

# Tax Nasional

Official Journal of The Malaysian Institute of Taxation

Vol.12/2003/Q1

RM38.00

CTIM |TN | 633/2



# Tax Controversies in Malaysia

**Priority of Federal Indirect Taxes** 

We welcome all readers
to submit question and answers
to the New Q & A section



# **Tax Nasional**

Official Journal of The Malaysian Institute of Taxation

Please complete this form and fax to your nearest CCH office.

#### **Tax Nasional Subscription Form 2003**

# 2003 Subscription Rates (per annum) MIT Member/MIT Student/CCH Tax Subscriber RM137.00 Non MIT Member/Non CCH Tax Subscriber RM152.00

> Please rush this order to:	Date:
Company:	
	omer No.:
	Postcode:
No. of Employees:	Nature of Business:
Email:	·
Tel No.:	
Fax No.	

Tax Nasiona	Tax Nasional
Are our somes bound by Acco	Nasional Parties Parti
ana.	<u>@</u>

#### Payment options

- ☐ Cheque amount of RM.....payable to the nearest CCH office
- ☐ Please invoice me .....

Commerce Clearing House (M) Sdn Bhd (2160303-M) Suite 9.3, 9th Floor, Menara Weld 76, Jalan Raja Chulan 50200 Kuala Lumpur Tel: 603.2026.6003 Fax: 603.2026.7003

CCH Asia Pte. Limited
11 Keppel Road, #11-01, RCL Centre
Singapore 089057
Tel: 65.6225.2555 Fax: 65.6224.2555



Creating Value for Professionals

Terms & conditions: Order subject to acceptance by CCH. Price valid in Malaysia only. Price subject to change without prior notice. Subscribers to Malaysian CCH Tax subscription titles will receive one copy of Tax Nasional as part of their subscription package.

#### Pilot Papers, December 1995, 1996, 1997, 1998, 1999, 2000 & 2001 Examinations



Signature

#### MIT Registered Students & MIT Members only Year Cost Per Level Level I Level II Level III 2001 Examinations Booklet RM6.00 RM7.00 RM11.00 2000 Examinations Booklet RM6.00 RM7.00 RM11.00 1999 Examinations Booklet RM6.00 RM7.00 RM11.00 1998 Examinations Booklet RM6.00 RM7.00 RM11.00 1997 Examinations Booklet RM6.00 RM7.00 RM11.00 1996 Examinations Booklet RM6.00 RM7.00 RM11.00 1995 Examinations Booklet RM6.00 RM7.00 RM5.50 Pilot Papers Booklet RM6.00 RM7.00 RM11.00

Non-MIT Registered Students & Non-MIT Members only					
Year	Cost Per Level				
	Level I	Level II	Level III		
2001 Examinations Booklet	RM8.00	RM9.00	RM13.00		
2000 Examinations Booklet	RM8.00	RM9.00	RM13.00		
1999 Examinations Booklet	RM8.00	RM9.00	RM13.00		
1998 Examinations Booklet	RM8.00	RM9.00	RM13.00		
1997 Examinations Booklet	RM8.00	RM9.00	RM13.00		
1996 Examinations Booklet	RM8.00	RM9.00	RM13.00		
1995 Examinations Booklet	RM8.00	RM9.00	RM5.50		
Pilot Papers Booklet	RM8.00	RM9.00	RM13.00		

Please tick box(es) to indicate your order.

## Question and Answers Booklet Order Form

Secretariat
Malaysian Institute of Taxation
41A, 1st Floor, Jalan Wan Kadir 2
Taman Tun Dr Ismail
60000 Kuala Lumpur

Date:

Mr/Mrs/Ms:	(Full Name
Address:	
Student Reg. No:	Tel. No:
I enclose a Cheque/PO/MG (including RM1.00 for posts Malaysian Institute of Tax	ge) pavable to

## President's Note



the Institute's

Secretariat has moved to its new premises in February 2003. The new location in Taman Tun Dr Ismail will allow the Secretariat to increase its staff strength and further improve on its services to the members.

The new year marks a new beginning for the Institute. For a start, the Institute's Secretariat has moved to its new premises in February 2003. The new location in Taman Tun Dr Ismail will allow the Secretariat to increase its staff strength and further improve on its services to the members.

The Royal Customs Department has given the Institute the privilege of hosting the Customs-private sector consultative panel meeting in March 2003. This is the first time that a private body has been give this tribute and the Institute is honoured to be the host.

Working along the same lines, the Institute is also in the process of arranging for the first dialogue with the Malaysian Industrial Development Authority (MIDA). The forthcoming dialogue will give the members a platform to clear some issues arising from the 2003 Budget. We also hope to develop a close working relationship with MIDA, where we will be able to present our views and provide assistance in formulation of relevant policies and guidelines.

I cannot begin to stress the importance of the contribution of our members' in presenting the views of Institute at the numerous dialogues with the various government authorities. It is essential that our views be presented to the relevant authority for consideration when they are formulating their policies and guidelines. Through our continuous dialogues, the recent *Finance Act (No. 2) 2002* was amended, to allow small and medium companies entitled to the lower rate of tax to frank dividends at the rate of 28%. I

believe we all breathed a sigh of relief when our efforts in the dialogues paid off and changes were made to prevent the occurrence of a 'dividend trap'.

The new year has also brought changes to the Council of the Institute. It is with great sadness that I inform you that Mr Michael Loh has resigned from his role as Deputy President of the Institute. Mr Michael Loh had been a member of the Institute's Council since the Institute's incorporation in 1991. His relentless contributions over the years have been both invaluable and instrumental to the growth of the Institute into the bigger and more formidable body is it today. I on behalf of the Institute deeply thank Mr Michael Loh for all his services rendered to the Institute and wish him the best in all his future endeavours.

I also wish to announce the appointments of Tuan Haji Abdul Hamid as the Institutes new Deputy President and Dr Veerinderjeet Singh as the Institutes new Vice President. On behalf of all the members of the Council, I congratulate and welcome them both on their new appointments and I look forward to their support and contribution in continuing to ensure that the Institute is well prepared in taking on the new challenges ahead and in propelling the Institute to even greater heights.

The year 2003 promises some exciting times for the Institute, in which we will continue to strive for the recognition of the Institute as the representative tax body of the country.

Ahmad Mustapha Ghazali President

# Heavilest Congratulations

## **DATO' KAMARIAH BINTI HUSSAIN**

Secretary, Tax Analysis Division, Ministry of Finance

on being conferred the

DATO' SETIA DIRAJA KEDAH (D.S.D.K.)

which carries the title "Dato"

by

#### the SULTAN of KEDAH DARUL AMAN

Kebawah Duli Yang Maha Mulia Al-Sultan Almu'tasimu Billahi Muhibbuddin Tuanku Alhaj Abdul Halim Mu'adzam Shah ibni Al-Marhum Sultan Badlishah, D.K., D.K.H., D.K.M., D.M.N., D.U.K., D.K. (Kelantan), D.K. (Pahang), D. K. (Selangor), D. K. (Perlis), D. K. (Negeri Sembilan) D. K. (Johor), D.K. (Terengganu), D.K. (Perak), D.P. (Sarawak), D.U.N.M., S.P.M.K., S.S.D.K., D.H.M.S.

in conjunction with the Sultan of Kedah's 75th Birthday on 19 January, 2003.

From



Malaysian Institute Of Taxation

The President, Council Members, Members and staff of the Malaysian Institute of Taxation

# Contents

1st Quarter 2003

Institute News

#### Counsel's Opinion

9 REFORM of the appeal procedure
By Dr Arjunan Subramaniam



10



The end of AMPAT TIN is in sight By Anand Raj

#### **Direct Tax**

14 Tax Controversies in Malaysia
By Adeline Wong/Karen Tan



Factors influencing compliance behaviour ...of small business entrepreneurs

By R. Mottiakavandar, T. Ramayah, Hasnah Haron & Ang Jili

27 Transfer Pricing...
Global attitudes towards transfer pricing
By Michael Stirling

30 Managing Self Assessment – An appraisal By Dr Sivamoorthy Shanmugam

33 Taxation Aspects of non-resident companies in Malaysia
By Bulvir Singh



#### **Indirect Taxes**

36



The Implications of the Recent Amendment ... to the Federal Indirect Tax Legislation with Regards the Priority of Federal Indirect Taxes in Liquidation and Receivership of Companies

By Chandran Ramasamy

#### **International Tax News**

40 Tax Changes in CHINA...
Impending upon Entry
into the World Trade Organisation



By Assoc. Prof. Lee Fook Hong

**46** Case Digest



47 Q&A

#### **Learning Curve**

48 Personal Reliefs
By Siva Nair



# **Tax Nasional**

Official Journal of the Malaysian Institute of Taxation

Tax Nasional is the official journal of the Malaysian Institute of Taxation and is distributed to members and students of the Institute as well as subscribers to CCH tax publications. Neither the Institute nor CCH Asia Pte Limited accepts liability for any views or opinions published herein. The contents of Tax Nasional do not necessarily reflect the views or opinions of the Institute or the publisher and no Ilability is accepted in relation thereto. Advertisements appearing within this journal should not be taken to imply any direct support for, or sympathy with the views and aims of the Institute or the publisher. Please read the Important Disclaimer below.

IMPORTANT DISCLAIMER. No person should rely on the contents of this journal without first obtaining advice from a qualified professional person. This journal is distributed/sold on the terms and understanding that (1) the authors, the institute or the publisher are not responsible for the results of any actions taken on the basis of information in this journal, nor for any error in or omission from this journal; and (2) that neither the Institute nor the publisher is engaged in rendering legal, accounting, professional or other advice or services. The authors, the Institute or the publisher, expressly disclaim all and any liability and responsibility to any person, whether a purchaser, subscriber or reader of this journal or not, in respect of anything, and of the consequences of anything, done or omitted to be done by any such person in reliance, whether wholly or partially, upon the whole or any part of the contents of this journal. If legal advice or other expert assistance is required, the service of a competent professional person should be sought.

© 2003 Malaysian Institute of Taxation and CCH ASIA PTE LIMITED All rights reserved. No part of this work covered by copyright may be reproduced or copied in any form or by any means (graphic, electronic or mechanical, including photocopying, recording taping, or any information retrieval systems) without the written permission of the copyright holder, application for which should be addressed to the publisher.

#### The Publisher

CCH Asia Pte Limited is a part of Wolters Kluwer group, a leading global publisher active in 26 countries, For nearly a century now we have been providing our subscribers with the highest standard of reporting, for which the CCH group of companies has an established worldwide reputation. CCH publications keep professionals and business people up-to-date with developments in a wide range of topics. What distinguishes CCH publications is the effective combination of accuracy, authority, practicability and ease of reference. Today we have an extensive range of knowledge products — a range, which is constantly expanding to meet our clients' changing needs.

CCH Asia Pte Limited, 11 Keppel Road, #11-01, RCL Centre, Singapore 089057. Tel: 65.6225.2555 Customer Support Hotline: 65.6323.3313 Fax: 65.6224.2555

Malaysia
Commerce Clearing House (M) Sdn Bhd
Suite 9.3, 9th Floor, Menara Weld,
76, Jalan Raja Chulan,
50200 Kuala Lumpur,
Tel: 603.2026.6003
Customer Support: 603.2026.2003
Fax: 603.2026.7003
Technical Support Hotline: 603.1800.801.813



**ENQUIRIES** Advertising

: Sandy Cheung

CCH Asia Pte Limited

Editorial : The Secretariat,

Subscription and: CCH Asia Pte Limited

Malaysian Institute of Taxation

other enquiries c/

c/o Commerce Clearing House

(M) Sdn Bhd

Designers

: Magic Nine Studio Sdn Bhd

Printers : Hopak Sdn Bhd

# Editor's Note

This year, we have introduced a new "Q&A" column to encourage more involvement with the journal and as a platform for readers to express their views and opinions on tax related matters. We look forward to readers taking advantage

of this space in conveying any questions or views they may have on tax for the interest and benefit of the other readers.

Under Institute News, we have coverage of AOTCA's first international convention at Kyoto, Japan on 6 November 2002, with a write up by Dr Jeyapalan on the significant role that AOTCA plays in harmonising tax development. Other articles of interest include:

#### Tax controversies in Malaysia

Under the self-assessment regime unless proper records are maintained and the taxpayer is in full compliance of the income tax regulations, tax audits are likely to prompt an increase in tax disputes and controversies in the near future. Adeline Wong and Karen Tan explore the tax audit process and investigation mechanisms available to the IRB under the ITA and the legal avenues pertaining to the resolution of tax disputes in Malaysia.

#### Priority of indirect taxes in liquidation or receivership of companies

Recent amendments were made to the duties of liquidators and receivers under certain federal indirect tax legislation. Chandran comments on these amendments and the impact (if any) they have on the priority of federal indirect taxes in the liquidation and receivership of companies.

#### Ampat Tin, is the end in sight?

Anand Raj casts serious doubt upon the foundations of Ampat Tin. If the Privy Council type arguments in Cosmotron were considered, Godden and by extension Ampat Tin would have been decided differently therefore, it could be just a matter of time before Ampat Tin is overruled.

#### Reform of the appeal procedure

Under Counsels' Opinion, Dr Arjunan proposes for an amendment to the income tax appeal procedure, to allow the taxpayer to forward the Form Q to the Special Commissioners to stop delays caused by slow reviews.

#### Factors influencing compliance behavior

This paper by R. Mottiakavandar, T. Ramayah, Hasnah Haron and Ang Jili identifies factors influencing compliance behaviour of small business entrepreneurs. The results show that there is a positive relationship between attitude towards own compliance and attitude towards other taxpayers' compliance as well as attitude towards fairness of the tax system. The implications of which are further discussed.

#### Managing self assessment

Dr Sivamoorthy explains the reasons and advantageous for the self-assessment system including it's effectiveness versus implementation problems and the rising cost of compliance. He also anticipates litigious actions by the IRB as the next obvious step in establishing self-assessment.

#### Tax Changes in China

Prof. Lee takes a look at the impact of the WTO membership on China's tax system. The current tax system in China is complex due to substantial tax reforms in the past and most of the tax incentives introduced more than ten years ago are now incompatible with the restructured economy brought about by WTO membership. Many of the tax incentives were initially granted to foreign investors to attract investment funds to China, without consideration to the types and nature of the industries.

#### Global Attitudes Towards Transfer Pricing

Under the International News section, Michael presents a general view of the global transfer pricing situation. Transfer pricing is in recent years becoming an issue that demands the attention of many corporations, and fiscal authorities throughout the world are rapidly falling in line with countries that have more established transfer pricing rules.

#### Personal reliefs

In this issue under the Learning Curve, Siva Nair takes a look at the personal reliefs available to residents individuals using excerpts from past MIT examinations to help readers better understand

#### Taxes affecting non-residents in Malaysia

Bulvir Singh provides an overview of tax legislation affecting non-resident companies in Malaysia, on issues such as residency, source rules and withholding taxes.

#### Harpal S. Dhillon

EDITOR OF TAX NASIONAL



Malaysian Institute Of Taxation

The Malaysian Institute of Taxation ("the Institute") is a compa 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 Malaysia and to be the consultative authority on taxation well as to provide leadership and direction, to enable its member to contribute meaningfully to the community and developme of the nation.

#### Council Members

President Encik Ahmad Mustapha Ghazali Denuty President Tuan Haji Abdul Hamid

Vice Presidents Mr Quah Poh Keat Dr Veerinderjeet Singh

#### Honorary Secretary Mr Chow Kee Kan Council Members:

Dr Ahmad Faisal Mr Lee Yat Kong Encik Atarek Kamil Ibrahim Mr Neoh Chin Wah Mr Harpal S. Dhillon Mr Richard Thornton Dr Jeyapalan Kasipillai Mr SM Thanneermalai Mr Kok Keng Siong Mr Venkiteswaran Sank

#### **Editorial Advisory Board**

Editorial Advisor : Encik Ahmad Mustapha Ghazali

Chairman/Editor of

Tax Nasional Mr Harpal S. Dhillon Members Tuan Haji Abdul Hamid

Mr Quah Poh Keat Dr Veerinderjeet Singh Mr Chow Kee Kan Dr Jevapalan Kasipillai Dr Arjunan Subramaniam Encik Nujumudin bin Mydin

Mr Anand Raj Mr Gurbachan Singh Mr Albert Chong Mr Robin Noronha

Institute Address The Secretariat,

Malaysian Institute of Taxation, 41A, 1<sup>ss</sup> Floor, Jalan Wan Kadir 2, Taman Tun Dr Ismail,

60000 Kuala Lumpur. 603.7729.8989 603 7729 1631 Institute E-mail secretariat@mit.org.my

#### MIT Branch Offices/Chairman East Coast Branch

Mr Wong Seng Chong Chairman Messrs Lau, Wong & Yeo 1, 2nd Floor, Lorong Pasar Baru 1

25000 Kuantan, Pahang Tel: 609.514.4875 Fax: 609.514.4890

#### Malacca Branch

Institute Tel

Institute Fax

Mr Koh Kay Cham Chairman KC Koh Tax Accounting & Corporate Services No. 114, Taman Kota Laksamana 75200 Melaka Tel: 606.284.1280 Fax: 606.283.1144

#### Southern Branch

Dr S Sivamoorthy Chairman Consultancy Network of Malaysia, CNM Taxlink No 17-03, Susur Dewata 1, Jalan Dewata Larkin Perdana Business Park 80350 Johor Bahru Tel: 607.238.7263/507 Fax: 607.238.7261

#### Northern Branch

Mr Ong Eng Choon Chairman Taxnet Consultants Sdn Bhd 12 Lorong Tambun Indah 16, Taman Tambun Indah 14100 Simpang Ampat, Pulau Pinang Tel: 604.227.6888 Fax: 604.229.8118

#### Perak Branch

Mr Lam Weng Keat Chairman KPMG Tax Services Sdn Bhd 99 Jalan Tasik Barat 2, Taman Anda 31400 Ipoh, Perak Darul Ridzuan Tel: 605.253.1188 Fax: 605.255.8818

#### Sarawak Branch

Mr Lau Yaw Joo Chairman Lau Yaw Joo & Co. No. 33, Lot 79, 1st Floor, Chan Bee Kiew Lane 2A Off Padungan Rd. 93450 Kuching, Sarawak Tel: 082.480.141 Fax: 082.489.751

> CCH ASIA PTE LIMITED are the official publishers of Tax Nasional

#### **CCH Publishing Team**

Sunita Nathan & Jagdish Singh

Contributing Editor Ashvin Raj **Editorial Assistant** Samini Nadarajah



The president, En. Ahmad Mustapha with Dr. Jongtae Koo, president of AOTCA at the VIP Dinner in Kyoto, Japan

#### Background

mpany unde mission ssion in ation as embers oomen

> The Asia-Oceania Tax Consultants Association (AOTCA) was founded in Tokyo in 1992 as an association of tax professional bodies located in the Asia-Oceania region. The objectives of AOTCA (hereafter referred to as the Association) are to promote mutual understanding and co-operation among the organisations whose membership include tax consultants in the Asia-Oceania region and to contribute to the expansion of the component members, businesses related to taxation and its related areas, and to promote friendship among the members.

