to amend subsection 30(1) of the *Sales Tax Act 1972* so as to provide a provision for the recovery of penalty.

The *Sales Tax Act 1972*, however, provides for claims of penalty under sec. 23(1) to be recovered by the Minister of Finance as a civil debt. (Likewise, sec.15 of the *Service Tax Act, 1975* provides for similar provision). In such an event, any recovery of such penalties is restricted by sec. 6(4) of the *Limitation Act, 1953*. This being the case, any claim under sec. 23(1) must be made by filing such claims in Court within one year from the date of the cause of action. Hence, any claim filed after the stipulated period can be considered invalid.

Without doubt some of us fear the law but in this case, the law also affords us protection from unjust "punishment". It also goes without saying that the tax administrators not only owe a duty to the government but also the taxpayers to ensure that the taxpayers are not wrongly assessed.

This being the case, to penalize or not to penalize, is not the question. The question is whether the tax authorities should withdraw such claims for penalties accrued prior to the amendments to sec. 23(1) and 30(1) of the *Sales Tax Act 1972*, or sec. 15 and 20 of the *Service Tax Act 1975* as there may be no legal basis to make such claims in the first place.

The Author

En. Mokhtar Mahmud worked in the Customs Department since 1973. Upon his optional retirement, he took up employment with PW as a Managing Consultant in the Indirect Tax Advisory Group in 1996. After 2 years with PW, he and his partner set up their own Indirect Tax Consultancy Practice (Top Tiers Services Sdn Bhd).

Taxation of E-Commerce: A Hong Kong Perspective

By Clement Yuen and Peter T. Ho

The advent of computer technology has changed the way business is conducted. Nowadays, a website is not only used for promotional purposes, it also serves as a platform whereby business transactions can be done across-the-border via the internet.

From a tax perspective, the emergence of e-commerce poses a new challenge to the tax authorities around the globe to search for a proper way to tax the profits derived from e-business.

A special task force was set up by the Organisation for Economic Co-operation & Development ("OECD") to consider the taxation issues faced by e-commerce and its underlying technologies. However, much debate focused on jurisdictions which tax on the basis of residence, while relatively fewer were discussed for source-based jurisdictions, like Hong Kong.

In this article, the author attempts to highlight the current law and practice in Hong Kong in the context of taxation of e-commerce. Obviously, it is impossible to embrace all taxation issues associated with the transactions surrounding e-commerce in such a short article. Readers should therefore appreciate that this article should be regarded as an introduction to the taxation of e-commerce from Hong Kong's perspective.

HONG KONG PROFITS TAX

Hong Kong adopts a territorial basis of taxation. The main charging sec. for the Hong Kong profits tax is contained in sec. 14 of the Inland Revenue Ordinance ("IRO"). Broadly, it provides that profits tax is imposed on a person who is

- carrying on a trade, profession or business in Hong Kong; and
- the profits to be charged must be derived from such trade, profession or business carried on by the person in Hong Kong; and
- the profits must be profits arising in or derived from Hong Kong.

Under the IRO, "profits arising in or derived from Hong Kong" is defined to include all profits from business transacted in Hong Kong, whether directly or through an agent. As you can see, profits tax is confined to the person who carries on a trade, profession or business in Hong Kong AND derives Hong Kong sourced profits.

There is also a deeming provision contained in the IRO (sec. 15(1)) that deems certain receipts, which might not otherwise be caught under sec. 14 of the IRO, to be receipts arising in or derived from Hong Kong from a trade, business or profession carried on in Hong Kong. This mainly captures receipts derived from intangibles and intellectual property, the generation of which does not necessarily require the physical presence of a business in Hong Kong. Such receipts include amounts received for the use of or the right to use in Hong Kong, a patent, design, trademark, copyright material, secret process, formula, or other similar properties.

TRADE, PROFESSION OR BUSINESS CARRIED ON IN HONG KONG

Traditionally, it would be convenient to establish an office and to hire staff to facilitate business transactions. In the context of e-commerce, a company carrying on its business may well require less physical operations, personnel and facilities in a particular location when compared to an enterprise which is engaged in a more conventional mode of business. Virtual business can be conducted almost anywhere and instantaneously without an office or even without human intervention. All that is required is a computer and a network that connects the buyers and sellers of goods and services. Therefore, would the maintenance of such a computer system in Hong Kong which conducts electronic transactions constitute "carrying on a business in Hong Kong"?

Whether or not a trade, business or profession is carried on is largely a question of fact to be decided based upon all circumstances. Generally, it does not require extensive activities to bring a person within the ambit of "carrying on a trade or business".

In a recent Hong Kong case, a taxpayer, a Hong Kong incorporated company owned by Australian residents, carried on all business in Australia. All decisions and negotiations of contracts took place outside Hong Kong. However, the taxpayer maintained a bank account in Hong Kong, together with some other records. While it appeared that the bulk of the activities were carried out outside Hong Kong, the court nonetheless held that a business was carried on in Hong Kong.

HONG KONG SOURCED PROFITS

However, even if one is regarded as carrying on a business in Hong Kong, it does not follow that profits tax liability will automatically arise. It is also necessary that the person has derived Hong Kong sourced profits from that business in order to bring that person within the Hong Kong profits tax net.

In this respect, determining whether one has derived Hong Kong sourced profits is never clear even in the context of conventional business. In e-commerce, this matter becomes more complicated as one can easily manipulate the *situs* of the transactions taking place.

On the issue of the locality of profits, the Hong Kong Inland Revenue Department ("IRD") has issued Departmental Interpretation & Practice Notes ("DIPN")[1] No. 21 that states the IRD's position on these matters. It should be noted that the DIPN is issued for guidance only, and have no binding force in law. Nevertheless, it provides good guidance to taxpayers and practitioners as the DIPN explains the stance adopted by the IRD on controversial issues. There is still no specific tax law in Hong Kong that addresses the "source rules". Therefore, apart from referring to the DIPN, people have to rely on previous cases as guidelines in determining the source of profits. With regards the trading of goods, one of the most important factors in determining the source of trading profits is the place where the contracts for sale and purchase were effected, as stated in DIPN No. 21. Nevertheless, case law is developing towards making other operational factors, which are part and parcel of the income generation process, relevant. Based on precedents[2] and the current practice of the IRD, the board guiding principle is to look at "what the taxpayer has done to earn the profits in question and where he has done it". It is the totality of facts that will be considered by the IRD and the courts in determining the locality of profits for tax purposes. Factors like:

- How were the customers solicited?
- How and where the goods were procured and stored?
- How and where the orders were received, processed and confirmed?
- How payment was arranged?
- How the financing was arranged?

are all relevant in determining the source of profits. Each factor should be identified, weighed and considered in the context of that particular business before the source can be determined.

THE CONCEPT OF PERMANENT ESTABLISHMENT ("PE")

It is well recognised that the concept of PE has been adopted by the OECD countries to facilitate the determination of taxing rights in the country of source and the country of residence. In Hong Kong, PE is defined in the Inland Revenue Rules No. 5 ("IRR 5"), a subsidiary legislation of the IRO.

Under IRR 5, PE is defined as "a branch, management or other place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of his principal or has a stock of merchandise from which he regularly fills orders on his behalf".

Therefore, if a non-resident person has a PE within the meaning of IRR 5, the non-resident person can be regarded as carrying on a trade or business in Hong Kong.

In applying IRR 5 in the context of e-commerce, an issue arises as to whether a non-resident person selling products through a server that it owns or rents and operates in Hong Kong should be regarded as having a PE in Hong Kong.

TRADING INCOME

Let's look at the Hong Kong profits tax implications on income derived from trading through e-commerce. There are two typical scenarios: firstly, an overseas supplier selling goods to Hong Kong customers ("scenario 1"); and secondly, a Hong Kong supplier selling goods to overseas customers ("scenario 2"). The IRD has issued a Departmental Interpretation & Practice Note No. 39 – Treatment of Electronic Commerce in July 2001 to lay down it's current position on e-commerce.

According to the DIPN No. 39, a "branch, management or other place of business" maintained by overseas supplier in Hong Kong is commonly understood to imply some physical place and personnel. With the exception of a representative office, the overseas supplier is likely be considered as maintaining a PE and carrying on a business in Hong Kong. However, IRD is of the view that a mere presence of a server in Hong Kong by the overseas supplier does not constitute a PE in Hong Kong. The IRD further clarifies that the term "agent" can refer to either a natural person or a legal person, but does not include software or a server. The IRD further confirmed that software on a server or an Internet Service Provider who merely operates a server under a web site hosting arrangement will not be regarded as an agent.

In fact, the IRD has made reference to the OECD's position in DIPN No. 39. The OECD takes the view that a server at the disposal of a business (i.e. owned or rented) can only be regarded as a PE of the business if an essential and significant part of its business activities are conducted through the server. This is the case even if no personnel of the business are required at the server's location for the operation of the server. However, given the different considerations and the slightly different definition of PE, the IRD maintains its view that a non-resident supplier selling products merely through a server it owns, rents and/or operates in Hong Kong does not in itself constitute a PE in Hong Kong. Similarly, a Hong Kong supplier doing substantially all of its transactions through a server located outside Hong Kong does not necessarily mean that it does not carrying on a business in Hong Kong.

The second criteria for taxability in Hong Kong is the source of profits. Without devising new rules in governing the source of profits derived from e-commerce, the IRD adopts the principle of neutrality and would apply the same Inland Revenue Ordinance and the same tax principles established by judicial precedents on e-commerce. Therefore, the DIPN No. 21- Source of Profits, that was promulgated in respect of conventional business, would also be applicable to e-commerce. Having

[1] Departmental Interpretation & Practice Notes ("DIPN") No. 21 (revised), entitled " Locality of Profits" issued in March 1998. Readers can access these DIPN via the Internet.

[2] Privy Council decision in Commissioner of Inland Revenue vs. Hang Seng Bank (3 HKCT 351)

recognised that business operations in the internet environment is largely automated and is commonly carried out using a server located outside Hong Kong, the IRD acknowledged that the mere location of a server, where contracts may be concluded and payment processed automatically, cannot be the sole determinant factor in deciding where the profits are earned. As afore-mentioned, the totality of facts has to be considered. The IRD has taken the view that it should be generally the physical business operations, rather than the location of the server alone, that determines the locality of profits. Therefore, the proper approach is to focus more on what and where the underlying physical operations were being carried out by the taxpayer to earn the profits in question rather than what was being done electronically. It is based on the rationale that the server does not operate on its own. Someone has to make it work, by performing functions like product procurement, warehousing, physical delivery of goods, maintenance of the server, etc. All of these functions require human involvement which are the physical business operations that the IRD would look at.

As a general example, under scenario 1, considering an overseas supplier carrying out all its physical business operations outside Hong Kong except for operating an intelligent server (or web-site) in Hong Kong which concludes contracts with Hong Kong customers. The overseas supplier will not be subject to Hong Kong profits tax as the supplier will not be considered as carrying on a business in Hong Kong and the profits derived will be regarded as offshore in nature.

On the other hand, under scenario 2, if the Hong Kong supplier has all its physical business operation conducted in Hong Kong apart from operating an intelligent server outside Hong Kong to conclude contracts with overseas customers, the supplier would most likely be considered as carrying on a business in Hong Kong, and deriving Hong Kong sourced profits.

CHARACTERISATION OF INCOME

With some goods, such as music, software, books, etc. that are being distributed electronically in a digital form, rather than in the traditional physical form, there is a real importance in properly characterising the income between the sale of goods and the exploitation of intellectual property as the tax treatment of the two are quite different. The tax treatment on the use of intangible property rights is governed by sec. 15(1) of the IRO under which a withholding tax is levied. Section 15(1) basically taxes an overseas licensor even if he/she is not carrying on a trade, profession or business in Hong Kong. Effectively, a withholding tax of 1.6% (possibly 16% if the amount is derived from associate) will be levied on sums derived from the use of or the right to use in Hong Kong of cinematographs, films, sound recordings, patents, designs, trademarks, copyright materials, secret processes or formulas or other property of a similar nature.

Where the software program is delivered digitally over the internet, one should consider whether the amount paid for the software program is considered royalty (1.6% withholding tax) or payment on a sale of goods (no Hong Kong profits tax if the supplier does not carry on a business in Hong Kong). In this regard, the differentiation largely depends on the terms of the agreement and the circumstances. If the payment is for the right to commercially exploit the digital product, such as allowing the buyer to make copies for distribution to the public, to display or perform the program in public or to prepare derivative programs, such activity should fall under sec. 15(1) and the withholding tax should apply.

It will be considered a sale of goods if the agreement only allows the buyer to install the program in one or a specified number of computers and does not allow for any modification or adaptation of the software, where the amount paid is for the use of the actual program.

IMPLICATIONS FOR INVESTORS

It should be noted that DIPN No. 39 has not entirely removed the uncertainties faced by investors in the areas of ascertaining the tax implications of e-commerce. This can be contrasted with the 28 detailed scenarios examined by the OECD in their work on e-commerce taxation and the complex situations already arising in practice. Given the rapid and unpredictable development of e-commerce, the IRD has deliberately employed fairly general terms and rather basic illustrations in DIPN No. 39 without attempting to address specific modes of e-commerce. It is highly likely that the IRD will revise or supplement the DIPN as e-commerce evolves or when there are new practical situations that need to be addressed.

Conclusion

The territorial basis of taxation in Hong Kong had previously cast a lot of uncertainty on the tax implications of e-commerce. The lack of a physical transaction and the boundless coverage of cyber transaction pose a great challenge to the IRD in applying the source-based concept. The adoption of the principle of tax neutrality and applying the existing Inland Revenue Ordinance, without introducing new provisions to cater for e-commerce, reflects the general tendency of the IRD in maintaining a simple tax system in Hong Kong. To help practitioners and taxpayers in assessing the tax implications associated with e-commerce, the IRD has issued a DIPN No. 39 in July 2001 to demonstrate the IRD's interpretation of the existing tax laws in the context of e-commerce. In essence, the IRD does not intend an e-commerce transaction enjoy any advantage or suffer any disadvantage as far as taxation is concerned. The old source of profit rules will still be applicable in the e-commerce context. However, given that the source of profits has long been regarded as the major uncertain and controversial area of Hong Kong taxation (the IRD and the various cases actually concede that the determination of source is a practical hard matter of fact), the DIPN No. 39 has not helped a lot in eliminating the uncertainty of the tax treatment over e-commerce. Future updates of DIPN No. 39 should provide us with more detailed guidelines in tackling this challenging subject.

The views expressed in this article are the views of the authors rather than of PricewaterhouseCoopers Hong Kong. The authors can be reached at clement.yuen@hk.pwcglobal.com and peter.tk.ho@hk.pwcglobal.com.

Specific provision in specific statute to exclude operation of general provision

IN 1980, THE TAXPAYER COMPANY WAS GRANTED INVESTMENT TAX CREDIT BY THE MINISTER OF INTERNATIONAL TRADE AND INDUSTRY. THE TAXPAYER COMMENCED BUSINESS IN DECEMBER 1983 BUT PRIOR TO THAT THE TAXPAYER INCURRED APPROVED CAPITAL EXPENDITURE. FOR THE YEAR OF ASSESSMENT 1985, THE TAXPAYER'S BASIS PERIOD WAS 1 DECEMBER 1983 TO 30 APRIL 1984. THE ASSETS WERE USED DURING THIS BASIS PERIOD AND THE TAXPAYER CLAIMED INVESTMENT TAX CREDIT IN RESPECT OF CAPITAL EXPENDITURE INCURRED. THE CLAIM WAS, HOWEVER, REJECTED BY THE DGIR ON THE GROUND THAT THE SUM WAS NOT INCURRED IN THE BASIS PERIOD AND THEREFORE NOT ELIGIBLE FOR INVESTMENT TAX CREDIT UNDER SEC. 26(1) OF THE INVESTMENT INCENTIVES ACT 1968 ("IIA").