> The current President of AOTCA is Dr Jongtae Koo who hails from the Korean Association of Certified Public Tax Accountants and his deputy is Encik Ahmad Mustapha Ghazali, President of the Malaysian Institute of Taxation.

> In order to achieve the objectives of the Association, Article 3 of the AOTCA Statute stipulates that the association engages in the following activities:

- provide and enhance opportunities to facilitate the exchange of information, expertise, knowledge on tax systems, tax administration, and tax consultant systems;
- enhance ties with other international organisations such as the International Fiscal Association (IFA), the Confederation Fiscale Europeenne (CFE) and Study Group on Asian Tax Administration and Research (SGATAR) to promote the collection and utilisation of relevant information; and
- iii) publish papers on tax-related matters in a journal published annually.

The member bodies of the Association (AOTCA) consist of Asia-Oceania region organisations whose members include tax consultants. These members are recognised either by domestic law or general consensus within their own countries as being substantial national organisations of good standing and whose admission have been approved at a General Meeting of the Association. The official language of the Association is English but the General Council may designate another official language

During the Tenth General Council Meeting held on 5 November 2002 at the Kyoto International Conference Hall, the members officially introduced the Kyoto Declaration (See Appendix 1). In the 'Declaration', member countries agreed to cooperate with each other to upgrade the quality of the tax profession, and act strongly wherever necessary so that the importance and role of tax professionals are fully recognised and supported in their respective societies and region.

#### Member Organisations

By Dr Jeyapalan Kasipillai

when it finds it necessary to do so.

Currently, AOTCA comprises of 17 member organisations located in 13 countries. The 17 member organisations are listed below:

- 1. Certified Public Accountants (CPA) Australia
- 2. The Taxation Institute of Australia
- 3. The Institute of Chartered Accountants in Australia
- 4. Hong Kong Society Accountants
- 5. The Taxation Institute of Hong Kong
- The Indonesian Tax Consultants' Association 6.
- Japan Federation of Certified Public Tax Accountants' Associations

member countries agreed to cooperate with each other to upgrade the quality of the tax profession, and act strongly wherever necessary so that the importance and role of tax professionals are fully recognised and supported in their respective societies and region.



En. Ahmad Mustapha with other representatives from the AOTCA member bodies

- 8. Japan Tax Research Institute
- 9. Korean Association of Certified Public Tax Accountants
- 10. Malaysian Institute of Taxation
- 11. Mongolian Tax Research Association
- 12. All Pakistan Tax Bar Association
- 13. Tax Management Association of the Philippines
- 14. The Tax -Accountancy Association of Republic of China
- 15. Institute of Certified Public Accountants of Singapore
- 16. Institute of Chartered Accountants of Sri Lanka
- The Institute of Chartered Accountants and Auditors of Thailand

#### International Convention

AOTCA organised it's first international convention at Kyoto, Japan on 6 November 2002. Over 1,200 delegates from the host country, South Korea, Taiwan, Hong Kong, Malaysia, Mongolia, Pakistan, Australia, Singapore, China and Philippines attended the convention held at the prestigious Kyoto International Conference Hall. The delegation from the Malaysian Institute of Taxation (MIT) was led by its president Encik Ahmad Mustapha Ghazali, Vice President Tuan Haji Abdul Hamid, secretary Chow Kee Kan and two Council members, namely, Harpal Singh and Dr Jeyapalan Kasipillai. Two senior members Lew Nee Fook and Lye Beow Yoke and two staff members of MIT, Robin Noronha and Ng Sheau Wei also joined the delegation.

The keynote address to the convention was given by the Vice Minister of Finance for International Affairs, Japan, Mr Haruhiko Kuroda. In his paper entitled "Economic Integration and Tax Harmonisation in Asia and the Oceania Region", Mr Kuroda covered several aspects of international taxation and deliberated on the need for regional cooperation to address tax issues. Several well researched papers were presented by distinguished speakers during the concurrent sessions and these included the following:

#### Title of paper

- (i) The Role of Certified Tax Accountants in Tax Compliance
- (ii) Prospects of Taxation System in EC Era
- (iii) Transaction Taxes in the Electronic Age: The Australian Experience

#### Speaker

Dr Ken-Ichiro Ohtake, Japan Professor Dr Jae Kyu Lee, Korea

Dr Jeffery Gordon Mann, Australia

#### **Need for International Cooperation**

In his keynote address, Haruhiko Kuroda highlighted the need for international cooperation to deal with emerging issues in the collection of taxes by both developing and developed countries. Liberalisation in financial systems and innovation in information and communication technology (ICT) have accelerated the globalisation of the world economy resulting in an enormous increase in cross-border transactions. During the last decade, global foreign direct investment has increased but portfolio investments have increased even more rapidly, and the active movement of capital involves developing countries as well. According to Kuroda, this "footloose" globalisation creates a close mutual inter-dependence among countries in different development stages. This emerging development allows situations where opportunities rapidly expand for conflicts of taxation rights and tax avoidance. At the same time, Governments actively introduce preferential tax treatment so as to promote the inflow of capital and minimise the outflow of capital. When this kind of tax competition intensifies, tax bases for economies are eroded and the foundation of national finance deteriorates, and this negative phenomenon is particularly true in the case of developing countries. In order to overcome this unhealthy trend, there is an urgent need for international cooperation in dealing with tax issues pertaining to cross-border transactions.

<sup>&</sup>lt;sup>1</sup>The keynote address by Mr Haruhiko Kuroda can be found at the following website: www.mof.go.jp/english/if/vmi021106e.htm.

The Japan Federation of Certified **Public Tax Accountants' Associations** (JFCPTAA) is a special premier corporation based on the Certified Public Tax Accountants Law

#### Background to Taxation System in Japan

The foundation to Japan's taxation system could be traced to the Meiji Era commencing some 135 years ago. In the initial period, Japan's taxation systems evolved based on land tax in the Meiji era (1868-1911), and continued through the Taisho era (1912-25) until early Showa (1926-88). During those years, other taxes such as personal and corporate income, inheritance tax, sales tax were successively introduced. With tax matters becoming increasingly complex, the need for a system to help merchants and manufacturers pay their taxes became obvious. The first attempt to establish one came in 1897 and was called the "National Tax Work Association." In 1906 it was changed to the "Tax Proxy" system. In 1942 this system was reorganised as the "Tax Practitioners" system. It marked the beginning of the current certified public tax accountants system, and the date of its establishment, February 23, became the anniversary of the system. Today, Japan's certified public tax accountants system can point to a history of more than half a century.

In 2001 the Certified Public Tax Accountants Law, passed in 1951, celebrated its golden jubilee. To help mark this limestone, the Japan Federation of Certified Public Tax Accountants' Association Hall was completed in Shinagawa, Tokyo, as a base for disseminating information among certified public tax accountants throughout the nation.

#### Japan's Premier Tax Organisation

The Japan Federation of Certified Public Tax Accountants' Associations (JFCPTAA) is a special premier corporation based on the Certified Public Tax Accountants Law, and it consists of 15 regional associations located throughout the country.

The activities of JFCPTAA include the following:

- research on tax administration, taxes and certified public tax accountant systems,
- research on ways to improve the activities of members of the regional Associations,
- registration of public tax accountants and reports of certified public tax accountants' corporations,
- implementing -training programmes for certified public tax consultants, and
- submission of recommendations to tax authorities, or respond to their requests for advice on systems of tax administration, taxes and certified public tax accountants.

#### Appendix 1

Asia-Oceania Tax Consultants' Association (AOTCA) First International Convention, Kyoto.

#### **Kyoto Declaration**

The regional economy in the Asia-Oceania region is expanding rapidly transcending national boundaries. The countries in this vast economic zone have entered into an era of cooperation.

Tax systems worldwide play a significant role in collecting stable revenue for the growth of national economies consequently, the roles of tax professionals who assist taxpayers and revenue officials in their obligations in connection with raising national revenues are extremely important and are indispensable factors for economic development.

We the member organisations of AOTCA, hereby declare that we will cooperate with each other to upgrade the quality of the tax profession, and act strongly wherever necessary so that the significance and role of tax professionals are fully recognised and supported in our respective societies and region, and valued by them.

#### November 2002

In his closing speech, the Chairman of JFCPTAA Mr Kinjori Mori called on all Asian and Oceania countries with abundant human resources to promote closer cooperation in seeking mutual prosperity among nations.



protile Lam Weng Keat,

Mr Lam Weng Keat is currently the tax director of KPMG Tax Services Sdn Bhd, Ipoh branch. He is a member of the Malaysian Institute of Accountants ("MIA"), Malaysian Institute of Certified Public Accountants and Malaysian Institute of Taxation ("MIT"). He has over 16 years of experience in tax and consultancy and 5 years of experience in assurance. His interest in the field of taxation covers investment incentives. corporate tax planning, real property gains tax and related tax issues

Ipoh Branch Chairman

Currently, he is also the Vice Chairman of MIA, Perak Branch. Mr Lam sits on the Taxation Committee of MIA and Technical and Public Practice Committee of MIT.

# The 1st AOTCA International Convention



1st AOTCA International Convention, Kyoto, Japan. From left to right: Tuan Haji Abdul Hamid, En Ahmad Mustapha

The President, En Ahmad Mustapha Ghazali led a delegation of 16 members from the Institute to the first ever Asia-Oceania Tax Consultants' Association ("AOTCA") International Convention held in Kyoto, Japan from 5 to 7 November 2002. Approximately 1,000 participants attended the convention from the ASEAN region.

AOTCA was founded in Tokyo in 1992 to foster better interaction and understanding between professional tax bodies in the Asia-Oceania region and it presently consists of 17 organisational members of which the Institute is one. AOTCA has enjoyed remarkable development since 1992 in representing the professional tax organisations in the Asia-Oceanic region. And in commemoration of AOTCA's 10th Anniversary, the first AOTCA International Convention was launched in November 2002. The theme of the convention attended to "Issues on Public Finance in the Asian and Oceanic Regions, and the Roles of Tax Professionals". Prestigious speakers, both from outside and within the tax and accounting profession, the government, private and academic sectors were invited to speak at the convention. Various issues were discussed in an effort to seek

measures to deal with contemporary changes facing the profession and of enriching the role and status of tax professionals from an international perspective. On top of this, the organisers hosted many other programmes for the participants and their accompanying persons, such as field trips to lead industrial areas and traditional Japanese folk arts centers, the arrangement of post- convention tours and entertainment programmes.

The Kyoto International Conference Hall, was the main venue for the convention and it is Japan's foremost national convention facility, having hosted such important gatherings such as the 3rd Session of the Parties to the United Nations Framework Convention on Climate Change, held in 1997. The Conference Hall is situated at the base of the mountains facing a pond surrounded by natural splendour. Although located slightly afar from the appointed hotels, it is easily accessible by subway, which takes approximately 20 minutes.

The first AOTCA international convention was indeed memorable and highly significant in the organisation's history since its inception in 1992.

#### GATHERING

#### of members in Johor Bahru

As a move to get to know the members of the MIT, the Southern Branch organised an Inaugural Gathering of Members in conjunction with Hari Raya and Christmas on 16 December 2002 at the Mutiara Hotel, Johor Bahru.

A total of 80 members from the southern region attended the dialogue session with the President, En Ahmad Mustapha Ghazali and Honorary Secretary, Mr Chow Kee Kan.

Encik Ahmad Mustapha and Mr Chow briefed members on the numerous projects and activities the Institute had undertaken in the past year. In an address to the members, the President emphasised the use of the pro-active approach being adopted by the Institute for anticipating the needs of the members and of the profession in the near future. 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 in the profession.

As part of providing further services to its members, the organising committee also organised a Special Talk during the dialogue session. Tan Sri Dato Ajit Singh, former secretary General of Asean and Distinguished Research Fellow Asia Europe Institute, Universiti Malaya spoke on "Afta – Challenges and Opportunities".

The state Director of Johor Inland Revenue Board, Mdm Ng Oi Leng was also present along with Mr Alan Chung from the MIT Secretariat.

#### DIALOGUE

#### with IRB, Kota Bahru

MIT members from Kota Bahru held a dialogue with the Inland Revenue Board (IRB), Kota Bahru on 24 November 2002. Various issues were brought up for discussion and resolved at the dialogue. The dialogue was held at the new premises of the IRB in the heart of Kota Bahru town.



Standing - left to right: Mr Lou Yin Teng, Mr Chua Eye Bee, En Ramli bin Mohamed, Mr Chu Eng Chiau, Mr Yeo Chin Meng & Mr Lau Keng Chian

Sitting - left to right: Puan Norizan, Mr Nakha Ratuam (MIT member & formerly SADIR, Kota Bharu Branch), En Zainal Abidin (SADIR, Kota Bharu Branch Head), Mr Wong Seng Chong & Mr Billy Kang Wei Geih

By Dr Arjunan Subramaniam REFORM peal procedu

I once stood at the Gates of Heaven. When it came to my turn the Gate Keeper refused to allow me into Heaven. He explained:

Your record shows that you are a taxman. If I allowed you into Heaven, you will set up an Income Tax Department and all Heaven will turn into Hell. You as a taxman can only be permitted to enter a 'Tax Haven"

lappealed to the Higher Authority. The appeal was forwarded and is in the process of being heard. This brings me to the subject at hand: Appeals to the Special Commissioners of Income Tax. Appeals are important. They must be speedily heard and disposed off. An appeal delayed is justice denied.

#### Right of Appeal: Section 99

Section 99, Income Tax Act 1967 sets out the correct procedure for an income tax appeal. The procedure has the following features:

- the appeal is to the Special Commissioners,
- (ii) however, the written notice of appeal is forwarded to the Director General,
- (iii) the notice of appeal is by way of a prescribed form.
- (iv) the appeal must state the grounds of appeal, and
- (v) such other particulars as required in the form must also be included

#### Review of Appeal: Section 101(1)

The Director General upon receipt of a notice of appeal under sec. 99(1), Income Tax Act 1967 shall within 12 months of the date of the notice of appeal review the assessment. If the Director General needs an extension of the said 12 months, he may apply to the Minister for an extension of the period not later than 30 days before the expiry of the 12 months period. (Section 101 (1A), Income Tax Act 1967).

#### The Practice of the Director General

In practice, an appeal in the first instance is by way of a letter and not by way of a Form Q. If an agreement between the parties upon appeal by letter is not forthcoming, the Director General sends Form Q to the taxpayer to lodge the formal appeal. This procedure has been conveyed by the Inland Revenue Board to all accounting / professional bodies in meetings and is also embodied in the Director General's Ruling in respect of the self assessment system.

If the appeal is successful and an agreement is reached between the parties on all relevant issues, the assessment is reduced and that is the end of the matter.

#### Failure to Review within 12 months

The focus of this opinion is on the position of a failure of the Director General to review within 12 months or an extended period and where the Form Q filed is not forwarded to the Special Commissioners.

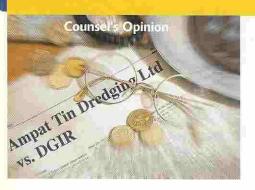
It is not proposed here to give definitive answers to the question "what is the position if the Director General fails to forward the Form Q to the Special Commissioners". Suffice it to say that there are the following possibilities:

(i) Since the Income Tax Act 1967 is silent, if the Director General fails to forward the Form Q to the Special Commissioners, it may be deemed that the Director General agrees with the taxpayer's views. The review under sec. 101(1) should be deemed to be completed in favour of the taxpayer, particularly where all information was forwarded to the Director General. If the Director General did not ask the review period to be extended and did not forward the Form Q to the Special Commissioners, then the Director General must accept the responsibility of the failure and the consequences.

- (ii) The taxpayer could apply to the High Court for a mandamus to force the Director General to forward the case to the Special Commissioners. But under sec. 102 (1), Income Tax Acr 1967, the Director General is permitted to send the appeal to the Special Commissioners anytime within the 12 months period or an extension thereof.
- (iii) Following from section 102(1) provision, it appears that the appeal if forwarded after the 12 months period (or extension thereof) it is not authorised under any section of the Income Tax Act 1967 and, therefore. if forwarded to the Special Commissioners, the appeal is not properly before the Special Commissioners, who are entitled NOT to hear the appeal.

It is not intended to consider here the merits of the different points made in this opinion, which are raised primarily to highlight the issues. In order to resolve the uncertainty that may be caused by a failure to forward appeals to the Special Commissioners in time, it is proposed that sec. 102(1), Income Tax Act 1967 be amended to allow the taxpaver to forward the Form Q to the Special Commissioners, where the Director General has failed in his statutory duty. The taxpayer must be allowed also to forward the Form Q within six months of the 12 months period given to the Director General to review. This will put a stop to the delays caused by slow reviews. Tax must be paid notwithstanding an appeal, and therefore the Inland Revenue should not be allowed to delay the appeal process. There is no point in feeding some one after he is dead.

The Author Dr. Arjunan Subramaniam is an advocate and solicitor, and a partner in Messrs Geraldine Yeoh, Arjunan & Associates. He worked in the Inland Revenue Department for 20 years and when he resigned to join the private sector he was an Assistant Director General. He is an adjunct professor, School of Accounting UUM. He is the author of Arjunan on Malaysian Revenue Laws. 8 volumes, Sweet & Maxwell Asia, comprising direct and indirect taxes.