The issue before the Special Commissioners was whether upon the true construction of sec. 26(1) of the IIA, the DGIR was correct in rejecting the taxpayer's claim for investment tax credit in the year of assessment 1985 on capital expenditure incurred by the taxpayer prior to the taxpayer commencing business in December 1985. Since, to qualify for investment tax credit under sec. 26 of the IIA, the expenditure must be incurred in the basis period for the year of assessment.

The court upheld the Special Commissioners' finding, in holding the view that the mandatory language employed in sec. 26(3) of the IIA denoted that it was imperative that this provision of the law be complied with before the investment tax credit could be granted. It was not in dispute here that the capital expenditure was incurred prior to the commencement of the business. There was therefore no compliance with sec. 26 IIA, and therefore, no investment tax credit should be granted.

The court on the basis that the Legislature never intended for para. 55 sch. 3 of the Act to be read together with sec. 26 of the IIA, further held that where there is a specific provision in a specific statute, providing for its own purposes, the specific statute excludes the operation of the general provision. Section 26 of the IIA was such a specific provision on a specific law granting investment tax credit whereas para. 55 sch. 3 of the Act was a general provision for granting capital allowance, which allows capital allowance notwithstanding that the capital expenditure is incurred prior to the commencement of a business.

SPCS v. Ketua Pengarah Hasil Dalam Negeri.
Special Commissioners of Income Tax.
Appeal No. PKCP (R) 1/2001
Judgment delivered on 12 October 2001.

Francis L K Tan (Azman Davidson & Co.) for the taxpayer.
Y M Raja Kamarul Zaman bin Raja Musa (Legal Officer, Inland Revenue Board) for the Revenue.

* Editorial Note: An appeal by the taxpayer is currently pending in the High Court. This case will be reported in the forthcoming issue of Malaysian & Singapore Tax Cases."

DGIR is empowered to prevent a bankrupt from travelling abroad

THE TAXPAYER WAS ADJUDGED A BANKRUPT ON 30 NOVEMBER 1987. HE APPLIED TO THE OFFICIAL ASSIGNEE, KUCHING FOR LEAVE TO TRAVEL OUTSIDE MALAYSIA. LEAVE WAS GRANTED ON RECEIPT OF A BANK GUARANTEE OF RM50,000. THE TAXPAYER THEN MADE A SIMILAR APPLICATION TO THE DGIR, BUT WAS REJECTED UNDER SEC. 104 OF THE INCOME TAX ACT ("THE ACT"), UNLESS THE INCOME TAX ASSESSMENT WAS SETTLED IN FULL OR A BANK GUARANTEE OF RM200,000 WAS FURNISHED.

The taxpayer argued that the DGIR has no authority to restrict the taxpayer, as his being adjudged a bankrupt placed the Official Assignee in control over his estate. The DGIR, having filed his proof of debt stood in the same position as other creditors and therefore had no authority to intervene. Any sec. 104 certificate should therefore be issued against the Official Assignee. The taxpayer, as a bankrupt is governed only by the *Bankruptcy Act 1967*.

The issue in the taxpayer's application before the High Court was whether sec. 104 of the Act empowered the DGIR to prevent a bankrupt from travelling abroad.

The court held that sec. 38(1)(c) of the *Bankruptcy Act* is only applicable to a bankrupt who does not owe the Inland Revenue Board any tax. Though the Official Assignee has granted leave to the taxpayer to go overseas, the DGIR still retains his power under sec. 104(1) of the Act to stop the taxpayer from leaving unless he fulfils certain conditions imposed. Likewise, where a bankrupt (the taxpayer) had settled his tax and was granted leave by the DGIR to travel abroad, under sec. 38(1)(c) of the *Bankruptcy Act*, the approval of the Official Assignee is still required if the bankrupt still owes other claimants.

The court viewed the *Income Tax Act* and the *Bankruptcy Act* as both complementary and yet independent of each other. The High Court advised prudence on these two bodies in giving due regard to their respective roles and responsibilities and to co-ordinate their decisions in order to avoid any unpleasant situation.

LMH@LBS v. The Government of Malaysia & Anor
High Court, Sabah & Sarawak (Kuching)
Originating Summons No. 24-197-2000-II
Judgment delivered on 5 April 2002

Anthony Bong (Satem, Chai & Dominic Lai Advocates) for the taxpayer
Hazlina Hussain (Inland Revenue Board) for the Revenue
Ko Fui Long (Official Assignee's Department)

A Student's Guide to Tax

Employment Income (cont'd)

by Siva Subramaniam Nair

In the last article, we looked at the taxable benefits received by employees that are in the form of monies or convertible to cash and settlement of the employee's pecuniary liabilities by the employer. In this article, we shall look into the taxability of other benefits and payments received by the employee in accordance with the provisions in sec. 13(1)(b) and (c) and relevant precedents established in tax cases.

SECTION 13(1)(b) reads

an amount equal to the value of the use or enjoyment by the employee of any benefit or amenity (not being a benefit or amenity convertible into money) provided for the employee by or on behalf of his employer excluding:

i) a benefit or amenity consisting of medical or dental treatment or child care facilities;

ii) a benefit or amenity consisting of leave passages within Malaysia not exceeding three times in any calendar year; or one leave passage for travel between Malaysia and any place outside Malaysia in any calendar year, limited to a maximum of RM3,000.

Provided that the benefit or amenity enjoyed under this subparagraph is confined only to the employee and members of his immediate family

iii) a benefit or amenity used by the employee solely in connection with the performance of his duties; and

iv) a benefit or amenity falling under paragraph (c)

Basically, sec. 13(1)(b) deals with the taxability of benefits not convertible to cash i.e. benefits in kind ("BIK") but not including unfurnished accommodation in Malaysia as it is specifically covered under sec. 13(1)(c).

For example, if an employer provides gardener allowances, the employee can either employ a gardener and use the allowances to pay his wages or alternatively he can pocket the money and do the gardening himself. Therefore, this is a benefit taxed under sec. 13(1)(a). However, if the employer employs a gardener and provides the employee with the services of the gardener, then the benefit is neither in money form nor convertible to cash, therefore it becomes a sec. 13(1)(b) benefit.

Similarly, if the employer wants to settle the utility bills for me, he can undertake the task in a number of ways.

1) The accommodation is registered with Tenaga Nasional Berhad (TNB) under the employer's name and the bills are issued to and settled by the employer. This is a sec. 13(1)(b) benefit.
2) The employee registers with TNB, therefore the bills are issued to and settled by the employee. The employer then reimburses the employee for the amount paid to TNB. This is a sec. 13(1)(a) benefit – settlement of the employee's liability by the employer.
3) The employee registers with TNB, therefore the bills are issued to the employee. However, the employee submits the bill to the employer who then settles the bills with TNB. This is still also a sec. 13(1)(a) benefit – settlement of the employee's liability by the employer.

IRB GUIDELINES ON BENEFITS-IN-KIND

It is not easy to place a value on benefits that do not take the form of cash or are convertible to cash. For instance, if an employer provides an employee with a car to be used for both official purposes and for personal use, how can the benefit derived from the personal use of the car be ascertained with a degree of certainty. The employee will argue that there was minimal personal use to which the IRB may not agree, giving rise to conflicting opinions with no concrete grounds for confirmation.

Therefore, to reach a compromise between the two parties, the IRB (after considerable deliberation with the accountancy and tax professional bodies, employer's associations and employee's unions) has issued through Income Tax Ruling 1997/2, Guidelines for Valuation of BIK Provided to Employees (which is reproduced in the appendix).

NON TAXABLE / EXEMPT BENEFITS

Certain benefits provided by the employer are specifically not taxable or exempt.

The Act, itself excludes certain benefits from income tax such as:

1) Any medical or dental expense incurred by the employee but borne by the employer is not taxable on the employee. This also extends to any child care facilities provided by the employer;

2) Provision of leave passage by the employer is not taxable, but is restricted as follows:
   a. Within Malaysia – 3 trips per year
   b. Outside Malaysia – 1 trip but the amount not subject to tax is restricted to a maximum of RM 3,000; and

3) Benefits relating to the performance of an employees' official duties for example accommodation and meal allowances provided to auditors conducting an audit, outstation;
   Through the *Income Tax (Exemption) (No. 56) Order 2000,* the Minister exempts a gift of **one** new personal computer from employer to employee from YA 2001 to YA 2003 to encourage and widen the use of information & communication technology.

Finally, the **BIK Guidelines** issued by IRB exempts:
1. Goods and services offered at a lower price or at a discount,
2. Food & drinks provided / subsidized, and
3. Free transport

The above would be useful when structuring a tax efficient remuneration package for an employee.

MIT TAX I DEC 2000 Q2 *(abstract)*

Mr. Leong and his family are provided the following:

		RM
a)	Air passage for him and his family	
	Kuching	20,000
	Pulau Redang	1,800
	Pulau Tioman	2,400
b)	Dental expenses for him & his family	2,500

c) During the year, the second child was hospitalised in London and had to undergo surgery to remove her appendicitis. The surgery and hospitalisation costs amounting to RM22,000 were paid by the company.

Solution: Note that the medical and dental are exempt and since all three holiday destinations are within Malaysia, they are exempt.

FORMULA FOR ANNUAL VALUE OF BENEFIT

The annual value of a given BIK is generally computed by reference to the following formula:

$$\frac{\text{Cost of the asset incurred by the employer}}{\text{Prescribed average lifespan of asset}}$$

Therefore, if a swimming pool (detachable) costing RM30,000 is provided to the employee, then he will be taxed annually on RM2,000, since the prescribed average lifespan of the swimming pool is 15 years as per the guidelines.

BENEFITS TAXED AT CONCESSIONARY RATES

- Motor cars and related benefit

Cost of car when new (RM)	Annual value of BIK (RM)	Fuel per annum (RM)
Up to 50,000	1,200	600
50,001 – 75,000	2,400	900
75,001 – 100,000	3,600	1,200
100,001 – 150,000	5,000	1,500
150,001 – 200,000	7,000	1,800
200,001 – 250,000	9,000	2,100
250,001 – 350,000	15,000	2,400
350,001 – 500,000	21,250	2,700
500,001 & above	25,000	3,000

- ⊙ **includes:** accessories
- ⊙ **excludes:** financial charges, insurance premium & road tax
- ⊙ **if the car is > 5 years:** Annual value – 50% **BUT** fuel remains unchanged
- ⊙ **Provided for < 12 months:** time apportionment
- ⊙ **Driver:** RM300 p.m.

Example 1: An employee is provided with a company car costing RM145,000 and fuel throughout the year 2002.
His taxable benefit would be RM5,000 for the private usage of the car and RM1,500 for fuel.

Example 2: As in example 1, but the car comes with radio cassette player costing an additional RM6,000.
His taxable benefit would be 7,000 for the private usage of the car and RM1,800 for fuel.

Example 3: As in example 1, but the company incurs RM8,000 on interest on a car loan and road tax.
His taxable benefit would be RM5,000 for the private usage of the car and RM1,500 for fuel.

Example 4: As in example 1, but the company purchased the car in 1996.
His taxable benefit would be RM2,500 for the private usage of the car and RM1,500 for fuel.

Example 5: As in example 1, but the company provides the car only from April 2002.
His taxable benefit would be RM3,750 for the private usage of the car and RM1,125 for fuel.

- Household furnishings, apparatus and appliances.
  - ⊙ semi furnished with furniture in the lounge, dining room or bedrooms - RM840 p.a. (RM70 per month)
  - ⊙ semi furnished - as above with either
    - air-conditioners,
    - curtains, or
    - carpets - RM1,680 p.a. (RM140 per month)
  - ⊙ fully furnished (as above plus one or more of kitchen equipment, crockery, utensils and appliances) - RM3,360 p.a. (RM280 per month)
- Mobile phone (rental & charges) - RM600 p.a.
- Gardener - RM300 p.m.
- Domestic servant - RM400 p.m.

OTHER BENEFITS

- Club Subscriptions/ Credit Cards -
  - ❑ corporate membership for entertaining business associates — Not Taxable
  - ❑ personal club membership provided — Taxable
- Training to enhance staff skills — Not Taxable
- Loan to employees:
  - ❑ from surplus funds — Not Taxable
  - ❑ from borrowings — Taxable
- life insurance premiums paid by employer:
  - ❑ where the beneficiary is the family of the employee — Taxable
  - ❑ under a company group policy — Not Taxable
- Scholarship/study grant

Exempt under Paragraph 24, Schedule 6

Note that although unfurnished living accommodation provided in Malaysia is a benefit in kind, it is not taxed under sec. 13(1)(b), because it's taxability is governed by specific rules contained in a sec. 13(1)(c)

SUMMARY OF BENEFITS WHICH ARE NON TAXABLE / EXEMPT AND TAXED AT CONCESSIONARY RATES

CONCESSIONARY BENEFITS	
Car & Fuel	Scale rates
Furniture	Semi furnished – RM840 p.a. Semi furnished - with air-con, – RM1,640 p.a. - curtains & carpets Fully furnished – RM3,360 p.a.
Gardener	RM3,600 p.a.
Mobile Phone	RM600 p.a.
Servant	RM4,800 p.a.
Driver	RM3,600 p.a.

MIT TAX I DEC 2000 Q2 *(abstract)*

Mr. Leong and his family are provided the following:

a) The company paid the tuition fees for the second child studying in London. The total amount paid in the year 2000 amounted to RM15,000.

b) Car (7 years old) RM150,000 (cost when new)

c) In addition to the above, the company also provided Mr Leong with a driver (salary RM1,000 per month) and a servant (salary RM850 per month).

d) The company also paid for his life insurance premium amounting to RM4,500.

e) Fuel RM4,800

f) Utilities paid by company RM4,000

g) Rental of fully furnished accommodation (1 out of 4 rooms frequently occupied by company's guests)
RM7,500 per month (inclusive of 2,500 for furniture)

Solution: Gross income under Section 13(1)(b) is follows.

Furniture (3,360 X +)	2,520
Utilities	4,000
Tuition fees	15,000
Car (5,000 X +)	2,500
Fuel	1,500
Driver	3,600
Servant	4,800
Insurance premium	4,500

SECTION 13(1)(c) reads:
an amount in respect of the use or enjoyment by the employee of living accommodation in Malaysia (including living accommodation in premises occupied by his employer) provided for the employee by or on behalf of the employer rent free or otherwise.

Section 32(2) provides the mechanics of computing the value of living accommodation. In the case of accommodation provided in a hotel, hostel, premises on plantation and forest, or non-rated accommodation in a rateable area, the taxable benefit is deemed to be 3% of gross income included under sec. 13(1)(a) income. However, where accommodation is provided in other accommodation, then the formula is the lower of the defined value of the accommodation or 30% gross income included under sec. 13(1)(a) income.

Defined value generally means the rent payable (in an arms length transaction for the unfurnished portion) paid by the employer to a landlord to obtain the accommodation. Alternatively, it can be the rateable value (i.e. the annual value of the accommodation for quit rent and assessment purposes as determined by the local municipality authorities. In the event both these value cannot be ascertained, then the economic rent will be used i.e. what rent would a similar accommodation fetch in the open market.