# The end of Ampat Tin is in sight1

By Anand Raj

The purpose of this article is to critically examine the genesis and scope of the High Court decision of Azmi J (as he then was) in Ampat Tin Dredging Ltd v. DGIR, 1981 (reported at (1950-1985) MSTC 428 and hereinafter referred to as "Ampat Tin"). By the end of this article, it will be apparent that the scope of the Ampat Tin decision is, potentially, not as broad as the Revenue would make it out to be.

In this regard, two cases which suggest that an alternative approach is possible are the cases of DGIR v KRP Ltd. 1950-85 MSTC 232 ("KRP") and Commissioner of Inland Revenue v. Cosmotron Manufacturing Co. Ltd. [1997] STC 1134 ("Cosmotron"). These cases dealt with the deductibility of compensation (KRP) and severance (Cosmotron) payments, which the taxpayers made either under a contractual obligation (e.g. KRP to its agents) or a legal obligation (e.g. Cosmotron to its redundant employees). The Malaysian Federal Court (as it then was) in KRP and the Privy Council in Cosmotron both found in favour of the taxpayers.

In considering the merits of the alternative approach it should be noted at the outset that the High Court judgment in Ampat Tin makes no reference to:

- a. KRP (which was decided a year before Ampat Tin); and
- b. arguments similar to those put forward in Cosmotron.

In keeping an open mind on the subject of deductibility of expenditure, it should be noted that case law, though helpful as a guide to this subject, is not exhaustive of all potential fact situations, each of which must be evaluated upon its own merits. As was held by Shah J in the Indian case of Bombay Steamship Navigation Co v CIT 1965 SC 1201 (which was cited with approval by the Malaysian Supreme Court in DGIR v RB (Rakyat Berjaya) 1950-1985 MSTC 259):-

"Whether a particular expenditure is revenue expenditure incurred for the purpose of business must be determined on a consideration of all the facts and circumstances, and by the application of principles of commercial trading."

#### Ampat Tin Dredging

Ampat Tin closed down its tin mining operations in mid 1970 when it exhausted

its tin ore reserves. Pursuant to its obligations under collective agreements with its workforce, Ampat Tin paid retrenchment benefits to its redundant workers. Although Ampat Tin went into voluntary liquidation in 1971, it had sought to obtain a tax deduction of the retrenchment payments (during the basis period 1970) on the basis that such payments constituted expenses "wholly and exclusively incurred in the production of gross income" or in other words a revenue expense within the meaning of sec. 33(1) Income Tax Act 1967 ("ITA"). (See further the judgment of Azmi J in Ampat Tin.)

Having examined the terms of the collective agreement, Azmi J held, amongst others, that any payments made thereunder by Ampat Tin on account of:

- a. retirement upon attainment of age 55;
- b. retirement upon medical boarding out;
- c. death whilst in service; or
- d. redundancy (due to downsizing and not mine closure);

would be deductible revenue expenditure as such payments would not have been made with a view to the cessation of the business but as an ordinary demand of doing business.

However, Azmi J held that Ampat Tin's payment of retrenchment benefits due to the closure of the mine would not fall within the foregoing categories and would not be tax deductible as such payments were made with a view to close down the business and "... both the obligation incurred and the cause of immediate payment have nothing to do with the production of income, or at least not wholly or exclusively for the production of income."

Ampat Tin has since been regarded as authority for the proposition that the payment of retrenchment benefits in the course of closing down a business are not tax deductible. Simply put, it was thought that such payments could not be incurred to produce income as, owing to the closure of the business, no further income could be produced. In deciding Ampat Tin, Azmi J placed great reliance upon the English cases of:

CIR v Anglo Brewing Co. Ltd. (1925) 12
 TC 803 (High Court) ("Anglo Brewing"); and

Godden v A. Wilson's Stores (Holdings)
 Ltd 40 TC 161 (Court of Appeal)
 ("Godden").

#### Kulim Rubber Plantation Ltd.

In KRP, Kulim Rubber Plantation Ltd was obliged to make compensation payments to agents (who had been appointed to manage KRP's rubber estates) in the event KRP reduced the acreage of such estates. (As the agents were remunerated on the basis of acreage managed, the loss of acreage would result in a loss of income to the agents.) The then Federal Court summarised the salient facts as follows:

"It is stated by T (KRP) and accepted by [the] Revenue that, in 1961, having doubts of the long-term prospects for rubber, it decided to convert to oil palm to maintain, if not to increase, its profitability, and to find the necessary finance for this conversion by the sale of the moreoutlying estates, particularly those with a large proportion of old rubber-trees which yielded only a marginal profit. In furtherance of this policy, T (KRP) sold several rubber estates. The net proceeds of the sales were wholly expended on oil-palm development. In the process, the agents were paid their compensation in accordance with the provisions in cl. 12 and 7 of the respective agreements. ..."

In determining that the compensation payments were deductible as revenue expenses, the Federal Court distinguished Godden when it held:

"...The true situation in our view is that there is no disappearance of any source of revenue; rather, the utilisation of the proceeds of sale for the conversion of the retained rubber lands into oil-palm estates results in the retention of the source of revenue from planting with, hopefully, increased revenue.

Godden v. A. Wilson's Stores (Holdings) Ltd, on which [the] Revenue relied strongly, can be easily distinguished. In that case the estate was sold when the estate owner clearly wished to discontinue business entirely. The payment to the manager for the six months in lieu of the contractual notice to be given by either side, in the words of Upjohn L.J., "cannot possibly be described as a payment for the purpose of trade. It was made because the company was not going on to trade, and they were left with the possibility

¹ This article is based upon a paper entitled "Tin Mines, Rubber Estates & Metal Factories — Ampat Tin Dredging Revisited" presented at CCH's Tax Cases Seminar on 23<sup>rd</sup> August 2001 at the Dorsett Regency Hotel, Kuala Lumpur.

of an action for damages against them for breaches of employment.

Here, the taxpayer was continuing to trade and while the action for damages was always a possibility if it should refuse to abide with the terms of its agreements, the purpose was factually not to invite this action and to retain the services of the agents of the remaining acres of its estate holdings in the new role they had to play."

In summary, the Federal Court in KRP found that:

I was

==sto

wwage

KRP

the the

s of

blucom

The

ent

the]

- the

to to

пилсе

muore-

Large Larly

willoy,

læ net

m on

THETTES

a with

www.e

milion.

mue

Hed

· mere

III into

m the

Itd,

m be

med to

in to

ur the

in in

₩ be

ming

Whitey

- firstly, compensation payments which a taxpayer was bound to make in the course of shutting down one business to open another (e.g. the conversion from rubber business to oil palm business in KRP), would be deductible as revenue expenditure; and
- secondly, in reliance upon Godden, payments made in consequence of a complete shut down of a taxpayer's business could be distinguished.

While Ampat Tin was also contractually bound to make the retrenchment payments, it is clear that Ampat Tin had no intention of converting its business at the material time and would fall within the second limb of KRP i.e. the Godden principle. On the strength of KRP alone (and despite Azmi J's failure to attach any significance to Ampat Tim's contractual obligation to make the retrenchment payments), though it may be arguable, it is unlikely that a Malaysian court would decline to follow Ampat Tin.

This is why the Privy Council case of Cosmotron, though not binding upon Malaysian courts, must be brought into the equation as, while the facts of Cosmotron were similar to Ampat Tin, the Privy Council adopted an entirely different approach.

#### Cosmotron Manufacturing

Cosmotron was in the business of metal manufacturing between 1968 - 1991. In March 1991 it ceased business and closed its factory in Hong Kong. Cosmotron was bound to make, and so made, severance payments to the redundant metal factory workers under local employment legislation. The HK Revenue refused to allow the payments to be claimed as revenue expenditure. Cosmotron appealed and the matter eventually came before the Privy Council, who refused to follow Godden and Anglo Brewing and allowed the taxpayer's claim for deduction on the basis that although the closing down of the business was the event that "triggered" the payment to the employees, that was not the reason for which the severance payments had been incurred.

The approach of the Privy Council was summarised by Lord Nolan, who cited the judgment of Findlay J. in the High Court with approval:

"In their Lordships' judgment the matter was well put by Findlay J in the following passage from his judgment in the present case:

It is, in my view, quite wrong to say that the liability to pay the expense of severance payments is incurred for the purpose of closing up a business. It is not a businessman's aim to close up his undertaking. It may be a consequence of the closing of the business that the employees become redundant, and, therefore, the liability crystallises. The employer has always had a potential liability as an unavoidable part of conducting his business; that potential is realised by the closing of the business, but liability was not incurred for the purpose of closing the business. The employer does not undertake the obligation in order to close up his business; he undertakes it because he wishes to employ people in order to make things, so that he can sell them and make a profit. It is true that the event which triggers the payment to the employee is the dismissal by reason of redundancy because the business is shut down, but that is not the purpose for which the expense was incurred."

The Privy Council went on to hold that Cosmotron was bound by law to make the severance payments and the potential liability to make such payments was incurred in order to attract, employ and retain the employees and, viewed in this way, constituted deductible revenue expenditure. In declining to follow the cases of Godden and Anglo Brewing, the Privy Council concluded that the outcome of the Godden case could well have been different if the arguments raised before the Privv Council were raised before the Court of Appeal in Godden. The Privy Council held:

"The obligation to make them was contingent, like many of the employer's other contractual or statutory obligations, but was none the less incurred as a necessary condition of retaining the services of the employees concerned. The argument advanced by Cosmotron in the present case was not put to the Court of Appeal in Godden, and the reception which it would have received must be a matter for speculation. The point does not appear to have been explored in the later cases in which Godden has been cited, and which have helpfully been brought to their Lordships' notice in a joint note prepared by

counsel for the parties. In the opinion of them Lordships the reasoning of the Comman Appeal in Godden should not be applied in the imperior case."

The obvious question therefore is how does this impact Ampat Tin and KRP!

#### Whither Ampat Tin?

If the Cosmotron arguments had been raised before the High Court in Ampat Tin, and the Federal Court in KRP, neither court may have held retrenchment benefits to be nondeductible (in the case of complete shut down of a business) as both courts were swayed by the reasoning in Godden, which was roundly disapproved of by the Privy Council in Cosmotron. The Privy Council in Cosmotron held instead that:

- a. although the event that "triggered off" the payment to the employees was the closing down of the business, that was not the reason for which the liability to make the severance payments had been incurred; and
- the potential liability to pay severance payments was an unavoidable part of conducting business and was undertaken as a necessary part of the same.

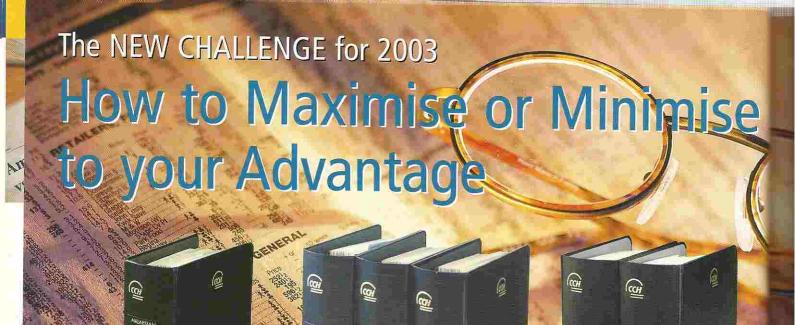
Recognising the strictures of judicial precedent in Malaysian law, it is not suggested that Ampat Tin and KRP (insofar as it approves of Godden) have been overruled by Cosmotron. As Cosmotron is not binding in Malaysia, Ampat Tin still represents Malaysian law on this subject, at least for the moment.

However, it would be wrong to disregard Cosmotron on this ground alone. The Privy Council's view that Godden (and by extension Anglo Brewing) could have been decided differently if Cosmotron type arguments were considered, casts serious doubt upon the foundations of Ampat Tm. Accordingly, it is open for a Malaysian court in subsequent cases to consider and, if thought desirable, abandon the Ampat Tin/ Godden approach, in favour of the Cosmotron approach.

However, until Ampat Tin is overruled or disapproved of by a Malaysian court through the industry of a taxpayer who is minded to press the point, the conservative majority of taxpayers will have to put up with the Revenue's outdated reliance upon Amount

The Author Anand Raj, Advocate & Solicitor is a Partner in the Tax & Pevenus Partner Group of Messrs, Shearn Delamore & Co.\*

<sup>\*</sup>The views of the author do not necessarily represent the views of the firm. Nothing herein contained a small be construed as legal advice on the applicability of any provision of law to a given set of faces



MALAYSIAN MASTER TAX GUIDE MANUAI

MALAYSIAN TAX REPORTER MALAYSIAN REVENUE LEGISLATION

A comprehensive loose-leaf manual that explains the Malaysian Tax System and its implications on individuals, partnerships, corporations and other taxable entities. The manual explains how tax laws affect businesses with worked examples and simple, practical reference systems. In addition, it also provides useful information in the areas of real property gains tax and double taxation.

#### Contents

- > Individuals, Companies and Mutual Concerns
- > Partnerships, Trusts, Pension and Provident Funds
- > Tax Accounting, Assessable Income Exemptions and Exclusions and many more

## Your annual subscription includes: [Print subscription]

- > 2 loose-leaf volumes
- > 4 loose-leaf updates
- > 4 issues of Tax Nasional Journal
- > 1 Annual Budget Report

Price: RM1,080

(Ref Code: MTG)

#### [CD-ROM subscription]

- > 1 CD-ROM
- > 4 CD-ROM updates
- > 4 issues of Tax Nasional Journal
- > 1 Annual Budget Report

Price: RM1,255

(Ref Code: MTG1)

#### [Print & CD-ROM subscription]

Price: RM1,465

(Ref Code: MTGPE)

A commentary reporter providing the most authoritative and detailed explanation of Malaysian Tax Law and Practice. Includes details of all relevant developments in tax law, landmark cases (both Malaysian and International), details of amending legislation and guidelines issued by the Inland Revenue Board to assist the taxpayers' decision making process. This reporter serves as a comprehensive reference for the practitioner who wants a thorough understanding of taxation in Malaysia.

#### Contents:

- > Calendar, Tax Rates and Checklist
- > Income and Deductions
- > Capital Allowances
- > Individuals, Partnerships, Estates and Trusts
- > Companies, Associations and Special Cases
- > Investment Incentives
- > Tax Avoidance
- > Returns, Assessments and Appeals
- > Administration and Collection
- > Real Property Gains Tax
- > Double Tax Agreement

#### Your annual subscription includes:

- > 3 loose-leaf volumes
- > 6 loose-leaf updates
- > 4 issues of Tax Nasional Journal
- > 1 Annual Budget Report

Price: RM1.958

(Ref Code: MTR)

Malaysian Revenue Legislation is the only indexed, loose-leaf Malaysian revenue law reporter in the market. It contains both current and pending legislation, designed to keep subscribers informed of developments in Malaysia's revenue laws.

This publication features simple and concise summaries of amendments to all legislation. It includes historical notes which provides all the amendments made to the legislation since 1987. The pending legislation will be especially invaluable for making informed business decisions.

#### Contents:

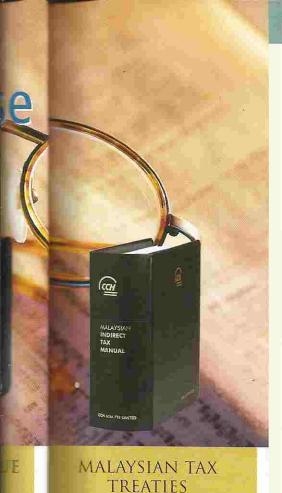
- > Income Tax Act 1967
- > Promotion of Investment Act 1986
- > Real Property Gains Tax Act 1976
- > Petroleum (Income Tax) Act 1967
- > Stamp Act 1949
- > Sales Tax Act 1972
- > Service Tax Act 1975
- > Employees Provident Fund Act 1991
- > Laws in relation to Labuan as an International Offshore Financial Centre
- Other relevant subsidiary legislations (i.e. PU (A) and PU (B) orders) which cover rules, notification, amendments and regulations

#### Your annual subscription includes:

- > 2 loose-leaf volumes
- > 6 loose-leaf updates
- > 4 issues of Tax Nasional Journal
- > 1 Annual Budget Report

Price: RM989

(Ref Code: MRL)



Tax Treaties is a complete and up-tome ection of double taxation agreements

Malaysia and other countries.

manication features the full text of all the taxation agreements and protocols. It general commentary and tables which comparisons on the treatment of ments such as interest, dividends and between all the treaties.

topics in 55 countries

#### unual subscription includes:

leaf volume Bloose-leaf updates ssues of Tax Nasional Journal Annual Budget Report

Fax your order now to 03.2026.7003

YES! Please deliver:

Make an order with this form and you will get a FREE complimentary CCH namecard cum handphone holder. Promotion valid until 15 April 2003

<ul> <li>Malaysian Master Tax Guide Manual</li> </ul>				
Print subscription (Ref Code: MTG)		RM1	,080	
CD-ROM subscription (Ref Code: MTG1)		RM1	,255	
Print & CD-ROM subcription (Ref Code: MTGPE)		RM1	,465	
Malaysian Tax Reporter (Ref Code: MTR)		RM1	,958	
Malaysian Revenue Legislation (Ref Code: MRL)		RM	989	
Malaysian Tax Treaties (Ref Code: MTT)		RM	415	
Yes! I would like to view the product. Please arran Manager to see me immediately.	nge for an A	ccoun	t	
Payment Options				
Please invoice me for RM				
I enclose a cheque of RM made payable to				
"Commerce Clearing House (M) Sdn Bhd"				
Please debit my:	Mastercard			
Card Number:	Expiry Date:			
Card Holder's Name:				
Card Holder's Signature:	Date:			
Customer Details				
Mr/Ms/Mrs/Dr				
Job Title:				
Company:				
Address:				
Nature of Business:				
Customer No.:	No. of Emp	loyees	s:	
Telephone:	Fax:			
Email:				
Order subject to acceptance by CCH. Price(s) valid in Malaysia of prior notice. Only one newsletter set will be issued for public Subscription(s) will be automatically renewed at a prescribed	cations that ha	ve the	same i	oackage.
	V = 10-1 10 10			WADU

CCH is a member of the Wolters Kluwer group with offices in 26 countries worldwide. For nearly a century, CCH has been providing our subscribers with the highest standard of reporting. The CCH publication is distinguished by the effective combination of accuracy, authority, practicability and ease of reference. CCH products can be found in print and electronic formats, in the following topics: Taxation, Auditing, Accounting, Company Law, Company Secretarial Practice, Business Law, e-Business, Employment Law, Human Resource, Training, Occupational Safety & Health, Real

Call our Customer Service at 603.2026.6003 for immediate details now or fax in the reply slip for us to show you our product range.