Section 32(3)(c) provides that an apportionment of the defined value should be done if

- The taxpayer is sharing the accommodation with other employees:
  if three other employees live in the same accommodation, then only a quarter of the defined value will be attributable to this employee.

- He is required by the employer to reside there.
  an employee residing in Seremban may be commuting everyday to his work place in KL, but sometimes, due to the nature of his work, he is required to attend to certain matters urgently even at night. Therefore, his employer provides him with an accommodation near the work place. On one hand, he cannot be taxed on the full defined value, since he is being forced to accept the accommodation in KL but on the other, his house in Seremban can be rented out and therefore there is a benefit for the employee. The amount of abatement for the employee should be a just and equitable figure agreeable to the IRB.

- He is expected to use the accommodation to advance the interest of the employer by the provision of hospitality (it is larger or more valuable accommodation than the employee would otherwise need)
  A single employee would probably only require a two-room accommodation. However, he may be provided with a six-room bungalow to facilitate the "provision of hospitality" to clients and business associates. Therefore, only a third of the defined value should be used in the computation

Once the 3% of gross income included under sec. 13(1)(a) income or the lower of the defined value of the accommodation or 30% of gross income included under sec. 13(1)(a) income is determined, sec. 32(3)(b) states that if the accommodation is provided for less than 12 months, then an apportionment on time basis should be done. The resultant figure is the amount to be included as gross income under sec. 13(1)(c).

In **MIT TAX I DEC 2001 Q2 *(abstract)*** above, the computation of defined value is
5,000 x 12 x + = RM45,000

In the case of a **non-service director of a controlled company**, the computation of gross income to be included under sec. 13(1)(c) differs. A service director is defined as a person who is employed in the service of the company in a managerial or technical capacity and is not directly / indirectly the beneficial owner of more than 5% of share capital of the company. A controlled company is one having not more than 50 members and owned or controlled by five persons or less. Having understood what is a non-service director of a controlled company, the difference is treatment lies in:

- the value of benefit is taken to be defined value of the accommodation i.e. there is no comparison with 3% or 30% of gross income from employment included under sec. 13(1)(a) therefore, the full defined value is used.

- they enjoy only two abatements relating to the gross income to be included under sec. 13(1)(c) i.e. if provided for less than 12 months time apportionment and if they are sharing the accommodation with other employees.

In ascertaining the adjusted income from an employment, certain expenses incurred by the employee in relation to the accommodation provided will rank for a deduction. The deductible expenses include

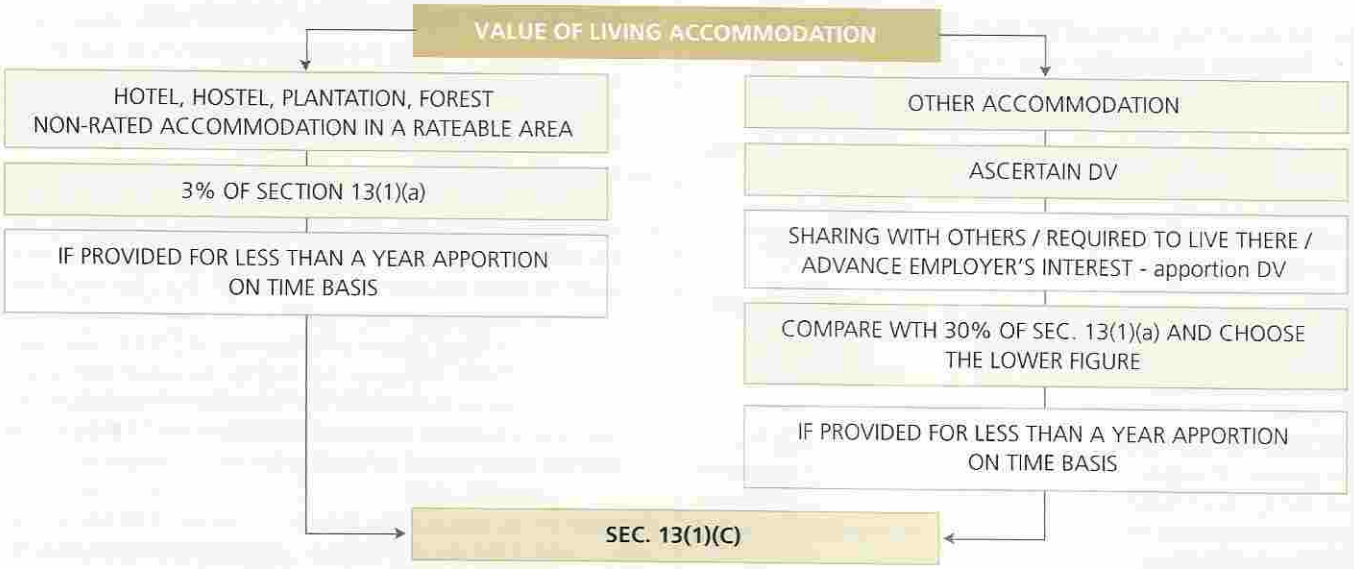
- public rates (quit rent, assessment etc.) payable by the employee;
- fire insurance premiums payable by the employee;
- repairs and maintenance costs (revenue expenditure only) incurred by the employee; and
- rent payable by the employee to the employer for the use of the accommodation.

MIT TAX I DEC 1999 Q3 *(abstract)*
Elias commenced employment in Malaysia on 1 January 1998. He was provided accommodation at a hotel until suitable premises were located. He moved into the condominium rented by his employer on 1 March 1998. Details of his remuneration for the year 1998 are as follows:

	RM
Salary	81,000
Incentive bonus	27,000
Overseas allowance	24,000
Rental of fully furnished condominium paid by employer	5,000 per month (inclusive of rental of furniture of RM500 per month)

Solution:	Elias - tax computation for 1998		RM
Sec. 13(1)(a)	(81,000 + 27,000 + 24,000)		**132,000**
Sec. 13(1)(c)	Hotel: 3% X 132,000 X 2/12	=	660
	Condominium: Defined value		
	(5,000 – 500) X 12	=54,000	
	30% X 132,000	=39,600	
	Lower of: 39,600 X 10/12	=33,000	**33,600**

The mechanics of the computation of gross income under Section 13(1)(c) is shown below:



FURTHER READING

1. Veerinderjeet Singh (2001), Malaysian Taxation – Administrative and Technical Aspects 5 Ed., Kuala Lumpur; Longmans Malaysia, Chapter 7
2. CCH Tax Editors (2002), Malaysian Master Tax Guide 19th Ed., Singapore CCH Asia Ltd. Paragraphs 800–856

APPENDIX

INLAND REVENUE GUIDELINES FOR VALUATION OF BENEFITS IN-KIND

GENERAL

(a) These guidelines are to be applied for Y/A 1998 and subsequent years of assessment.

(b) Generally, the annual value of a given benefit-in-kind provided is computed by reference to the following formula:

$$\frac{\text{Cost of the asset providing benefit / amenity}}{\text{Prescribed average life span of asset}} = \text{annual value of benefit}$$

Cost means the actual cost incurred by the employer or market value of the asset. Thus, in the case of an asset costing RM10,000 and having a life span of 10 years the annual value would be RM1,000.

(c) The prescribed life span of the various assets (the list to be amended from time to time) is as follows:

Asset	Prescribed Average Life Span
1. Motor Car	8 years
2. Furniture and Fittings:	
Curtains, carpets	5 years
Furniture, sewing machine	15 years
Air-conditioner	8 years
Refrigerator	10 years
3. Kitchen Equipment (i.e., crockery, rice-cooker, electric kettle, toaster. coffee-maker, gas cooker, cooker hood, oven, dish-washer, washing machine, dryer, food processor, etc.)	6 years
4. Entertainment and Recreation:	
Piano	20 years
Organ	10 years
Colour television, video player, stereo set	7 years
Swimming pool (detachable), sauna	15 years
5. Miscellaneous	
Mobile telephone	5 years

MOTOR CARS AND RELATED BENEFITS

(a) In the case of motor cars provided, the benefits to be assessed will be the value of the private use of the car and fuel provided. For simplicity and ease of application, the benefits will be based on the following table:

Cost of Car (when new) (RM)	Annual Value of private usage of car (RM)	Fuel per annum (RM)
Up to RM50,000	1,200	600
50,001 – 75,000	2,400	900
75,001 – 100,000	3,600	1,200
100,001 – 150,000	5,000	1,500
150,001 – 200,000	7,000	1,800
200,001 – 250,000	9,000	2,100
250,001 – 350,000	15,000	2,400
350,001 – 500,000	21,250	2,700
500,00l and above	25,000	3,000

Cost here means actual or market value of the car including accessories but excluding financial charges, insurance premium and road tax.

(b) Where the car provided is more than 5 years old the value of the car benefit to be assessed will be equivalent to half the above rates but the value of fuel provided will remain unchanged. Where a driver is provided, the value of the benefit is fixed at RM300 per month. Where the driver is not provided solely for the use of a particular employee but comes from a pool of drivers provided by the employer only for purposes of the business, the value of benefit-in-kind will not be assessed on the employee concerned.

(c) Where a car is not provided throughout the basis year the value should be adjusted appropriately. Employers should indicate in the individual employee's statement of remuneration the type, year and model of the car provided to the employee.

(d) Employers should in all cases report the car and fuel benefits provided to employees based on the above table. If a particular employee disputes the values as being excessive, he should take this up with the Assessment Branch concerned when submitting his Return. In considering such claims the annual value of the benefit will be based on the formula given earlier except that an abatement of 20% for the average residual value at the end of 8 years and a further abatement for business use of the car will be given. To substantiate the claim for business use, detailed and adequate records must be available.

HOUSEHOLD FURNISHINGS, APPLIANCES, ETC.

(a) To avoid detailed calculations employers may, instead of using the formula, determine the values of benefits in respect of household furnishings, equipment and appliances by adopting the following figures:

(i) Semi-furnished with furniture in the lounge, dining room, or bedrooms — RM70 per month (RM840 per annum).
(ii) Semi-furnished with furniture as in (i) above plus, one or more of air-conditioners, curtains and carpets — RM140 per month (RM1,680 per annum).

(iii) Fully-furnished with benefits as in (i) and (ii) above plus, one or more of kitchen equipment, crockery, utensils and appliances — RM280 per month (RM3,360 per annum).

(iv) Service charges and other bills such as for water, electricity and telephone — amount of benefit is based on service charges and bills paid by the employer.

(b) These values may be adjusted suitably by reference to whether any or all of the above categories of furnishings are provided. Thus, an employee provided with all the stated furnishings except those in category (i) will be assessed on the value of RM2,520 (RM3,360 — RM840) per annum.

(c) Where it is felt that the above values are excessive, the valuation by the employer of the benefit provided may be made by reference to the formula stated earlier on an item-by-item basis.

(d) Other assets provided to employees for entertainment, recreation or other purposes such as piano, organ, colour television set, stereo set, swimming pool (detachable), sauna, mobile telephone, etc., would constitute additional benefits and should be separately valued based on the formula. If the asset is provided for part of the year or shared with other employees, the value should be adjusted appropriately.

(e) Fans and water heaters would be treated as forming part of residential premises and thus disregarded.

OTHER BENEFITS

Other taxable benefits are as follows:

(a) Mobile telephone (rental and charges) – RM600 per annum. If the mobile telephone belongs to the employee but the employer pays for the telephone rental and all business calls, the employee will be subject to tax on the value of RM600. The employee will not be subject to the RM600 benefit if the mobile telephone belongs to the employer and personal usage is fully borne by the employee.

(b) Gardeners – RM3,600 per annum.
Domestic servants – RM4,800 per annum.
If the gardener/driver/domestic help is hired and paid by the employee, who then claims the amount expended as reimbursement from the employer, the amount of reimbursement paid by the employer will be assessed under sec. 3(l)(a) of the ITA 1967.

If domestic help is provided by the employer, the amount of RM4,800 will be assessed on the employee as benefit. However, the employee may make a claim for reduction of the amount assessed if the domestic help is provided for business purpose i.e. where the employee is required to entertain clients at his place of residence.

(c) Insurance premium will be assessed as a taxable benefit-in-kind if the beneficiaries of the insurance scheme is the employee, the employee's family members or appointed nominees. If the employer is the beneficiary, no benefit-in-kind will be assessed.

(d) Tuition or school fees paid by the employer will be assessed as benefit-in-kind on the employee.

(e) If a staff or director of a company holds an individual membership in a recreation club and the entrance fees and monthly subscriptions are paid or reimbursed by the employer, these fees will be taxed in full. For corporate membership, entrance fees are not taxable. Where the membership in a recreation club is paid by the employer and utilized by senior staff of the company for the purpose of fulfilling business objectives for the company, monthly subscription for one recreation club is exempted in full from income tax.

If the employer pays monthly subscription for more than one recreation club, only fees paid for the club which charges the highest amount will be exempted from income tax.

(f) For interest-free loan to employee, the benefit will be the value of interest paid by employer. This is not applicable if the loan is provided from the surplus funds of the business without having to borrow from any party.

(g) If the employer subsidises a loan or interest below the market rate to employees, the subsidy will be taxable as benefit-in-kind. If a loan is provided at a rate similar to the cost paid by the employer, no benefit-in-kind would be assessed.

(h) Insurance premiums which are obligatory for foreign workers in lieu of contributions to SOCSO and group policy insurance premiums for workers in case of accident/injury are tax exempt benefits.

TAX EXEMPT BENEFITS

(a) Goods and services offered at a lower price or at a discount

(b) Food and drinks provided/subsidised

(c) Free transport

(d) Child care facilities/benefits

(e) Medical/Dental benefits

(f) Leave passages:
  (i) Within Malaysia not exceeding three times in any calendar year.

  (ii) Outside Malaysia not exceeding one passage in any calendar year subject to the maximum of RM3,000.

OTHER BENEFITS NOT LISTED

(a) If there are other facilities and benefits provided to the employees, the amount so provided must be reported by the employer based on the formula.

(b) Benefits arising from Share Option Scheme (SOS) are assessable to tax as an additional income. The current practice requires all employers to inform the Technical Division of IRB before any employees' SOS is launched. After the employees' SOS is studied and the value of the benefit agreed by the IRB, the employer will issue the relevant Form EA or other notification to each employee.

CERTIFICATION

In submitting the "Return of Remuneration By An Employer" under Form E, the employer (the Sole Proprietor, Precedent Partner or the Principal Officer) is required to make a separate certification as regards the reporting of values of benefits-in-kind. The following format should be adopted:

CERTIFICATION

I _____ (NRIC No. _____)

being _____ hereby certify
(Designation)

that in reporting the values of benefits-in-kind provided to employees, I have duly adhered to the Guidelines issued by the Director General of Inland Revenue, Malaysia, and the information and values reported are true and complete to the best of my knowledge.

Date _____

Signature of Employer

The Author

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

Solution for Practical Exercise on Employment Income (Part II)

Q1 Since the combined periods of employment does not exceed 60 days, Wilma can take advantage of the exemption provided under Paragraph 21 & 22 of Schedule 6 and therefore her employment income for both the years of assessment will not be subject to tax.