Commerce Clearing House (M) Sdn Bhd (216303-M) Suite 9.3, 9th Floor, Menara Weld No. 76, Jalan Raja Chulan

50200 Kuala Lumpur, Malaysia. Tel: 603.2026.6003 Fax: 603.2026.7003 Email: support@cch.com.my

Website: www.cch.com.my



Price: RM415 (Ref Code: MTT)

only

== rrent reep ts in

\_\_\_cise mion. It

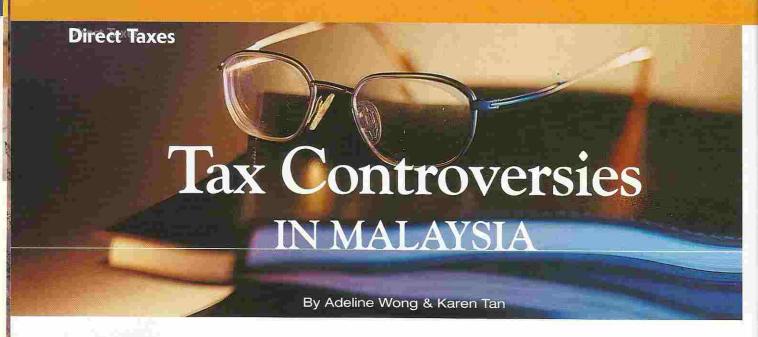
# the

1987. medially ness

Effonal

PU (A)

lation,



#### INTRODUCTION

In an effort to modernise its tax administration and to facilitate the collection of taxes, Malaysia introduced the Self-Assessment System ("SAS") in 2000. The switch from the traditional assessment system to the SAS means that taxpayers are now responsible for assessing their own tax liabilities and report accordingly to the Inland Revenue Board ("IRB"). In effect, the onus for compliance has shifted to the taxpayer.

In line with the SAS, the IRB has taken various steps to ensure tax compliance amongst its taxpayers and these steps include, amongst others, educating the public on aspects of tax administration and putting the necessary enforcement measures in place.

Tax audits have also become increasingly important under the SAS, as audits provide the opportunity for IRB to check and verify information disclosed in the tax returns at the post-assessment stage. The IRB has indicated that corporations will be audited at least once in five years to ensure compliance with the provisions of the Malaysian Income Tax Act 1967 ("ITA"). In addition, the IRB has the discretion to choose to visit any corporation more than once over a five-year period to carry out an audit at any time.

During the audit process, investigations and examinations of the taxpaver's business records are carried out. Unless proper records are maintained and the taxpayer is in full compliance with the income tax regulations, tax audits are likely to prompt an increase in tax disputes and controversies in the near future.

This article seeks to explore the audit process and investigation mechanisms available to the IRB under the ITA and the legal avenues available to resolve tax disputes in Malaysia.

#### PREPARING FOR A TAX AUDIT

A. Assessment of Income Tax by the Director General of Inland Revenue ("DGIR")

#### i. Deemed assessment

Under the SAS, sec. 90(1) of the ITA provides that once a taxpayer furnishes his returns to the DGIR for a year of assessment, the DGIR is deemed to have made an assessment in respect of that person in the amount of tax payable on the chargeable income as specified on the returns.

However, the DGIR is empowered under sec. 90(3) of the ITA to raise an assessment on the estimated income of a taxpayer where the taxpayer has not furnished his returns as required by law. The DGIR may, in such cases, raise an assessment on a taxpayer for an amount of chargeable income determined according to the best of his judgment.

#### ii. Best judgment assessment

In making a "best judgment assessment", the DGIR should use whatever information is available to him. He ought to take into consideration all matters which he thinks will assist him in arriving at a fair and proper estimate. In the usual course of raising an assessment, the DGIR will be

required to exercise his powers in such a way that he makes a value judgment based on the materials which are before him.

Further, there must be some basis upon which the DGIR can form a judgment, otherwise it would be impossible for the DGIR to form a judgment on what taxes are due. In summary, the DGIR must consider all materials placed before him fairly and on that basis, come to a decision as to the amount of tax due which is reasonable and not arbitrary. As long as there is some basis upon which the DGIR may reasonably act, then he is not required to carry out investigations which may or may not result in further justifications being placed before him.

The DGIR will normally take several factors into consideration when making an assessment. These factors include:

- the assessment for the last preceding year,
- · the state of affairs of the taxpayer in previous years as they relate to his returns and assessments;
- local knowledge and reputation in regard to the taxpayer,
- the average rate of profits made by the taxpayers carrying on a similar trade; and
- his personal knowledge, observations and assessment of the taxpayer's trade.

#### iii. Additional assessments

Under sec. 91 of the ITA, the DGIR may raise additional assessments in the following circumstances:

- where for any year of assessment, it appears to the DGIR that no or no sufficient assessment was made on the taxpayers; or
- where the tax charged in the first assessment was too low, due to a mistake of fact or law.

The time frame for raising additional assessments has been reduced from 12 years to 6 years after the expiration of the particular Year of Assessment in 1999. However, in cases of negligence, willful default or fraud by the taxpayer, additional assessments may be raised at any time with no limitation period.

#### B. Tax Audits and Investigations

#### i. Introduction

ras in

alue

Tials

asis

rm a

III be

rm a

due.

must

efore

tome

of

■ and

ere is

GIR

not

ions

in in

Faced

take

ntion

ent.

last

the

ms as

and

and

the

ion a

Ige,

ar of

There are no specific provisions in the ITA in relation to tax audits. There are also no specific rules or subsidiary regulations in respect of tax audits in Malaysia.

However, the IRB has issued a number of public rulings as well as user-friendly booklets which provide general guidance on record-keeping and on tax audits ("Audit Guide") respectively. The public rulings and guides are intended to assist taxpayers to understand the procedures relating to tax audits conducted by the IRB.

The public ruling and guidelines do not have the force of law. They merely reflect the IRB's approach and position pertaining to the specific aspects as set out therein and they are generally regarded as persuasive authority. Briefly, the Audit Guide sets out two types of tax audits:

- Desk audits They normally concern straight forward or tax adjustment queries and can be easily dealt with correspondence/brief interview with the IRB.
- Field audits Field audits are normally conducted at the taxpayer's premises and involves investigation into the taxpayer's business as well as into the taxpayer's nonbusiness records.

It is through field audits that investigations usually begin as the DGIR and/or its officers may discover incriminating information and/or suspect that the taxpayer has either omitted some source of income or has understated his income during the audit. Sometimes, such suspicion may be aroused by discrepancies in the taxpayer's returns or even by a third party informant.

#### ii. Selection criteria for tax audit

Taxpayers are selected for audit in a number of ways that include:-

- Selection through risk analysis;
- Manual checking of return forms:
- Examination of third party records, normally arising from audit or investigation of other taxpayers;
- Previous records on Return Form compliance:
- Selection based on specific industries;
- Selection based on specific issues peculiar to a particular group of taxpayers;
- Selection based on locality.

During the audit process, the following issues may arise such as disproportionate gross profit percentages, inexplicable business losses, disproportionate repair charges to depreciable assets, excessive travel expenses, claims which are not supported by documents, irregularities in distribution of partners' income and substantial variation in amounts on the balance sheet.

Upon the discovery of any of the above issues and discrepancies, the IRB is generally granted wide powers to take copies of the records and may subsequently raise assessments. The powers of the IRB to gather information are discussed in detail (Please refer to (C)) below.

#### iii. Other alternative methods

Various other methods have also been used by the DGIR to discover a taxpayer's failure to state his income properly:

- personal survey of the taxpayer's growing prosperity. In this respect, the DGIR may resort to several sources of information including information available at the Registrar of Vehicles, Companies Commission of Malaysia, Land Offices, Stamp Office, Government Gazettes, Immigration Department etc;
- a study of the average profits made by taxpayers carrying on a similar trade;
- local knowledge reputation of the taxpayer; or
- "tip-offs" by third parties.

#### C. Gathering of information

The ITA confers wide-ranging powers to the DGIR to enable him and his officers to discharge their duties accordingly i.e. to gather and obtain information to enable him to identify income subject to tax.

Some of the powers granted to the DGIR include the power to obtain information from persons who have made payments, such as wages or rent, to persons who may be liable for income tax thereon e.g. returns required from employers, returns required from person receiving income on behalf of others, returns required from occupiers. The pertinent sections of the ITA in respect of the powers

granted to the DGIR are discussed in more detail below.

#### i. Specific returns and production of documents

Section 78 of the ITA provides that the DGIR may, by giving notice, require any person to complete and deliver any return specified in the notice. He may also require any person to attend personally before him and produce for examination any books, accounts, returns and other documents. These demands to furnish information or produce documents can be made of any person and not just the person subject to tax.

The type of books or documents that may be compelled for production have not been defined. They could possibly include records, registers, paper and other documents and all photographic plates, microfilms, prints, tapes, discs, computer reels, perforated rolls or any other type of records whatsoever. Failure to furnish any information or produce any books or documents for inspection as and when required by the DGIR amounts to an offence, the conviction for which may lead to a fine not exceeding RM1,000 or imprisonment for up to six months or both. It is a defence to such a charge if the defendant can prove that he did not have the information or books or documents in his knowledge, possession or control.

#### ii. Statement of bank accounts and assets

Under section 79, the DGIR may also require any person to furnish a statement containing particulars of:

all banking accounts (a) in his own name or in the name of a wife or dependant child of his or jointly in such names, (b) in which he has been interested jointly or solely, or

(c) on which he has had power to operate jointly or solely;

- all savings and loan accounts, deposits, building society accounts and co-operative society accounts in regards to which he has or had any interest or power to operate solely or jointly;
- all assets which he and any wife or dependant child possess;
- all sources and the gross income from those sources;
- all facts bearing upon his present or past chargeability to

#### iii. Access to buildings and documents

As part of his powers to gather information, sec. 80 grants the DGIR virtually unrestricted access to all properties and materials. Thus, the DGIR (or any one of his officers duly authorised by him) is at all times entitled to full and free access to all lands, building and places and to all books and other documents. He may search such lands, buildings and places and inspect, copy or make extracts from any such books or documents without making payment.

Section 80 (2) states that the DGIR can take possession of any books or documents to which he has access if he is of the opinion

- the inspection, copying or making extracts from the documents cannot reasonably undertaken without taking possession of the books or documents;
- they may be interfered with or destroyed unless he takes possession of them; or
- they may be needed as evidence in any legal proceedings under the ITA.

These powers are however not without limits. These statutory powers must be exercised bona fide reasonably, without negligence and only for the purpose for which they were conferred, that is for the assessment of income tax.

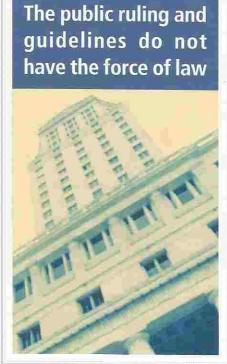
Section 137 of the ITA specifically provides that IRB officers who are authorised by the DGIR to exercise the right of access or the right to take possession of books or documents under sec. 80, must carry a warrant in the prescribed form issued by the DGIR. Section 137 (1) of the ITA further stipulates that the warrant must identify the officers and must be produced on demand to any person having reasonable grounds to make the demand e.g. the taxpayer.

The DGIR may also require any person to give such information, either orally or in writing, as may be in the possession of that person (Section 81 of the ITA). However, the information must be required for the purposes of the ITA.

iv. Power to call for information

#### v. Retention of records

Section 82 (1) of the ITA requires every person who carries on a



business to retain records for a period of seven years from the end of the year to which any income relates to enable the income from the business for each year of assessment to be readily ascertained by the DGIR.

With effect from 1 January 2003, sec. 82A of the ITA requires all taxpayers (including individuals) to keep documents and records for a period of seven years from the end of that year of assessment for the purposes of ascertaining chargeable income and tax payable.

Also if the gross takings for any basis year exceed RM150,000 from the sale of goods or RM100,000 from the performance of services, the business must issue printed receipts serially numbered and duplicates thereof must be retained. Section 82(6) states that entries made in respect of such records must be made within 60 days of each transaction.

#### vi. Calculation of undisclosed income

Where a case of evasion is detected during a tax audit, there are various methods that might be employed to calculate the amount of tax which should have been paid. Most commonly, an assets accretion statement might be prepared. Alternatively, the "gross profit ratio" method might be employed. In cases where incomplete records maintained, the "receipts and payments account" method can be employed.

Other methods that may be used are the "add back" method (i.e. adding back into the taxpayer's assessable income, items of income which the DGIR discovers the taxpayer should have returned) and the comparative method (i.e. comparing returns of taxpayers whose affairs are very similar).



#### TAX LITIGATION

#### A. Objections to an Assessment

#### i. Right of appeal

A taxpayer who wishes to dispute an assessment should formally object to it within 30 days from the date of service of the notice of assessment by the DGIR. Appeals against advance assessments must be made within 3 months of the assessment year for which the assessment was made. (Section 99 of the ITA)

The 30 day time limit may in certain circumstances (e.g. sickness or absence) be extended by the DGIR under sec. 100 of the ITA.

At this stage, the taxpayer need not expound his case in full. It will be sufficient for the taxpayer to express as grounds of appeal the following:

- · that the amount of assessment is in variance with the return made:
- that the assessment is bad in law: or
- that the assessment was incorrect and excessive.

Where the appeal is against an estimated assessment, the objection must be accompanied by the taxpayer's return.

#### ii. Payment of tax pending appeal

must be noted that notwithstanding any objections, the tax payable as shown in the assessment must be paid within 30 days of the issue of the notice of assessment (Section 103 of the ITA). However, in special circumstances (e.g. in cases of protective assessments, obvious hardship etc.), the DGIR may agree to stand over collection until such time as an agreement is reached between the parties.

#### iii. Review of appeal by the DGIR

The DGIR shall, upon receipt of the notice of appeal by the taxpayer, review the appeal and he may either allow or disallow it in whole or in part. The DGIR is entitled to require the taxpayer to furnish further information. produce all books and documents in the taxpayer's custody or summon any person to give evidence in respect of the assessment.

In certain cases, the taxpayer may come to an agreement, either orally or in writing, with the DGIR in respect of the assessment. If the taxpayer reaches an agreement with the DGIR on a revised sum, the DGIR will issue an amended assessment based on the revised

sum. The DGIR may also make written proposals that the assessment should be confirmed, reduced, increased or discharged and if the taxpayer does not reject the proposal within 30 days of service, he will be deemed to have accepted the proposal.

#### iv. Appeal to the Special Commissioners of Income Tax

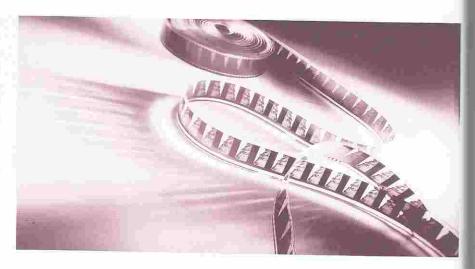
If at any time, the DGIR is of the opinion that there is no reasonable prospect of coming to an agreement with the taxpayer on the assessment, he may forward an appeal to the Special Commissioners at any time within a 12-month period from the date of receipt of the notice or, if an extension was granted, within the extended period.

The Special Commissioners must give the taxpayer and the DGIR at least 28 days' notice of the date and place for the hearing. The appeal must be heard by three Special Commissioners, at least one of whom must be a person with judicial or legal experience. The DGIR may be represented by an authorised officer, a legal officer or an advocate. The taxpayers may be represented by an advocate or an accountant or by both.

The Special Commissioners have wide powers in conducting the hearing of the appeal, including summoning and examining witnesses, requiring a witness to produce any books, papers or documents, admitting or rejecting any evidence adduced, exercising all the powers of the subordinate courts in Malaysia in respect of enforcement of attendance of witnesses, hearing of evidence on oath etc. Further, the procedure for the hearing of the appeal is regulated by the Special Commissioners themselves.

#### v. Onus of proof

In general, the onus is on the taxpayer to discharge the



assessment, notwithstanding that it is an estimate made by the DGIR. The onus of proving that the assessment is excessive or erroneous is placed on the taxpayer.

If the taxpayer fails to discharge an assessment because he has conveniently lost his memory or his books, or failed to keep proper accounts, he must accept the consequences. The taxpayer must not only claim that there is an error in the assessment but must go further to show either that there should have been no chargeable income or that another figure should have been substituted in the assessment.

#### vi. Decision by the Special Commissioners

Following the hearing of the appeal, the Special Commissioners must give their decision in the form of a deciding order as soon as possible. The deciding order must either confirm or discharge the assessment to which the appeal relates, or direct the DGIR to amend the assessment. There is no duty on the Special Commissioners to give reasons for their decisions unless they are required to state a case for the High Court.

The Special Commissioners' decision on a question of fact is final. It is not possible to appeal against their decision to the High

Court unless it is an appeal on a question of law or mixed law and fact. Where an assessment has been determined and no further appeal is made to the High Court, the assessment becomes final and conclusive

#### vii. Appeal by way of case stated to the High Court

If the taxpayer or DGIR is dissatisfied with the decision of the Special Commissioners on a point of law or mixed fact and law, he may, by notice, require the Special Commissioners to state a case for an appeal to the High Court. The case stated is usually laid out in numbered paragraphs and is set out in the following format:

- the statement of facts admitted or proved:
- the contentions on behalf of the taxpayer:
- the contentions on behalf of the DGIR;
- the question of law submitted for the determination of the Special Commissioners;
- the grounds of decision,
- the question for the opinion of the High Court.

#### viii. Appeal to the courts

The High Court will determine any question of law arising in the case stated and may confirm, reduce, or annul any assessment determined by the Special

Commissioners. The High Court may remit the case to the Special Commissioners with the opinion of the court.

Decisions by the High Court are subject to appeal to the Court of Appeal and the Federal Court thereafter. There is no right of appeal against the decision of the High Court on a question of fact only.

#### **MANAGING A TAX DISPUTE** A. Position vis-a-vis the DGIR

Although public policy dictates that there should be an efficient system of tax collection and that the administration of tax collection ought to be conducted fairly, the fact remains that there is an apparent disparity between the information available to the DGIR and the relevant taxpayer, with respect to the taxpayer's chargeable income.