Q2 Wilfred exercised employment in Malaysia for not more than 60 days. Since he was in Malaysia in 2002 for only 138 days with no links to the next nor the last year and was not in Malaysia for the past 2 years, he would be non-resident for YA 2002, and qualify for the 60 day exemption rule. Since his employment is in Sydney, his overseas income is in no way incidental to his employment in Malaysia, and is therefore not subject to Malaysian tax. Further by virtue of the fact that he is a non-resident, the amounts received in 2002 would be exempt from tax under Paragraph 28 of schedule 6.

Q3 a) The exercise of the option triggers a taxable benefit for Siew Beng which should be included in his gross income under Section 13(1)(a)

b) Taxable benefit: [RM1.75 – (RM 1.00 + 0.03)] X 1,500
= RM 1,080

This will be taxable for YA 2001 but only after the option is exercised on 27 May 2002.

	RM
c) Sales proceeds (RM4.15 X 1,500 shares)	6,225.00
Less: cost of shares + option cost	(1,545.00)
interest expense	(19.50)
tax payable (1,080 X 20%)	(216.00)
Net gain to Siew Beng	**4,444.50**

Q4 The payment and shares represent inducement payments. Based on the precedent established in ***Pritchard v Arunsdale*** and ***Glantre Engineering Ltd v Goodhand,*** the inducement payments would not be taxable if it is:

- in consideration of giving up substantial rights,
- made prior to commencement of employment,
- irrecoverable even though there may be a breach of contract
and
- not for future services

Therefore, in this case the shares received by Sinbad would not be taxable because:

1) They were given as an incentive to Sinbad to take up the new position in the other college including the inherent risk of embarking into new areas of human resource and administration and giving up his present position where he is very comfortable and secure.

2) They were given, prior to his signing the contract of employment i.e. he does not have nor was he exercising an employment.

3) There was no requirement for him to return the shares if he was not satisfied with the new appointment and wished to leave the college. This shows that the shares were in no way related to the provision of future services to the new college.

However in the case of Alauddin, the cash sum received would be taxable because:

1) there is not much difference between his present position and the new one and therefore the payment cannot be attributed to the taking up of additional risk

2) The payment will only be made once he signs the acceptance letter thus its receipt is at a point where he has an employment albeit not exercising it.

3) He is tied down to the college for two years thus establishing a relationship between the payment of RM20,000 and the performance of future services at the new college.

BUDGET MEMORANDUM

Preamble

In response to the invitation of the Ministry of Finance, the Malaysian Institute of Taxation (MIT) is pleased to submit this Memorandum which we believe will contribute to achieving this year's theme "Promoting A Dynamic and Resilient Private Sector"

Foremost the MIT wishes to congratulate the Malaysian Government for initiating rapid and radical measures to safeguard national interest and placing us on the road of economic recovery.

Promoting a Dynamic Private Sector

The Malaysian Institute of Taxation would like to recommend the following as measures to enhance the competitive edge of domestic entities and policies:

1. **Holistic Approach**

   MIT proposes that the government consider the creation of a "one stop centre", which is able to grant tax incentives on a holistic approach after considering the "entire mass" of the investment.

   In short, to have a single authority to grant tax incentives to all companies in a conglomerate investing in Malaysia, without having to segregate each entity.

   This will allow global conglomerates to consider Malaysia as an attractive place of business rather than, attracting investments which are mainly manufacturing based.

2. **Group Relief**

   We recommend extending group relief in our corporate tax system to allow corporate groups to utilise the losses of one company against the profits of another company within the same group. This will give companies flexibility to start new activities through subsidiaries and contribute to a more supportive environment of new ventures.

3. **Malaysian Tax Regime**

   We propose that our corporate tax rate be reduced from 28% to 25% so as to sustain or increase Malaysia's domestic resilience.

   This reduction in corporate tax rate by 3% should be followed with a planned reduction of the corporate tax rate to 20% in the near future.

4. **New Areas of Business**

   i. Need for a Domestic and International Framework on Tax & E-Commerce

   MIT proposes that a working group or task force be instituted to deal with domestic tax issues relating to e-commerce in Malaysia, and to prepare an initial paper or framework on tax and e-commerce

   MIT is willing to contribute our experience and knowledge to such a working group.

   ii. Deduction for Computer Software and Upgrades

   MIT proposes that the current RM400 rebate be raised to RM1,000 rebate, as well as, for the rebate to be extended to include expenditure on authentic software and/or upgrading (includes hardware and software) the computer.

5. **Knowledge Economy**

   Malaysia's future lies with a skilled and semi-skilled workforce.

   Double Deduction for Approved Training

   MIT recommends that the current double deduction for approved training be extended to include other training institutions and courses. e.g. Malaysian Institute of Management, Malaysian Institute of Accountants, Malaysian Institute of Taxation, Malaysian Institute of Certified Public Accountants, etc.

6. **Protecting the Environment**

   MIT proposes that a double deduction be given on expenditure incurred by a company for the sole or dominant purpose of :

   a. Preventing, combating or rectifying pollution of the environment by the taxpayer's business or on the site of that business; or

   b. Treating, cleaning up, removing or storing waste produced by the Company's business or on the site of that business.

   The double deduction however shall not apply to expenditure on buildings, structures or capital expenditure.

Promoting a Resilient Private Sector

The Malaysian Institute of Taxation would like to recommend the following measures to enhance our domestic resilience

1. Rebate on Overpayment

Under the new tax regime of "Self Assessment and Current Basis of Assessment System", a company shall furnish an estimate of tax payable to the Director-General not later than 30 days *before the beginning* of its financial year and may only vary the estimation in the sixth month. In the event the instalments paid on the estimation (revised or otherwise) is lower, then the company shall be liable to a penalty.

We are concerned that, with the introduction of the above procedural requirements on tax payments, the system is now forcing taxpayers to maintain some form of tax credit surplus with the LHDN.

To this effect, MIT proposes that a "rebate" be given on the overpayment of taxes as:

i. incentive to encourage a taxpayer to settle tax liabilities within the stipulated time; and

ii. to compensate a taxpayer for the loss of use of funds.

The rate of the "rebate" may be fixed by the authorities on an annual basis (i.e. 10% per annum), and will be computed on a daily basis until such time the tax credit is refunded or utilised against any other forms of tax liability.

On the argument that such a rebate will interfere with the Government's cashflow, we further propose that the "rebate" be structured in such a way that it can only be used to set off or reduce other forms of tax liability.

Even before the implementation of the new tax system, about 8.0% (based on the LHDN's *Annual Report 2000*) of the total revenue collected in the year has been set aside for repayment.

We wish to express our concern that with the implementation of the new tax requirements under the "Self Assessment and Current Basis of Assessment System" (i.e. pay first, offset later), commercial and economic vitality may be inhibited by the locking-down of funds due to administrative procedures on repayment by LHDN. In short, the taxpayer should be compensated for the loss of use of funds by way of a rebate.

2. Promotional Products

MIT is of the view that the expenses incurred on advertising and promotion with the intention to improve the company's profile and promote its products and services should not be regarded as entertainment.

This will be in line of the government's policy of promoting Malaysian products and services.

3. Withholding Tax under Section 109B

Withholding tax plays a crucial role as to the nature of services rendered to and from Malaysia.

3.1 Regional Hubs

MIT is of the view that the aforesaid reimbursement of costs or management fee payments to non-residents should not fall within the ambit of sec. 109B (1)(b) of the *Income Tax Act, 1967* and be subject to withholding tax.

For multinational conglomerates, the use of shared service centres for "backroom activities" is an essential part of the efforts to reduce costs and increase competitiveness of its businesses.

3.2 Reimbursements of Out-of-Pocket Expenses

A non-resident consultant entering into Malaysia to perform work for a short period of time (i.e. a permanent establishment would not arise and therefore sec. 109B of the *Income Tax Act, 1967* applies) for a local entity. The consultant incurs air fare, taxi fare, hotel accommodation and meal expenses, etc., in the course of the work and these expenses are duly reimbursed by the local entity.

MIT would like to propose that the reimbursements of direct expenses be excluded from the ambit of withholding tax under sec. 109B of the *Income Tax Act, 1967* as the general ethos of sec. 109B(1)(b) was to tax "technical services" rendered by a non-resident consultant and to tax disbursements will only add to the total cost of the entire project.

3.3 Scope of Withholding Tax

MIT suggest that the relevant authority issue some clarification or guideline to set out clearly the scope of withholding tax, in particular, under sec. 109B(1)(b).

4. Streamline Services Industry

4.1 Sales and Service Taxes on Bad Debts

MIT proposes that the relevant Acts be amended to allow taxable persons to claim bad debts in computing sales tax payable, i.e. net-off sales and service taxes which have been paid on bad debts against those collected within the taxable period.

4.2 Service Tax on Management Services

Therefore, MIT proposes that the service tax levied on "intra-group" management services provided within a group of companies be removed to enhance group efficiency

4.3 Service tax payable on payment received.

MIT would like to recommend that sec. 14(2) of the *Service Tax 1975* be deleted and service tax to be due and payable upon the service provider receiving the payment for the services rendered.

It is inequitable to require a service provider to pay the service tax before receiving any payment for the services rendered.

5. Liberalisation of Services under GATS

One of the terms contained in the General Agreement on Trade and Services (GATS) is the reciprocal recognition of professionals and cross-border practices.

Currently, Malaysia does not have any single body that is able to represent the tax profession.

MIT believes that it is essential that a national body or institute be recognised by the Government, as the main organisation representing and safeguarding the interest of domestic tax practitioners.

Administrative Proposals under "Self Assessment"

We wish to highlight two important issues which are paramount to the success of the self assessment tax system.

1. Estimation of Tax Payable

We propose the following :

i. That the *Income Tax Act, 1967* be amended to allow companies to make two (automatic) revisions of their ETP, either in the first quarter, second quarter or third quarter of the basis period of a year of assessment, as follows:

107C(7) - "A company may in the *third, sixth or ninth month* of the basis period for a year of assessment furnish to the Director General a revised estimate of its tax payable for that year in the prescribed form provided that *not more than two revisions* may be submitted and -

a) where the revised estimate exceeds the amount of instalments that have been paid for that year, the difference shall be payable in the remaining months in equal proportion; or

b) where the amount of instalments that have been paid for that year exceeds the revised estimate, the remaining instalments shall cease immediately";

or

ii. That as an interim measure, the administrative concession allowing the additional two revisions of the ETP be extended to Year of Assessment 2002 and subsequent years of assessments.

2. Extension of the Period to submit Tax Returns.

We propose the following:

i. Section 77(1A) of the *Income Tax Act, 1967* be amended to allow companies to submit their tax return within eight months from the end of the basis period of a year of assessment, as follows:

"Every company shall for each year of assessment furnish to the Director General a return in the prescribed form within *eight* months from the date following the close of the accounting period which constitutes the basis period for the year of assessment"

or,

ii. As an interim measure, the administrative concession of allowing an additional two months to submit a tax return be extended to Year of Assessment 2002 and subsequent years of assessment.

MIT Workshop on Tax Practice

For tax and financial services professionals and managers

Pan Pacific Hotel, Kuala Lumpur. Time: 9:00am - 12:30pm

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

By Chow Chee Yen

Tax is a vast fluid subject matter and it is imperative under the Self Assessment tax regime for tax staff to be competently aware of basic tax fundamentals and principles.

In responding to the need for the creation of qualified and competent tax personnel and in accordance with the mission statement of the Institute, the Malaysian Institute of Taxation is conducting five tax modules on industrial based tax practice.

Participants are expected to, after attending the tax modules, to come away with a comprehensive understanding of current tax principles and practice of the respective industries. The tax modules will focus on tax treatment of capital expenditure, revenue deductibility as well as, other practical aspects relating to that industry.

The Malaysian Institute of Taxation, would like to invite you or your staff to learn how to properly compute tax of the following industries.

WORKSHOP HIGHLIGHTS

Module 1 — 12 October 2002, Saturday

Taxation for Property Developers and Construction Companies

- Accounting treatment
- Tax treatment
- Common issues raised by the Inland Revenue Board
- IRB guidelines

Module 2 — 26 October 2002, Saturday

Taxation of Hotels and Tour Agents

- Capital Expenditure by a Hotel company
- Tax Incentives of a Hotel company
- Tax issues of a Hotel company
- Tax incentives of a Tour Agent
- Tax issues of a Tour Agent

Module 3 — 9 November 2002, Saturday

Incentives for Venture Capital Company and Investment Holding Company

- Venture Company
- Tax exemption for a Venture Capital Company
- Tax deduction for investment in a Venture Company
- Disposal of Shares in a Venture Company
- Tax computation of an Investment Holding Company
- Tax issues of an Investment Holding Company

Module 4 — 30 November 2002, Saturday

Tax Incentives for Manufacturing companies (Part 1)

- Pioneer Status v. Investment Tax Allowance
- Research and Development activities

Module 5 — 7 December 2002, Saturday

Tax Incentives for Manufacturing companies (Part 2)

- Reinvestment Allowance
- Application to the Malaysian Development Authority (MIDA) and IRB

The Speaker

Chee Yen is a Fellow Member of the Chartered Association of Certified Accountants (FCCA), an ATII and is a Chartered Accountant of the MIA. He is also a graduate of the Malaysian Institute of Certified Public Accountants Examinations and has successfully completed the Certified Financial Planner (CFP) conversion programme. He was previously attached with two international accounting firms in Kuala Lumpur, specialising in corporate taxation and has more than 10 years of corporate tax experience and was involved in tax engagements concerning cross border transactions, tax due diligence review, restructuring schemes, corporate tax planning, group tax review and inbound investments. Chee Yen has been lecturing extensively in various colleges in Klang Valley for the past 7 years, specialising in taxation papers for professional examinations namely ACCA, MICPA, ICSA and MIT.

He is currently managing his own tax practice, specialising in tax consultancy and training.

Fee

- ❑ **Member of MIT : RM120.00** *per module*
  (inclusive of one tea break only)
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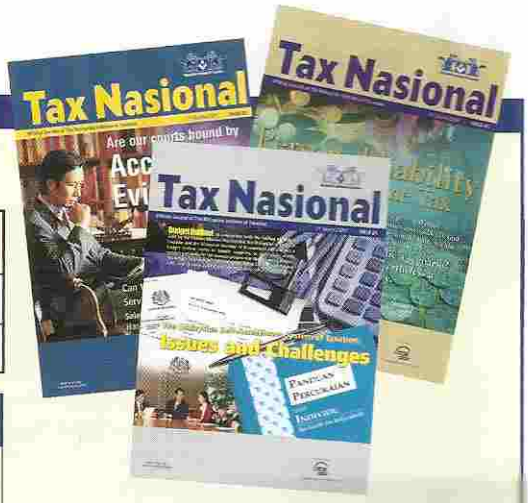

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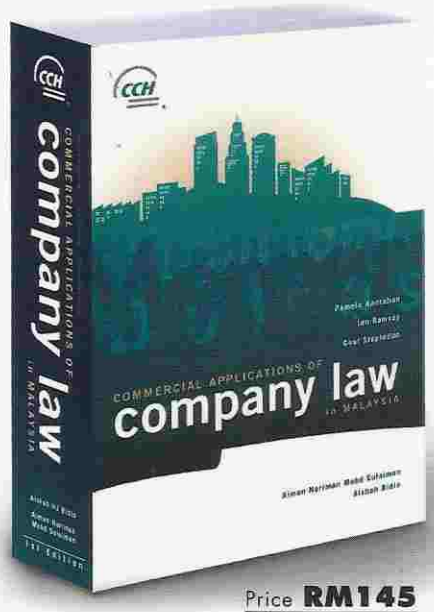

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The Authors:

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