Furthermore, the ITA confers broad powers in favour of the DGIR and it's officers and is weighed heavily in favour of the DGIR. Apart from wide powers of investigation, the DGIR also has the discretion to issue an assessment based on a "best judgment basis". In addition, he also has wide powers under the existing tax

avoidance provisions in the ITA (under secs. 140 and 141) to disregard or vary any transaction which he believes was designed to avoid tax.

Furthermore, the litigation of a tax dispute is often lengthy and time consuming. The taxpayer also bears the burden of adducing evidence to specifically prove the actual figure for the chargeable income which should have been assessed or that there was no chargeable income at all. He cannot merely claim that the assessment was excessive.

In view of the foregoing, it is important and necessary for taxpayers to ensure that an efficient and comprehensive system is maintained in respect of records for business transactions and other matters relevant to determining a person's chargeable income. For the unsophisticated taxpayers, the technical aspects of a tax appeal will also be a further deterrent.

Although there is an avenue for appeal from the DGIR to the Special Commissioners and further, on points of law, to the courts, tax litigants must be aware that the process for the resolution of an appeal in their favour may be a long drawn out and expensive affair.

#### B. Settlements

Where an omission or understatement of tax is detected, the DGIR can either institute criminal proceedings against the taxpayer, or the matter can be settled between the DGIR and the taxpaver.

The DGIR will usually be prepared to settle the matter without prosecution where the taxpayer has co-operated with the DGIR. The practice of negotiating settlements is based upon the DGIR's powers to compound any offence and to impose any fine and/or penalty to which the taxpayer would have been liable if he had been convicted of the offence. The DGIR may invite a taxpayer, who in their opinion has committed an offence, to make a settlement. The taxpayer must however, admit in writing that he has committed the offence and request the DGIR to deal with the offence under Sec. 124 of the ITA.

#### The Authors

Adeline Wong, Partner Karen Tan, Associate Tax Practice Group Wong & Partners (Correspondent law firm of Baker McKenzie)

and Has ther purt, and

to

is

the

int

he

al

for

The

in

of

n of

m,

rial

Although it has been noted recently that the issue of non-payment of taxes or of tax evasion is not a serious problem in Malaysia, the IRB has taken stringent measures to ensure that taxes which are due to the

Government of Malaysia are duly paid. The improved efficiency and the concerted efforts taken by the IRB has enabled the IRB to successfully collect RM13.9 billion in corporate taxes in 2000 and RM21.5 billion in 2001 respectively. It has been reported that the 2002 collections are likely to exceed the existing tax collections.

With the implementation of the SAS in gradual stages i.e. for companies in 2001 and for individuals by 2004, the SAS system represents a fundamental change from the previous system of official assessment. Individual taxpayers must compute their

own tax liabilities under SAS and pay over to the IRB the amount of taxes due.

Taxpayers would be mistaken to believe that the SAS will encourage under-declaration. avoidance or evasion of taxes. Under the ITA, the IRB has been granted broad powers to review and investigate errant taxpayers for up to six years. Furthermore, if taxpayers had fraudulently evaded taxes, there is no time limitation to a tax investigation. The IRB can investigate at any time upon the discovery of the fraud or wilful evasion and the onus of proof lies with the taxpayer.

Some tax practitioners have expressed the need to publicise the names of tax evaders in Malaysia. They are of the view that such publicity would, to an extent, have a deterrent effect on potential defaulters, especially if the taxpayer is a well-known figure or a famous person.

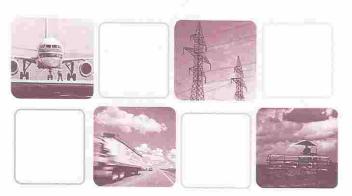
In addition, the IRB's recent proposal to establish a criminal investigation unit could also have an effect on taxpayers and could potentially reduce the number of tax evasion cases in the future.

Whilst its efforts has, so far, been commendable, the IRB must keep up and continue to be vigilant and take steps to further improve the tax administration system. Voluntary compliance amongst taxpayers would have to be encouraged to reduce the IRB's collection burdens. Amongst others, greater transparency and clarity in applying the tax laws as well as educating the taxpayers accordingly are amongst some of the steps which could assist in improving voluntary compliance.

# Factors influencing compliance behaviour

...of small business entrepreneurs

By R. Mottiakavandar, T. Ramayah, Hasnah Haron and Ang Jili



This paper identifies factors influencing compliance behaviour of small business entrepreneurs. The factors studied are amount of tax knowledge possessed by the small entrepreneurs, attitudes towards compliance by other taxpayers, attitude towards effectiveness of the Inland Revenue Board ("IRB") and attitude towards fairness of the tax system. Attitude towards own compliance was used as the dependent variable in this study. Information was collected from 312 respondents who participated in interviews and responded to the questionnaire. The results of this study show that there is no relationship between attitude towards own compliance and amount of tax knowledge as well as attitude towards effectiveness of the IRB. However, the results show that there is a positive relationship between attitude towards own compliance and attitude towards other taxpayers' compliance as well as attitude towards fairness of the tax system. Implications of the findings are further discussed.

#### INTRODUCTION

Income tax has become one of the main sources of revenue for the Malaysian Government. In the year 2001, RM40.136 billion of taxes were collected, whereas for the year 2002 it was forecasted to increase to RM43.932 billion and by the year 2003 it was forecasted to reach RM48.043 billion (Economic Report, 2002-2003). For the year 2000, the biggest contributor to the national tax collection were companies which made up about 47.93% of the total tax collected. (Inland Revenue Annual Report, 2000). In the year 2000, 2,984,988 income tax return forms was sent out to taxpayers and about 2,080,787 were returned which represents a 69.7% return rate. (Inland Revenue Annual Report, 2000). The percentage of taxpayers who did not return the forms was 30.3%. Since the definition of non-compliance includes late submission or non-submission of tax returns (Kasipillai, 1996), this is an indication of non-compliance.

Tax compliance has been defined by Alm (1991) as reporting all income and paying all taxes according to the laws, regulations and decisions of the courts where applicable. Non-compliance, however, is an indication of a taxpayer's failure to pay tax on time, whether on purpose or not (Weigel et al., 1987). According to Clotfelter (1983), non-compliance not only causes loss of current income to the Government but also reflects the "couldn't-care-less" attitude towards paying tax and is a serious threat towards voluntary tax compliance by the majority. Tax avoidance, on the other hand, refers to specific transactions being entered into with the view of reducing or minimising tax liability.

#### Factors Influencing Tax Non-compliance

Kasipillai (1996) showed that there was strong positive corelationship between tax knowledge and the level of tax compliance; and postulated that the level of tax compliance can be improved with increased tax knowledge of the taxpayer through formal education.

A study by Fallan and Eriksen (1996) on the effect of specific tax knowledge on attitude towards taxation showed significant changes in attitude towards avoidance of personal tax and also attitude towards fairness of a tax system. Studies on the effect of tax attitude showed a close relationship between attitude and behaviour. Among these studies were those on tax evasion and tax compliance behaviour among taxpayers. Tax ethics (tax attitude) has also become an important measurement of the intention to avoid paying tax. Previous studies had shown that specific knowledge on tax did increase tax compliance. Experiments carried out by Fallan and Eriksen (1996) showed



that respondents' perception of fairness improved with increased tax knowledge.

ı Jili

e for Lion a ted was 0002-

io nal

S of

100).

sent -ich

wort,

TINS

are W36).

ii all

MIODS

wace.

on.

rling

te of

in't-

reat

mace.

rered

L CO-

tax

miver

cant also

mint of

m and

Teax

the

that

mce.

wed

Earlier studies also showed that there was a relationship between perception of the tax system being fair as against tax compliance and one's readiness to pursue one's duty towards tax compliance (Alm, 1991). Furthermore, a tax system was perceived as fair when taxpayers had better tax knowledge. One study in Europe (Lewis, 1982) showed that a lower level of tax knowledge would bring about negative attitudes towards tax compliance. When attitude towards taxation was positive, tax compliance would improve and the inclination towards tax avoidance would decrease. Jackson and Milliron (1986) reviewed previous studies to check whether there was any relationship between the educational background of a person and one's behaviour towards taxation. Their results indicated that the influence of education is somewhat unclear and suggested that further research be carried out. However, results of their research showed a significant relationship between increase in tax knowledge and the attitude dimensions such as tax ethics and perception of fairness. The attitude dimension is known to be a reliable and also a good measure of the link between tax knowledge and behaviour.

A study by Sabri (1993) showed significant differences between age, occupation, personal monthly income and educational background as against tax knowledge of a person. It was also reported that tax knowledge was positively correlated with attitude towards tax compliance. This would mean that respondents with a higher level of tax knowledge would also have a better attitude towards tax compliance. A study by Witte and Woodbury (1985) showed significant positive relationship between the effectiveness of the tax agency and fairness of the tax system with tax compliance.

Song and Yarbrough (1978) carried out an experiment to determine if there is a relationship between knowledge of tax and attitude towards tax. In 1994, Roberts et al. carried out a study in the United States on a sample of taxpayers to test for objective tax reforms1. It was found that those with higher tax knowledge scored higher in positive tax attitude compared to those with lower tax knowledge. Taxpayers' knowledge was ascertained from a set of questions or queries on taxation related to procedures and calculation of tax liabilities. Thus, for the purpose of this research, it is hypothesised that:

H: The amount of tax knowledge is positively related to attitude towards own compliance.

On the tax fairness dimension, taxpayers may think that the tax system is not fair to them compared to other taxpayers. As an alternative, tax rules may not be complied with through tax avoidance, resulting in lower tax payment by taxpayers who may be sincere or otherwise. In psychology terminology, an unfair tax system would bring about cheating that is condoned and perceived to be rational by the public. Andreoni and Brian (1998) found that individuals who were notified that their tax liability was higher than other people would try to avoid paying their taxes. On the other hand, those who were told that their tax was lower compared to others would also try not to pay all their taxes but the total is proportionately lower. Various aspects of attitude towards tax such as tax ethics and fairness of the tax system have shown their influence on the level of tax compliance (Jackson and Milliron, 1986; Fallan and Eriksen, 1993). Thus, it is hypothesised that:

- H. The more positive the attitude towards other taxpayers' compliance level, attitude towards effectiveness of the IRB and attitude towards the fairness of the tax system, the more positive is the attitude towards own compliance.
  - H2a The more positive the attitude towards compliance by other taxpayers, the more positive is the attitude towards own compliance.
  - H2b The more positive the attitude towards the effectiveness of the IRB in collecting taxes, the more positive is the attitude towards own compliance.
  - H2c The more positive the attitude towards the fairness of the tax system, the more positive is the attitude towards own compliance.

The objective tax reforms actually refers to the study where attitudes toward and understanding of progressive taxation by comparing subjects' choices of fair tax rate structures in response to questions framed in both abstract and concrete terms

#### METHODOLOGY AND SAMPLE

This research used a questionnaire comprising of seven parts spread over nine pages. English and Malay language versions of the questionnaires were used in this study. Four research assistants assisted the researchers to gather the data from the 500 individuals selected randomly to form the sample population. Due to the negative attitude (i.e. a number of individuals were not cooperative), only 312 interviews were completed instead of the 500 originally intended. To ensure uniformity, discussion sessions were held between the researchers and the research assistants to clear any doubts over the wordings in the questionnaire.

#### Attitude

Part A of the questionnaire was used for four dimensions of attitude, i.e. attitude towards compliance by other taxpayers, attitude towards effectiveness of the IRB in collecting taxes, attitude towards the fairness of tax system and attitude towards own compliance. There are a total of 35 questions in Part A. All these attitude dimensions were measured using the dimensions formulated by Schmolders (1970), Fishbein and Ajzen (1975), Song and Yarbrough (1978), Lewis (1982), Fisher et al. (1992), Sabri (1993), Robert et al. (1994), and Fallan & Eriksen (1996). Their dimensions were modified to suit the conditions and background of the largely different Malaysian respondents. Attitude towards own compliance is an individual's attitude towards paying income tax. The questions are basically about "How the taxpayers perceive their own tax compliance". This attitude is measured after taking into consideration the level of tax knowledge, attitude towards the compliance by other taxpayers, attitude towards the effectiveness of the IRB in collecting taxes and attitude towards the fairness of the tax system.

Attitude towards compliance by other taxpayers was measured based on eight questions posed to the respondents. The questions essentially concern "How the respondent perceives tax compliance by other taxpayers". Attitude towards effectiveness of the IRB and attitude towards fairness of the tax system were measured by seven further questions. The questions on attitude towards effectiveness of the IRB are basically about "Taxpayers opinion on how the IRB works and the services it provides to the taxpayers". The questions on attitude towards fairness of the tax system measures "Whether the Malaysian tax system is fair or not". All these variables were measured using a 5 point Likert scale ranging from Strongly Disagree to Strongly Agree.

#### Amount of tax knowledge

Part B was formulated to measure the amount of tax knowledge of respondents. Tax knowledge scales were measured using the dimensions formulated by Kasipillai (1996), Sabri (1993) and Fallan and Eriksen (1993). Respondents were asked questions on tax law such as personal tax exemptions and understanding of income tax matters. All these rules on taxation were readily available in the Tax Return Forms and other tax information disseminated by the IRB. This section was also formulated to

Table 1: Reliability Coefficients

Variables	No. of Items	Items deleted	Cronbach Alpha
Attitude towards compliance of other taxpayers	8	2	0.76
Attitude towards effectiveness of the IRB	7	÷	0.74
Attitude towards the fairness of the tax system	7	3	0.56
Attitude towards own compliance	13	=	0.83
Amount of tax knowledge	24	=	0.82

evaluate respondent's perception and their readiness to face self-assessment. Twenty-four questions with "yes", "no" and "do not know" answers were formulated by the researchers based on previous research. Three marks were given for each correct answer and one mark for each wrong answer and two for the "do not know" answer. This is in line with the system of marking set up by Fallan and Eriksen (1996) in their study where scores were given for the amount of tax knowledge of each respondent.

Table 1 shows the reliability estimates of all the major variables in the study. All the coefficients are more than 0.7 as suggested by Nunnally (1978) except for the attitude towards fairness of the tax system, which was slightly lower but within acceptable limits. Thus, it can be concluded that all the measures are reliable.

#### Sampling procedure

This study involved small business entrepreneurs in rural and urban areas located in the northern region of Peninsular Malaysia, namely, the States of Perlis, Penang, Perak and Kedah only. This was done due to the time and financial constraints faced by the researchers and also the nature of the research which required the respondents to have some knowledge of taxation. Also care was taken to check the representativeness of the sample profile with the profile of the population as a whole and the data collected indicated that the sample under study was representative of the small entrepreneurs population in Malaysia. For example, these States represent a good ethnic mixture, a wide level of income and age, and particulars of employment are reflective of the national data. A most up-to-date list of registered small business entrepreneurs was made available to the researchers from the office of the Registrar of Business located at Kuala Lumpur.

bach

face

# "do

ed on

Iswer

not.

et up were

bles

ested s of

table

= are

and

the

ired

care

file

data

was

æ, a

are

sted

the

-I at

There was no sampling list of taxpayers available from the IRB as data from the IRB is classified material and highly confidential in nature. Hence, a systematic sampling of all the taxpayers was not possible as no proper listing of taxpayers was available from the IRB. Sample size was based on measurements used by Roscoe (1975) who recommended that a sample of 30 to 500 items and to respondents for each variable would be appropriate for the study. The total population of small business entrepreneurs as at 31 December 1999 (Registrar of Business, Kuala Lumpur) was approximately 2,000,000 in Malaysia with roughly 160,000 located in northern peninsular Malaysia. From this total, the researchers discarded all the hawkers on the assumption that they did not possess sufficient basic tax knowledge to participate in the survey.

The method of sampling used in this study was non-random sampling. The sample was selected from the list of names available from the Registrar of Business. The business category was selected because previous studies have identified that businesses such as transport, pharmacy and restaurants are among business types found to be not fully complying with tax laws. Thus, this study tried to select respondents from these categories.

#### FINDINGS

Although the total sample size selected was 500 but due to non-cooperativeness, there were only 312 respondents. The main reason for the failure to interview were the indifferent attitude of the small entrepreneurs.

The profile of the respondents is presented in Table 2. The sample has been classified into eight categories. These are demographic factors such as age, gender, race, education level, income level, business location, business classification and types of business.

As 312 out of 500 questionnaires were useable, the response rate was 62.4%. Out of a total of 312 respondents, 76.6% were male and 23.4% were female. Most of the respondents were between 31 to 60 years of age. A majority of them were of Chinese and Malay origin. As for the educational background, a majority of them have completed at least a secondary education.

A majority of the respondents earned income between RM12,001 and RM48,000 per annum. Most of the respondents were situated in urban areas and are sole proprietors. As for types of business, there was an equal number of respondents involved in businesses such as mini markets, restaurants, laundry-services, tuition centres, plant nurseries, book stores, pharmacies, computer shops, retail stores and the transport business.

To test the hypotheses generated for this research regression analysis was employed. Care was taken in checking all the proper diagnostics and the assumptions of the analysis before any interpretation was done. Table 3 presents the results of the regression analysis.

Hypothesis 1 states that the higher the amount of tax knowledge of the taxpayers, the more positive the attitude towards own

Table 2: Profile of respon	ndents	
Characteristics	N	Percentage (%)
1. Gender		
Male	239	76.6
Female	73	23.4
Total	312	100.0
2. Race		
Malay	113	36.2
Chinese	125	40.1
Indians	22.8	22.8
Others	3	1.0
Total	312	100.0
3. Age		7.5 505
18 to 30 years	37	11.9
31 to 45 years	129	41.3
	119	38.1
46 to 60 years		8.7
60 years and above Total	27	
70,70,02000,	312	100.0
4. Education level		
Never attended a formal sc		4.8
Primary school	50	16.0
Lower Secondary School	89	28.5
Upper Secondary School	56	17.9
Diploma	37	11.9
Degree/ Professional	57	18.3
Higher degree	8	2.6
Total	312	100.0
5. Income Level (Yearly)		
Below RM12,001	32	10.3
RM12,001 - RM24,000	93	29.8
RM24,001 - RM48,000	122	39.1
RM48,001 - RM96,000	44	14.1
RM96,001 - RM192,000	11	3.5
Above RM192,000	10	3.2
Total	312	100.0
6. Business Classifications		
Sole Proprietor	238	76.3
Partnership	74	23.7
Total	312	100.0
7. Business Location		
Rural	65	20.8
Urban	247	79.2
Total	312	100.0
	7.2	100.0
8. Types of Business Mini Market	30	0.6
	32	9.6
Restaurant	29	10.3
Laundry	30	9.3
Tuition center	31	9.6 9.9
Plant nursery	30	
Book store		9.6
Pharmacy	30	9.6
Computer shop	31	9.9
Retail Store	29	9.3
Transportation Total	40 312	12.8 100.0
Total	312	100.0

Table 3: Results of Multiple Regression

Variable	В	Std Error	Beta	t-value
Amount of Tax Knowledge	-0.09	0.08	-0.06	-1.22
Attitude Towards Compliance of Other Taxpayers'	0.15	0.05	0.16	3.05**
Attitude Towards Effectiveness of the IRB	-0.02	0.05	-0.12	-0.36
Attitude Towards Fairness of the	0.39	0.06	0.38	6.94**
Tax System				
F Value		16.85	**	
R		0.42		
R2		0.18	;	

\*\* p < 0.01

compliance. Results from a multiple regression analysis revealed that the relationship between the two variables was insignificant. Hence, the hypothesis could not be accepted. This means that the extent of tax knowledge does not influence attitude towards own compliance.

However, the findings contradict a previous study by Song and Yarbrough (1978) which showed a positive relationship between the two variables, that is, the higher the level of knowledge the more positive is the attitude towards own compliance. This may be due to the fact that taxpayers in advanced countries like the United States tend to file the tax return forms themselves and are able to obtain assistance and guidance from the tax authorities there. The recent campaign in Malaysia to educate taxpayers and also the numerous roadshows organised may contribute somewhat to a change in the attitude of the taxpayers in Malaysia over time.

A study by Fallan and Eriksen (1995) also showed a significant relationship between the two variables. The results of that study differ from this survey because it used a completely different methodology, which was quasi-experimental where pre-tests and post-tests were carried out on a group of students in an institution of higher learning in Europe.

Hypothesis 2a states that the more positive the attitude towards compliance by other taxpayers, the more positive is the attitude towards one's own compliance. By using the results of multiple regression analysis (refer to table 3), it can be seen that the relationship between attitude towards other taxpayers' compliance and attitude towards own compliance, is positively related (b=0.16, p< 0.01). Hence, Hypothesis 2a is supported.

The results of this study are similar to the result from the study done by Sabri (1993). This shows that when attitude towards compliance of other taxpayers is positive then the attitude towards own tax compliance will also be high.

Hypothesis 2b states that the more positive the attitude towards effectiveness of the IRB, the more positive would be the attitude towards own compliance. It can be seen that the relationship between attitude towards the effectiveness



of the IRB and attitude towards own compliance is not significant. Hence, hypothesis 2b is not accepted. The results of this study differ from the study by Witte and Woodbury (1985). This may be because the function and effectiveness of the tax agencies/authorities in Malaysia differ from those in the United States. Apart from this, the taxpayers in the two countries also differ in terms of perception of their tax agencies/authorities, namely the IRB in Malaysia and Inland Revenue Service ("IRS") in the United States. This shows that the attitude towards IRB effectiveness does not influence attitude towards own compliance.

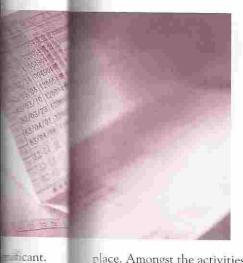
Attitude towards fairness of the tax system and attitude towards own compliance is positively related (b=0.38, p<0.01). Hence, hypothesis 2c is accepted. The results of this study are in line with the results of studies by Witte and Woodbury (1985), Sabri (1993) and Andreoni and Brian (1998). This shows that when the attitude towards fairness of the tax system is positive, the attitude towards one's own tax compliance will also be positive.

#### **IMPLICATIONS**

Attitude towards the effectiveness of the IRB (for example, brochures issued by the IRB, campaigns held by the IRB, promptness in processing annual tax returns, etc.), and amount of tax knowledge is not seen to be of significance in moulding the compliance behaviour of taxpayers. This may be due to the fact that the IRB is seen as a Government body capable of meting out stiff punishment and as such the respondents are not willing to openly criticise the effectiveness of the IRB.

IRB conducts "Taxpayers' Service Week" campaigns once every year throughout the country to assist taxpayers if they have problems filling in their tax returns. Their service counters can be found in public places such as in shopping complexes, factory sites, schools and Government agencies. Through conversations with some of the participants, the researchers concluded that these services have helped many of the small entrepreneurs to clear any misunderstanding that they had about their tax matters.

Other than that, the IRB also conducts road shows regularly and organises lectures, seminars and forums to highlight to the public the new issues and tax regulations, the effect of the regulations on taxpayers and the responsibility of taxpayers in paying tax.



This is more so in the last two years (2001 and 2002), as the country moves towards self-assessment.

Of late, the IRB also carries out activities to foster closer relationships with business organisations and professional bodies. The intention is to improve the reputation of the IRB as an institution that is accountable for the tax revenue and also to get feedback and comments regarding new regulations that they have put in

place. Amongst the activities conducted are having discussions over radio and television where there is direct contact with the public to air their views and comments. Another activity of this nature is having dialogues and talks with the Companies Commission, Registrar of Business and Professional Accounting and Tax Bodies such as the Malaysian Institute of Taxation , Malaysian Institute of Accountants and Malaysian Institute of Certified Public Accountants to discuss technical issues.

As a result of the feedback obtained, new tax rules have been modified in some instances. The IRB also has a computerised system in place to take over the manual system for some services relating to tax matters.

The intensive efforts of the IRB may have led the public to improve their tax knowledge and to cause them to have an opinion that the IRB is effective in its task. Thus, these two variables were not seen to have an effect on their compliance behaviour.

The Government needs to instill a positive attitude amongst taxpayers as the study has shown that attitude towards other taxpayers' compliance level influences taxpayers compliance behaviour. As such, the Government should impose heavier penalties on errant taxpayers to encourage compliance. At the moment, the various penalties imposed upon conviction for various tax offences can be considered light. It is suggested that the Government impose higher penalties than the current ones.

Imprisonment would also be a way of conveying the seriousness of efforts to curb non-compliant behaviour.

Currently, small businesses registered with the Registrar of Business need not have their annual accounts audited. This could, in most cases, lead small business enterprises to present accounts which may be incorrect (i.e. sales may have been understated and expenses may be overstated, etc.) thus leading to either a nil or a low tax liability.

Hence, the Government and the IRB should consider making it mandatory that the accounts of small and medium scale businesses be audited by external auditors before submission to the Registrar of Business and the IRB. With the implementation of this proposal, attitude towards positive tax compliance behaviour is expected to improve. Moreover, with the implementation of self-assessment, tax audit functions would be the main focus of the IRB.

Fairness of the tax system is also important in instilling compliant behaviour amongst taxpayers. The Government should take serious efforts to inform the public, for example, on how tax payable is computed. Greater efforts to educate and assist in advising on proper record keeping could go some way in clearing the misperception that small business enterprises are paying higher taxes compared to other taxpayers.

#### LIMITATIONS

The study involves a survey of attitudes of taxpayers regarding their tax compliance behaviour. It involves a sensitive area and the researchers were not able to determine whether the respondents were sincere in providing their answers. In other words, will the answers provided be similar to how they would behave in real situations?

The study is also unable to differentiate between intentional and non-intentional non-compliance. In other words, was the reason for non-compliance due to ignorance of tax regulations or was it due to the inability of the taxpayers to understand the complex nature of tax regulations. This can be observed from the results of the study which states that the amount of tax knowledge has no effect on their non-compliance behaviour.





tory

ations

that

curs to

mers.

study

his may

mencies/

States.

Fer in

ly the

in the

IRB

is own

wards

Hence,

in line

Sabri

when

the the

milive.

ample,

The method of sampling used in this study was non-random sampling. The sample was selected from the names available from the Registrar of Business. The sample did not include hawkers. As such the findings should be interpreted with caution.

Another limitation is the fact that the lack of a significant relationship between the effectiveness of the IRB and amount of tax knowledge with own compliance may be due to the fact that taxpayers are sensitive about openly criticising the IRB as these may have undesirable consequences.

The study is confined to the northern region of peninsular Malaysia and thus the results might not be representative of the population as a whole. However, this limitation has been somewhat overcome, as the sample profile is quite similar to the whole population at large.

The results from this study would be beneficial to tax policy makers and to other researchers who have an interest in this area of study. In this study, the researchers had tried to put together various variables, which were analysed separately in earlier studies, into one model.

Based on the outcome of this research, it is the opinion of the authors to suggest that the IRB should scale down programmes that are implemented for increasing tax knowledge of taxpayers. This is because the outcome of this study shows that the level of tax knowledge does not have a significant effect in improving tax compliance. Hence, the Government should not solely concentrate on allocations for education programs, which supposedly increase tax knowledge among taxpayers. On the other hand, the Government should emphasise programs, which stress on positive attitudes towards compliance by other taxpayers and towards the fairness of the tax system because, based on the findings of this study, these two factors seem to influence attitude towards own compliance. Hence, programs emphasising on positive attitudes towards compliance by other taxpayers and towards the fairness of the tax system, could help to increase tax revenue collection in the future.

The Authors\* Mottikavandar Ramasamy, B.Acc. (Hon.) (UUM), M.A. (USM) is a college trained teacher attached to a secondary school in Penang.

T. Ramayah is currently Chairman of the Operations Management Section, School of Management, Universiti Sains Malaysia.

Assoc. Prof. Dr. Hasnah Haji Haron, Dip. In Acctg. (ITM), B.Sc. (N. Illinois University), MBA (Governors State), Ph.D. (Hull) is currently Chairman of the Accounting Section, School of Management, Universiti Sains Malaysia.

Ang Jili, B.Ec. (Hons) (UM), Dip.In Acctg. (UM), M.A. (Ohio State) is a lecturer in Taxation and Accounting at the School of Management, Universiti Sains Malaysia. He is also a member of MIA.

\* This paper is based on the research and study of the authors. All analysis and conclusions drawn are the sole opinion of the authors. The authors would like to thank the Malaysian Accountancy Research and Education Foundation and the Malaysian Institute of Accountants for partly sponsoring the research.

#### REFERENCES

Ajzen, I. and Fishbein, M. (1980). Understanding Attitudes and Predicting Socia-Behaviour, Englewood Cliffs, New Jersey: Prentice-Hall.

Alm. J., (1991). A Perspective on the Experimental Analysis of Taxpayer Reporting The Accounting Review, 66(3), pp. 577 – 593.

Andreoni, J. and Erard, B. (1998). Tax Compliance, Journal of Economic Literature pp. 818-861.

Baron, M. R. and Kenny A. D. (1986). The Moderator-Mediator Variable Distinction in Social Psychological Research: Conceptual, Strategic, and Statistica Considerations, Journal of Personality and Social Psychology 1986, Vol. 5.1, No. 6, pp. 1173 -1182.

Clotfelter, C.T. (1983). Tax Evasion and Tax Rates: An Analysis of Individual Returns 65 Review of Economics and Statistics, pp. 363 -373.

Cohen, J. (1988). Statistical Power Analysis for the Behavioral Sciences (2nd ed.) Hillsdale, New Jersey: Lawrence Erlbaum.

Fallan, L. and Eriksen, K. (1996). Tax Knowledge and Attitudes Towards Taxation A Report on a Quasi-Experiment, Journal of Economic Psychology, pp. 387-402

Fallan, L. and Eriksen, K. (1993c). The Principal-Agent Model, Ethical Utilitarianism and The Tax Evasion Decision: An Empirical Study. Working Paper. TOH- Series No.

Fischer, C. M., Wartick, M. and Mark, M. M. (1992). Detection Probability and Taxpayer Compliance: A Review of the Literature, Journal of Accounting Literature Vol.2.

Fishbein, M. and Ajzen, I. (1975). Belief, Attitude, Intentions, and Behaviour Reading, MA: Addison-Wesley.

Gay, L. R. and Diehl, P. L. (1996). Research Method For Business and Management. Prentice Hall International, Inc.

Http://www.hasilnet.org.my/Hasilnet/hasil.html.

Inland Revenue Board. (1997). Annual Report 1997. Kuala Lumpur: Nationa Government Printers Ltd.

Jackson, B. R. and Valerie C. Milliron, (1986). Tax Compliance Research: Findings Problems, and Prospects, Journal of Accounting Literature, 5, pp. 125-165.

Kasipillai, J. (1996). Taxpayer's Understanding and Knowledge Index (TUKI) as a Clue to Non-Compliance, Ph.D. Thesis, Australia.

Ministry of Finance, Malaysia. (1997). Annual Economic Report 1997/98. Kuala Lumpur: Percetakan Nasional Malaysia Berhad.

Ministry of Finance, Malaysia. (2000). Annual Economic Report 2000/01. Kuala Lumpur: Percetakan Nasional Malaysia Berhad.

Klepper, S. and D. Nagin. (1989). Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution. Low and Society Review, 23(2), pp. 209 -

Lewis, A. (1982). The Psychology of Taxation, Oxford: Martin Robertson.

Nunnally, J. C. (1978). Psychometric Theory (2nd ed.), New York: McGraw Hill-Hill Book Company.

Roberts, L. H., P. A. Hite and C. F. Bradley, (1994). Understanding Attitudes Toward Progressive Taxation. Public Opinion Quarterly, 58, pp. 165-190.

Roscoe, J. T. (1975). Fundamental Research Statistics for the Behavioral Sciences (2nd ed.), New York: Holt, Rinehart and Winston.

Sabri, S. (1993). Tax Ethics and Taxpayers Attitudes, Master Thesis, Kuala Lumpur University of Malaya.

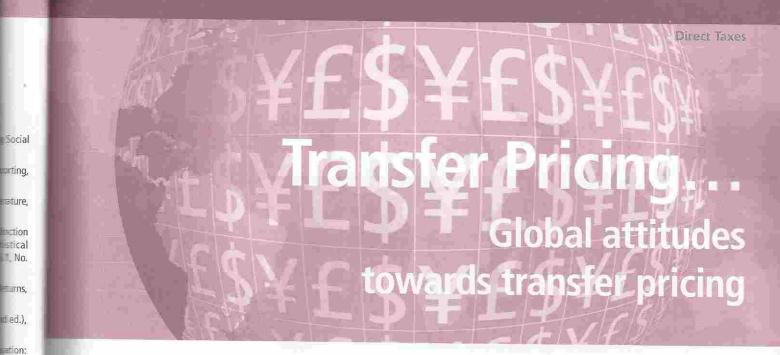
Savandiah, A., (1998). Perceived Factors Affecting Hypothetical Tax Compliance Master Thesis, Penang: University of Science Malaysia.

Schmolders, G. I. (1970). Survey Research in Public Finance - A Behaviora Approach to Fiscal Theory, Public Finance Review, pp. 300-306.

Song, Young-dahl and Yarbrough, T. E. (1978). Tax Ethics and Taxpayer Attitudes A Survey, Public Administration Review, (38), pp. 442-457.

Weigel, R. H., D. J. Hessing and H. Elffers, (1987). Tax Evasion Research: A Critical Appraisal and Theoretical Model, Journal of Economic Psychology, pp. 215-235

Witte, A. D. and Woodbury, D. F. (1985). The Effect of Tax Laws and Tax Administration on Tax Compliance, National Tax Journal, 38(1).



Michael Stirling, Head of Transfer Pricing, Field Fisher Waterhouse, discusses the current global attitude to global transfer pricing.

402.

mism,

ES No:

inture.

wour.

ment,

dings,

as a

llos of

I-Hill

Global attitudes towards transfer pricing are in a stage of continuous development. The subject of transfer pricing has in recent years grown from being a relatively unimportant aspect of tax compliance and planning to now becoming an issue that demands the attention of many corporations. Fiscal authorities throughout the world are rapidly falling in line with countries that have a more established set of transfer pricing rules.

The two main authorities that have had the greatest impact on the development of transfer pricing rules are the US government and the OECD. The rules contained within the US Federal Tax Regulations, sec. 482 are well developed and do not suffer from the uncertainty and lack of clarity that plagues the OECD Transfer Pricing Guidelines. Indeed, the US transfer pricing rules are arguably clearer than those found in any other jurisdiction. The US has consistently resisted applying the OECD Transfer Pricing Guidelines and instead, opted to develop its own framework.

The US recognised the erosion to it's tax base in tax avoidance through transfer pricing and created a legislative framework against companies' manipulation of pricing before any other developed economy. This has enabled the US transfer pricing rules to become far more developed and settled as there is a substantial body of transfer pricing case law that provides the certainty and guidance which is often missing in many OECD and non-OECD jurisdictions. The US debates are on a more mature level. The competency of tax authorities in dealing with transfer pricing issues varies tremendously between different countries. Those that have only relatively recently introduced transfer pricing legislation are essentially coming to terms with the most basic of issues affecting the subject. Whereas, countries where transfer pricing rules have been established for longer and which have invested more resources, have developed more

sophisticated systems in investigating related party transactions. As revenue authorities develop competency in analysing and enforcing transfer pricing legislation, inspectors will become more knowledgeable and place greater emphasis in reviewing related party transactions during enquiries.

#### Monitoring your Transfer Pricing Systems

This season's "theme" offered by many advisors within transfer pricing, is "central management and control". This is the catch phrase that is being mentioned at many conferences and on the lecture circuit. Although, in principle, it appears to be a good idea to manage all your transfer pricing centrally in order to achieve consistency of policy throughout the group, what is often overlooked is the necessity for head office to seek the views of their local entities to apply their local knowledge of tax requirements. It is neither constructive nor helpful to the local entities should the head office create standard documentation for the whole group. Value is added by each local entity adjusting the documentation to suit the local tax authorities' requirements and reporting to the central point what changes it has made to the documentation and the reasons for doing so. In different jurisdictions, the attention to detail and the documentation for compliance varies significantly. Local entities should adjust documentation so that it suits the attitudes of their local fiscal authority. Corporations should avoid using higher standards of documentation than is necessary for each particular jurisdiction. Providing greater documentation than is required will only encourage further questioning by inspectors. Using standard US documentation outside the US is not advisable. In summary, head office should guide its local entities, but allow its local entities to adjust documentation to meet local requirements.

#### Approaches by Tax Departments to Transfer Pricing

Attitudes towards transfer pricing vary significantly depending on the experience the management have had with the tax authorities. Those who have had to deal with a transfer pricing investigation are much more aware of having compliant and well thought-out transfer pricing strategies, whereas those with less experience tend to view transfer pricing as an additional cost and adopt a minimalist approach. More advanced and experienced tax departments do not view transfer pricing as merely a compliance issue but as a tax planning opportunity to review the group's practices and obtain greater efficiencies.

#### **Overview of Transfer Pricing Regimes** Europe

Attitudes and practices towards transfer pricing across Europe are at different stages of development. In the main, European countries apply the OECD Transfer Pricing Guidelines.

There has not been a uniform implementation of the OECD Guidelines and the rules have been in many instances adjusted to be consistent with national tax law. This has provided for different emphasis being placed by revenue authorities on different aspects of the Guidelines. For example, in Germany there is currently no documentation requirement, although a recent draft circular suggests that there will be one soon. Finland has no documentation requirements, whereas the UK has relatively strict rules on documentation.

Penalties also vary substantially between jurisdictions. Some authorities charge a filing fee to consider an application for an advanced pricing arrangement ("APA"), as is the case in Denmark, whereas in France or the UK there is no such charge. These examples demonstrate the different approaches and attitudes of revenue authorities.

Although many European countries have modernised their transfer pricing rules, the European transfer pricing rules are still behind in their development in comparison to the US rules. In our personal experience, UK Revenue inspectors are trained to be generally more experienced in inquiring into related party transactions than those in other European countries such as Sweden, Romania, Italy and Spain.

#### UK transfer pricing update

There is still limited UK case law on transfer pricing. However, the recent case of Waterloo Plc v Others has provided some guidance in that:

- Transactions should be considered from a commercial perspective.
- Absence of legal contracts does not mean that there should be no charge where value is provided to a related party.

It is anticipated that more cases in the UK will go to the Special Commissioners to clarify various points of law, as the rules there are still in need of interpretation.

#### The Americas

The US was aware of potential losses to its revenue base as early as the 1930s. Much of the initial thinking in creating transferpricing legislation to prevent an erosion of the US tax base took place in the 1960s. The culture in the US is more legally orientated, with lawyers actively involved in the creation of transfer pricing strategies. Corporations are also generally more willing to litigate on transfer pricing due to vast sums of money at stake.

The IRS is sophisticated in its appreciation of transfer pricing issues and has dedicated agents ensuring that corporations comply

with its fiscal code. The IRS actively shares information with countries where international treaties are in place. Corporations need to be aware of this information gathering facility between revenue authorities. This is particularly strong between countries such as the US and UK where a common language is shared between revenue authorities.

The IRS has also co-operated in the training of a number of fiscal authorities in South America, exchanging agents so that a common approach can be taken towards transfer pricing enquiries. As a result, a number of countries in the Americas are competent and advanced in their approach to addressing transfer pricing issues, notably Mexico. Brazil, an exception, has expressed reservations with some aspects of the OECD Guidelines and favours safe harbours.

The transfer pricing rules in Canada were revised in 1997 to comply with the OECD Guidelines. There are now specific penalties for inadequate documentation. There has been little litigation in Canada on transfer pricing by the Canada Customs and Revenue Agency (CCRA), but this is expected to change as the number of revenue investigations increase.

#### Asia

Japan, as a member of the OECD, is keen to achieve consistency with the OECD Guidelines. The Japanese National Tax Authority (the "NTA") is thought to favour the use of 'secret comparables'. It is also distinctive in that, unlike most developed economies, it does not use the range concept. Instead it favours the use of the single comparable. There is some discussion within the Japanese NTA as to whether to charge a filing fee for an APA application.

In China, the revenue authority relies on the use of disclosure forms. There is however, a low level of compliance with these forms by multinational companies. The State Administration of Taxation (the "SAT") is however, constantly increasing its knowledge and skills in the transfer pricing area with an increase in the number of transfer pricing specialists throughout the country from between 100 and 200 in 1998, to 300 in 2002.

There is a tendency in both Japan and China for transfer pricing inspectors to rotate to other departments and positions within the tax authority. This has often been frustrating for corporations, which can find themselves training inspectors on transfer pricing rules. However it is anticipated that as expertise grows, this will become less of an issue then at present.

Malaysia would be introducing transfer pricing guidelines. Although Malaysia is not a member of the OECD, the Malaysian tax authorities will follow the OECD Guidelines as do most tax jurisdictions. The transfer pricing rules in Malaysia are still in their infancy but as knowledge and experience grows with the Inland Revenue Board, transfer pricing will increasingly become more of a significant issue during tax audits. Companies should follow best practice procedures to avoid expensive and resource intensive enquiries.

#### Australasia

with

tions

een

arries

hared

her of

mat a

icing

tricas ssing

has

lines

of to

**eific** 

little

Toms

ange

⊪ncv

Tax

ecret

**D**ped

DUIS

thin

or an

osure

these

inn of

≡⊈ its

- ease

the the

meing

hin

mons,

ricing

is will

sian

t tax ll in

some

bould

ource

Australia has been pro-active in the development of global transfer pricing regulations and the Australian Tax Office ("ATO") is advanced in its transfer pricing analysis. The ATO has issued substantial guidelines on the application of Australian requirements. The ATO conducts a programme known as Transfer Pricing Record Review and Improvement Project with the objective of checking the level and quality of compliance. This shows the ATO's determination to ensure compliance with it's transfer pricing regulations.

#### New Zealand

New Zealand enacted new transfer pricing regulations in December 1995, which came into effect in March 1997. New Zealand has stated express agreement in applying OECD Guidelines.

New Zealand's focus is voluntary compliance by taxpayers and this is encouraged by questionnaire based risk analysis programs, education and an APA program. Transfer pricing is treated as just another tax topic in the audit process. Audits are carried out by Corporate Investigators for \$100m+ turnover companies and by general auditors for the smaller companies. The transfer pricing specialists provide support to all investigators and auditors when required and provide national training on the subject.

#### Middle East

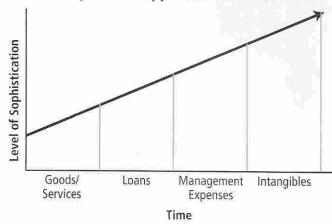
Most countries in the Middle East do not have rules for regulating transfer pricing. However, Israel has general anti-avoidance tax principles which are applied to transfer pricing. Although not a member of the OECD, it is anticipated that Israel will soon adopt the OECD Guidelines. Given the extent of trade between Israeli companies and the EU and US companies, it is expected that more attention will be given to transfer prices between related companies in these jurisdictions. This will be particularly significant for companies within the IT and software sector that have related entities in Israel.

#### The Future of Transfer Pricing

Globally, with the exception of the US, transfer pricing is still in its infancy. Many countries are in the process of updating their legislation or introducing transfer pricing rules. Different tax authorities are at various stages of sophistication in their analysis of inter company cross border transactions. Experience shows that tax jurisdictions which have recently introduced transfer pricing legislation focus on the elementary aspects of cross border transactions i.e. goods and services, then as authorities gain more expertise on issues such as financing, management expenses and more recently a very real issue in developed economies is charging an arm's length price for the use of intangible assets.

Corporations ought to be aware of the level of sophistication of local revenue authorities on transfer pricing issues, when preparing transfer pricing documentation. Companies should not provide more or less information than is required for local jurisdiction. Providing too much analysis and documentation or too little can result in an expensive transfer pricing inquiry.

#### The development in approach of tax authorities



The OECD Transfer Pricing Guidelines are, of course, no more than guidelines unless, as in the UK, they have been incorporated into legislation and therefore carry legal force.

It is anticipated that transfer pricing litigation and the number of cases brought by competent authorities due to double taxation will increase as different interpretations of the rules are applied globally. In jurisdictions where there have been little or no transfer pricing litigation to date more cases will be contested. Although many revenue authorities avoid allowing disputes to reach the stage of formal litigation, it is a matter of time before corporations defending their transfer prices will argue their points before the local legal forums, due to the sums at stake.

Due to different practices and priorities within each tax jurisdiction, the level of documentation, enforcement and attitudes towards transfer pricing can vary considerably. Corporations must avoid using the same standard documents across all group companies and should instead, have them tailored to meet the expectations and requirements of the local tax authority.

Corporations should analyse the volume of transactions between their related companies throughout all jurisdictions where they have related entities. Where cost savings are high on the agenda, a risk management exercise should be undertaken in analysing where exposure to transfer pricing adjustments is greatest. In those jurisdictions where significant trade is undertaken. it is particularly important for a group to have independent studies undertaken. Although many corporations have in-house legal and transfer pricing capabilities, it is suggested that their global transfer pricing policies and strategies should be reviewed independently.

The Author Michael Stirling is the Head of Transfer Pricing at City of London law firm Field Fisher Waterhouse. He may be contacted on 00 44 207 861 4000 or by e-mail at mxs@ffwlaw.com. He regularly speaks at international tax conferences on transfer pricing matters and offers training to Revenue authorities

# **Managing Self** Assessment

# - An Appraisal By Dr Sivamoorthy Shanmugam

The introduction of self assessment was part of a major tax reform process undertaken by the Inland Revenue Board after it was corporatised in 1996. Various reasons were highlighted for the changeover from an Official Assessment System ("OAS") to the Self Assessment System ("SAS").



The following problems were associated with the OAS: -

- Costly and complicated to administer, especially since the assessment and appeal process places a heavy burden on the IRB.
- Long delays in processing and issuing returns. During the past years, the IRB issued approximately 2.5 to 3 million returns annually but processed only 80% of the returns.
- Highly dependent on taxpayers on the correctness and completeness of the information submitted.
- Time restriction as assessments are statute time barred
- Weak enforcement due to lack of qualified staff
- Back log problems and staff shortages

With the above backdrop, top management of IRB had to attend to a process of re-engineering eventually leading to the launch of the SAS. The Government is implementing the SAS in stages as follows: -

Operationally, the SAS in the United States, New Zealand (1988), Australia (1986), Sri Lanka (1972) and Pakistan (1979) have proven to be better at bringing down management costs and improving efficiency by cutting down on non-value adding or income producing processes. The following are the main reasons for implementation of the SAS: -

- Drive down the cost of tax collection
- Need to accelerate tax payment and reduce tax arrears.
- Increase compliance rate of filing

It must be noted that the introduction of self assessment followed extensive consultation between the Revenue and representatives of professional bodies like the Malaysian Institute of Taxation ("MIT") and Malaysian Institute of Auditors ("MIA"). This reflected an acceptance by the Revenue that such radical change could not simply be imposed upon taxpayers without the full consultation and cooperation of the taxpayers advisors.

The first years of self assessment for companies have now passed and notwithstanding teething problems and some frustrations the system however is now established. This is the tribute both to the endeavours of the IRB and the hard work of the tax practitioners. The IRB has conducted various dialogues with professional bodies both at federal and state levels and the professional bodies have offered their fullest cooperation in assisting the IRB in aspects pertaining to education and training.

## Self assessment - implementation

In order for the SAS to be successfully implemented various measures were undertaken, namely

- Work processes and procedures were instituted like electronic facilities, payment facilities which includes decentralised collection branches and
- Need to educate taxpayers as well as the IRB officers on the new system. Taxpayer education in the form of rulings, guidelines pamphlets, books and seminars.
- Procedures must be consistent with policy objectives and can only be achieved through the skills and commitment of IRB staff. The top

Category	Year of Implementation
Companies	2001
Businesses, Partnership and Cooperatives	2004
Salaried Individuals	2004

level is business orientated but lower levels do not appreciate the business scenario.

- Require more consultation with the profession through dialogues, seminars, conferences and joint advisory committees
- The IRB as a whole must be committed to understanding and appreciating the competitive business environment and settle appeals on a timely basis.

The main concern for the taxpayers are s follows: -

- Certainty of the law and interpretation of public rulings.
- Penalty imposition

nd

in

on

- Conduct of officers during the field and tax audit
- Section 114(A) penalties (reasonable care)
- Should not create additional verification work for tax advisers who conduct their affairs in accordance with their professional standards
- If a person exercises due deligence (reasonable care) penalties should not apply but reasonable care is not defined.

#### Does the SAS overcome the perceived difficulties of the OAS

Clearly the change in the assessment procedures places the onus of responsibility of complying with the law on the taxpayer and not on IRB. This corollary is that taxpayers now consider that they are disadvantaged as their exposure to review and possibly amendment may be open ended. This does have a significant impact on financial reporting and auditing guidelines.

The onus is now on the taxpayers to ensure that sufficient records are maintained to support claims made in returns. Hence the arguments about full and true disclosure have virtually disappeared.

The elimination of "desk assessments" under the SAS has resulted in virtually a total dismantling of the Assessment Division within the IRB as the assessment staff have mostly been deployed to the tax audit teams. The tax audit staff would also.



previously having only being involved in an assessment function, have had to undertake a significant retraining programme to enable them carry out investigative reviews and audits. The success of the SAS would largely depend on the system of balanced and systematic tax audits and this tax audit system would form the mainstay of any self assessment environment. Revenue Officers undertaking tax audits must be cautious not to undertake a "mini investigation" or extend the period under review beyond two or three years in ordinary situations, as such investigations or reviews could be significantly disruptive to a taxpavers affairs, unnecessarily increasing further the taxpayers cost of compliance.

The sheer volume of returns under the Official Assessment System compared with amount of resources available was a structural weakness which is overcome by the SAS. The SAS also eliminates unnecessary tax appeals and objections.

Unlike the existing legislation under the Official Assessment System, the SAS has brought into being a public rulings and an advance rulings program. In these rulings, the IRB sets out its interpretation of a particular area of law or sets out the parameters within which it will accept interpretations of the laws. Some 15 public rulings, after consultation with professional advisers and taxation bodies. have been issued to date.

#### The Effectiveness of the SAS

#### 1. Administration - issues & challenges

After having implemented the SAS in 2001 for companies the question must be asked of whether the introduction of self assessment has been a success. From the IRB's point of view it is almost certainly resulted in the much needed revision of its work practices. better use of resourses and more efficient way of achieving their objective. The mindless and totally ineffective assessing procedures of the past have given way to a more investigatory and performance based process of review, checking and auditing.

The downside in the IRB's point of view are the amount of effort and resources required to meet the increasing demands of taxpayer education and awareness programmes under the SAS. Coupled with the above, the issue of public rulings under the SAS must be supported by thorough and time consuming research by the "authorities". This includes detailed research of legislation and case laws and the development of soundly based opinions.

However, the IRB has offset some of its burden by shedding some of its work-to the tax agents. Increasingly, tax agents are being asked and to an extent forced into providing more information and retaining more records in relation to their clients affairs. This in turn increases the agents cost of compliance, a cost not necessarily capable of being passed on to clients.

#### 2. Increased revenue and acceleration of tax payments

The SAS, judging by the performance of some of the countries, has been very successful in ensuring the enforcement of tax laws thereby increasing the level of tax compliance and most importantly increasing government revenue.

The success of the SAS has been mainly due to the following factors: -

- The voluntary compliance programme's underlying reliance on thorough audit review process
- The extensive legislative provision granted by the government and supported by public rulings giving wide powers to the IRB in enforcing the tax laws.
- Increase in computerisation and automation coupled with more tax education and awareness programmes.
- Co-operation between the IRB and representative professional bodies to enhance compliance.

A comparison of total direct tax revenue collected each year from 1997 to 2002 reveals an interesting trend.

The calendar year 2001 or Year of Assessment 2001 was the year self assessment was implemented for companies. The year 2000 marked the replacement of the preceding year (PY) basis of assessment for all categories of taxpayers with the current year (CY) basis. Advance payment of tax payable were estimated for companies through prescribed forms CP204 (Section 107 (1) and

	1997	1998	1999	2000	2001	2002
Total Direct Tax (RM Billion)	30.5	27.9	27.2	27.706	42.098	46.125
Growth Rate %	ω.	(-8.52%)	(-2.81%)	1.86%	51.95%	9.56%

individuals through CP200 and CP203 (Section 107 B(1).

The changes in the transitional period led to accelerated tax payments. Coupled with the transitional provisions the IRB also undertook various measures to recover arrears of taxes through the issue of sec. 104 certificates and civil recovery proceedings. Special task forces were set up in the Collection Branch to recover all arrears in taxes.

The various assessment branches were also given clear deadlines to raise

All these measures led to a substantial increase in revenues collected amounting to RM42 billion in 2001, a significant increase of 52% over the previous year.

It is envisaged that the IRB's enforcement activities are likely to steadily increase over time and as such taxpayers are advised to pursue the management of their tax affairs actively. It is also anticipated that a large proportion of taxpayers, particularly from the business community would be more likely to seek the assistance of tax agents, raising their cost of compliance considerably. The compliance cost should not be unduly exorbitant so as to interfere with the economic incentives consistent with macro economic policy.

A new era may dawn for the IRB when it decides to commence criminal. proceedings for fraud and willful evasion, in order to maximum it's impact under the SAS. In a UK case, the Crown Prosecution Service (which is independent of Revenue) commenced criminal proceedings for false accounting although the Revenue agreed to accept the tax and penalties as a settlement offer.

The criminal proceedings will definitely attract a lot of public attention and may act as a deterrent to tax evasion and non-compliance. As in the past, Singapore has undertaken criminal proceedings against a taxpayer resulting in the taxpayer being jailed (Ng Kwee Poh vs Public Prosecutor). Hence, IRB may not settle for monetary settlement alone but may also want it's "pound of flesh too".

Although, there is a great deal of evidence to suggest that countries with self-assessment have higher compliance costs, according to Standford (1994) there is no reliable evidence to suggest that self-assessment increases evasion. The higher compliance costs should not neutralise Government's efforts of fiscally stimulating the private sector to develop small and medium enterprises as engines of growth, during the recovery phase of the economy. It is critical during the current phase of recovery that the tax system is continuously modified so as to make the system responsive to economic growth. As a result, the IRB must be conscious of the fact that taxation policy is an essential instrument of resource allocation, income redistribution and economic stabilisation. Hence, the principle of taxation is to augment adequate revenue for financing of capital formation, public utility services and act to improve industrial efficiency and productivity.

The Author Dr. Sivamoorthy Shanmugam B. Econs (Hons) University of Malaya (AIM) Ph. D (CAL), MMIM, FTII. He is a tax Principal of CNM Taxlink Sdn Bhd specialising in tax investigation, tax appeals and tax consultancy. Prior to this appointment Dr. Sivamoorthy was an Assistant Director with the Inland Revenue Department (Investigation Unit) and has been practicing since 1993. Currently, he is the Chairman of the Malaysian Institute of Taxation (Southern Branch) and National Advisor for the Malaysian Indian Business Association (MIBA).



# TAXATION ASPECTS of non-resident companies in Malaysia

By Bulvir Singh

The object of this article is to present a brief outlook of the tax position of non-resident companies, particularly the situation for determining the non-residents income that is chargeable to tax and of withholding taxes.

#### Residence status of a company

A company is resident in Malaysia for tax purposes if at any time during the basis period for a year of assessment the management and control of its business or any of its businesses are exercised in Malaysia [Section 8(1)(b), *Income Tax Act* (ITA), 1967].

Thus, any other company is non-resident in Malaysia if the management and control of its affairs is exercised outside Malaysia by its directors.

#### Scope of charge and concept of source

Section 3 of the Act reads as follows:

"Subject to and in accordance with this Act, a tax to be known as income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia".

In accordance with this provision, income derived from Malaysia is taxable whether a taxpayer is resident in Malaysia or not. Income derived from outside Malaysia is not taxable unless it is remitted to Malaysia by a resident taxpayer. With effect from year of assessment (YA) 1995, only remittances by resident individuals, co-operative societies and partnerships are taxed, as overseas-derived income remitted to Malaysia by a resident company (other than a company carrying on the business of banking, insurance, shipping and air transport) is exempt from income tax.

Thus, the basis of taxation is territorial as Malaysia generally follows the source principle in the taxation of income.

As such, non-resident companies and individuals are only liable to tax in respect of income arising from Malaysian sources. Foreign income received would-not be subject to tax.

In addition to a number of Commonwealth Tax Cases (inclusive of Yates v GCA International Ltd (1991 STC 157) the decisions of the Privy council in CIR v Hang Seng Bank (1990) STC 733, KHTVB, International Ltd v CIR (1992) 3 HKTC 468 and CIR v Orion Caribbean Ltd 1997 STC 923 have established principles and guidelines to assist in locating the source of income. The Hong Kong case laws are relevant in view of the fact that the territorial basis of taxation, similar to Malaysia, has been fundamental to the taxation of income as Hong Kong only taxes income arising in or that is derived from Hong Kong.

Thus, the principles derived from the above cases would apply in Malaysia, where pursuant to Section 3 income is taxed" accruing in or derived" from Malaysia.

The Privy Council's decision in Hang Seng Bank's case, which established principles for determining the source of business income/profits, is of paramount importance and significance in Malaysia.

Based on the principles, three (3) cumulative tests or conditions must be satisfied in order for a person to be subject to tax on income "accruing in or derived" from Malaysia:

- i) the person must carry on a business in Malaysia;
- ii) the deriving of gains or profits from the business carried on by the person in Malaysia; and
- iii) the gains or profits must accrue or derive from Malaysia.

Non-resident companies and individuals are taxed at 28%. Non-resident individuals are not entitled to any personal reliefs except a non-resident individual who is a citizen and exercises an employment outside Malaysia in the public services or the service of a statutory authority.

In relation to the third condition based on their Lordships' decision, the principles determining the source of gains or profits are enumerated below:

- i) whether gains or profits accrue or are derived from Malaysia depends on the nature of the gains or profits and the transactions giving rise to them.
- ii) What were the activities which produced the gains or profits and where those operations took place.
- iii) The contract value between onshore (Malaysia) and offshore sources can be apportioned as arising partly in Malaysia and partly offshore.

The Malaysian tax laws do not draw a distinction between a resident company, a non-resident company or a branch of a foreign company, in the method of taxation.

Non-resident companies and non-resident individuals have the same obligations and rights as resident companies under the Act. They are entitled to claim all the deductions as provided in the

Non-resident companies and individuals are taxed at 28%. Nonresident individuals are not entitled to any personal reliefs except a non-resident individual who is a citizen and exercises an employment outside Malaysia in the public services or the service of a statutory authority.

#### Permanent establishment - branch operations

Where Malaysia has entered into a tax treaty with another country, to attach tax liability on the business profits of a non-resident enterprise, it is necessary to establish that the business is carried on through a permanent establishment ("PE") in Malaysia. Malaysia generally adopts the standard definition of PE as found in the QECD model with minor variations to accommodate Malaysia's needs.

The term "PE" is generally defined to mean a fixed place of business which interalia includes a branch in which the business or the enterprise is wholly or partly carried on. Thus a PE can be said to exist where:

- There is a place of business located in Malaysia
- There is a continuity of activity in Malaysia, and / or
- There is a right of use of the facilities in Malaysia

Malaysia recognises the PE and the head office of the company as separate tax entities for the purpose of computing the income of the non-resident company. In most of Malaysia's double taxation treaties the profits to be attributed to a PE are those that the PE would have made, if instead of dealing with its Head Office, it had been dealing with an entirely independent enterprise under conditions and at prices prevailing in the ordinary market or trading at arm's length.

Where there is no Double Tax Treaty, a non-resident company is regarded as carrying on a business in Malaysia when the contract performance and transactions undertaken by the company point to the fact that it is trading within Malaysia and not merely with Malaysia.

It is also to be noted that there is no necessity to establish that a PE exist in Malaysia to tax non-residents on income in respect of interest, dividends and royalties. As Malaysia, generally does not subscribe to the force of attraction principle.

#### Treatment of allocation of expenses

A contentious issue in the taxation of multinational companies is the allocation of Head Office expenses. There is no specific provision in the Malaysian Revenue Legislation or Guidelines and Public Rulings that provides for allowable deductions or restrictions of overhead expenses that maybe attributed to a PE in the country.

The Malaysian tax authorities would accept any method of allocation that is reasonable and equitable. The general principle

for deduction i.e. "all outgoings and expenses wholly and exclusively incurred ..... in the production of gross income" is still relied upon.

In addition the "benefit test" - something of economic or commercial value rendered to the PE by the Head Office is taken into account.

#### Inland Revenue Board's (IRB) stance on section 4A income

The

of to

nany

the

a's

= PE

ling

rces

nv

- the

the

usia

ice of

Smot

mies

ines

Ein

ciple

The IRB intends sec. 4A(ii) to be wider in its scope. It views the word "technical" as merely qualifying the noun "advice". Assistance or services of whatever nature, whether technical or not, fall within the ambit of sec. 4A(ii).

Contrary to the ES Pte Ltd case, the IRB holds the view that so long as services are technical in nature the related payment would fall within sec. 4A(ii) regardless of whether or not

- (a) they are rendered in connection with technical management or administration of the business of the payer; or
- (b) the non-resident is involved in the technical management or administration of the payer ("in connection with" does not mean active involvement).

The Director General of Inland Revenue (DGIR) has advised that payments made for ordinary day to day administration or management services of a routine nature are not within Section 4A(ii). Examples of these include payment for share of overhead expensed incurred by the head office of a branch or parent company of a subsidiary.

The IRB has treated payment for routine training as not falling within sec. 4A(ii).

The DGIR has also advised that procurement commission and secondment fees which are commission normally payable for staff recruitment would not be treated as sec. 4A(ii) income.

The IRB treats reimbursable expenses connected with the provision of a service falling within sec. 4A(ii) as also being subject to withholding tax.

Whilst the IRB agrees that tax treaties may override the ITA, they do not accept that sec. 4A(i) and (ii) income (Special Classes of Income) should be treated as business income for treaty purposes. The IRB is of the view that sec. 4A(ii) income unless specifically dealt with in a tax treaty or other income article. which, with the exception of the treaty with Germany, gives Malaysia the right to tax the income. (However, the IRB accepts

#### Procurement commission and secondment fees which commission normally payable for staff recruitment would not be treated as Section 4A(ii) income.

that Section 4A(iii) falls within the royalty article of tax treaties concluded by Malaysia).

#### Overlapping / apparent overlapping

Where there is an overlap of the withholding tax provisions of sec. 109B and sec. 107A, only one of the two sections apply. Section 107A applies where the non-resident is carrying on business in Malaysia, especially if his income is attributable to a PE here. In other cases, sec. 109B is applicable.

There may be an apparent overlap between the royalty definition in sec. 2 and sec. 4A(i) or (ii) income provisions. Technical advice, assistance or services may convey knowhow or information concerning technical knowledge. The consideration received for Section 4A(i) and (ii) income is active in nature whereas the provision of intellectual property rights is passive. Section 4A(i) refers to situations where in relation to the use of property belonging to the non-resident (in respect of which royalty may well be paid) services are rendered. Withholding tax under sec. 109 applies to royalty whereas withholding tax under sec. 109B applies to the payment for services.

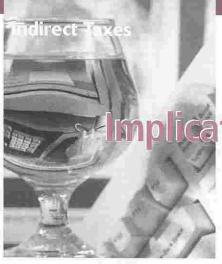
#### Review of withholding tax on services - section 109B

With effect from 21st September 2002 payment made to nonresidents for services rendered under sec. 4A(i) and (ii) of the Income Tax Act, 1967 will no longer be subject to withholding tax under sec. 109B if the services are performed offshore. The income is therefore taxed on territorial scope basis i.e. taxable if the services are performed in Malaysia.

The above outlines some of the central features affecting the taxation of non-resident companies in Malaysia. A particular attribute of the taxation of non-residents is Malaysia's use of near 'catch all' type provisions generally excluded from being subject to DTA type provisions (except for Germany) such as section 4A to tax all income of nonresidents derived from within Malaysia.

#### The Author

Bulvir Singh Associate Director Deloitte Kassim Chan Tax Services Sdn Bhd



## ications of Recent Amendments

#### to Federal Indirect Tax Legislation with Regards to the Priority of Federal Indirect Taxes in Liquidation and Receivership of Companies

By Chandran Ramasamy

#### Introduction

This article comments on some recent amendments to the duties of liquidators and receivers under certain federal indirect tax legislation and the impact, if any, of these amendments on the priority of federal indirect taxes in liquidation and receivership of companies.

The federal indirect tax legislation in question (the federal indirect taxes which they regulate are stated in parentheses), are as follows:

- Customs Act 1967 (customs duties)
- Excise Act 1976 (excise duties)
- Sales Tax Act 1972 (sales tax)
- Service Tax Act 1975 (service tax)

(For ease of reference, the above legislation and indirect taxes are collectively referred to herein as "the indirect tax legislation" and "the indirect taxes" respectively, and individually referred to as "the relevant indirect tax" respectively.)

The duties of liquidators and receivers under the indirect tax legislation apply in the liquidation of companies and receivership of companies and other persons (except in the case of the Excise Act 1976, where it is limited to only companies), who are operators of licensed manufacturing warehouses under the Customs Act 1967, manufacturers and other licensees of dutiable goods and importers of dutiable goods under the Excise Act 1976, manufacturers and importers of taxable goods under the Sales Tax Act 1972 and taxable persons providing taxable services under the Service Tax Act 1975.

The amendments to the duties of liquidators and receivers under the indirect tax legislation, which are the main focus of this article, were made in 1999 vide the following Acts:

- Customs (Amendment) Act 1999
- Sales Tax (Amendment) Act 1999
- Service Tax (Amendment) Act 1999
- Excise (Amendment) Act 1999

(The above Acts are collectively referred to herein as "the 1999 Amendment Acts".)

The 1999 Amendment Acts came into operation on 1st of January 2000, with the exception of the Customs (Amendment) Act 1999, which came into force on the 9th of July 1999.

Other amendments to the indirect tax legislation, which are of relevance to the present discussion, were made in 2001 and 2002, vide the following Acts:

#### 2001

- Customs (Amendment) Act 2001
- Sales Tax (Amendment) Act 2001
- Service Tax (Amendment) Act 2001

(The above Acts are collectively referred to herein as "the 2001 Amendment Acts".)

The 2001 Amendment Acts came into force on the 6th of July 2001.

Excise (Amendment) (No.2) Act 2002

The Excise Amendment (No.2) Act 2002 came into operation on the 1st of January

Background to the indirect tax provisions on the duties and responsibilities of liquidators and receivers of companies

Prior to the 1999 Amendment Acts

Before the 1999 Amendment Acts came into operation, the duties of a liquidator of a company under the indirect tax legislation, were to notify the Director General of Customs ("Customs") within fourteen (14) days of the passing of an effective resolution or the making of an order for the winding up of the company and to set aside out of the assets of the company such sums as appears to Customs to be sufficient to provide for any liability for the indirect taxes that is or will thereafter become payable in respect of the company. Where a company is under receivership, prior to the 1999

Amendment Acts the receiver would generally have had to notify Customs within 14 days of the appointment of the receiver and set aside such as appears to Customs to be sufficient to provide for the indirect taxes that is or will thereafter become payable on dutiable or taxable goods sold or manufactured by the company, or taxable services provided by the company, before the appointment of the receiver.

After the 1999 Amendment Acts

The 1999 Amendment Acts impose a duty on liquidators and receivers that they " ... shall pay (the indirect taxes)" in addition to setting aside such sums to provide for the indirect taxes.

The 1999 Amendments Acts, also inserts a new penalty subsection to penalise the failure of liquidators and receivers to carry out their duties, which after the 1999 Amendments Acts, would include the paying out of the indirect taxes in addition to setting aside such sums to provide for the indirect taxes.

As example of the amended provisions of the indirect tax legislation on the duties of liquidators and receivers, the following are the provisions of secs. 51 and 52 of the Service Tax Act 1975 respectively with the relevant amendments italicised.

#### Section 51 of the Service Tax Act 1975

"(1) Where after the passing of [the Service Tax Act 1975] an effective resolution is passed or an order is made for the winding. up of a company to which a licence under section 8 or 8A is issued the liquidator of the company shall give notice thereof to the Director General within fourteen days after the passing of the resolution or the making of the order, and shall before disposing of any of the assets of the company set aside such sum out of the assets as appears to the Director General to be sufficient to provide for any service tax that there is or will thereafter become payable in respect of the company and shall pay such service tax.

(2) A liquidator of any company who fails to give notice to the Director General within the time specified in subsection (1) or fails to provide for payment of the service tax as required by that subsection shall be personally liable for any service tax that is or becomes payable as aforesaid.

tes

les

ould Thin

iver to

exes

e on

OF

able

the

Buty

... tion

rthe

TIS a

the

arry

999

the

tion

rthe

s of ⊫ of

are

the

the

the

rion

ling

der

= of

the

inter

ing

e of

i de

the

=ill

the

- (2A) Any liquidator who fails to comply with subsection (1) shall be guilty of an offence against this Act and shall be liable on conviction to a fine not exceeding ten thousand ringgit.
- (3) Where two or more persons are appointed liquidators or are required by law to carry out the winding up of any such company the obligations and liabilities attaching to a liquidator under this section shall attach to all such persons jointly and severally, subject to a right contribution between themselves as in cases of contract.'

#### Section 52 of the Service Tax Act 1975

- "(1) Where a receiver is appointed of the property of a taxable person to whom a licence under section 8 or 8A is issued the receiver shall give notice thereof to the Director General within fourteen days after the appointment being made, and shall before disposing of any of the assets of that taxable person set aside such sum out of the assets as appears to the Director General to be sufficient to provide for any service tax that there is or will thereafter become payable in respect of the taxable service that have been provided by that taxable person before the appointment of the receiver, and shall pay such service tax.
- (2) A person appointed as receiver who fails to give notice to the Director General within the time specified in subsection (1) or fails to provide for payment of the service tax as required by that subsection shall be personally liable for any service tax that is or becomes payable as aforesaid.
- (2A) Any receiver who fails to comply with subsection (1) shall be guilty of an offence against this Act and shall be liable on conviction to a fine not exceeding ten thousand ringgit.
- (3) Where two or more persons are appointed receivers the obligations and liabilities attaching to a receiver under this section shall attach to all such persons jointly and severally, subject to a right contribution between themselves as in cases of contract."

Background to the priority of federal taxes in a liquidation and receivership of companies

Since this article's focus on the 1999 Amendment Acts and their impact on the issue of priority of the indirect taxes in liquidation and receivership, some background to the subject of priority of indirect taxes is necessary.

#### Liquidation

The development of case law prior to the 1999 Amendment Acts, had made it clear that the order of priority for federal taxes in the case of a company under liquidation, would be decided solely by reference to the Companies Act 1965. Federal taxes (which include the indirect taxes), are considered unsecured preferential debts which rank sixth in line of the preferential payments listed under sec. 292(1) of the Companies Act 1965.

#### Receivership

The recent Court of Appeal ruling in Lim Tian Huat v Ketua Pengarah Hasil Dalam Negeri [("Lim Tian Huat"), judgement dated 5 November 2002, Civil Appeal No. W-01-17-1997] has cast some doubt on the principle regarding priority of federal taxes in a receivership, as laid down by the Federal Court in Kenneth Teh Ah Kiam & Anor (Receivers and Managers of Global Pacific Textiles Industries Sdn Bhd, in receivership) v Ketua Pengarah Jabatan Kastam & Eksais & Ors [1998] 1 MLJ 289 ("Global Pacific Textiles").

The principle laid down by Federal Court in Global Pacific Textiles, is stated at p.301 of the report of the judgement, as follows:

"Under sec. 292(1) read with sec. 191 of the Companies Act 1965... federal government taxes would rank sixth in terms of priority of payment to all other unsecured debts".

Lim Tian Huat agreed that in a case of a company under receivership, sec. 191 and sec. 292(1) of the Companies Act 1965 would come into play, but only to the extent as specified in sec. 191 of the Companies Act 1965. And since sec. 191 of the Companies Act 1965 omits federal tax, therefore federal tax would not, in the judgment of Lim Tian Huat, rank as a preferential debt in a receivership.

The Court of Appeal in Lim Tian Huat proceeded to voice its preference for the

Supreme Court ruling in Raja Arshad bin Raja Tun Uda & Anor v Director-General of Inland Revenue [1990] 1 MLJ ("Raja Arshad"), which decided that, in a receivership, federal tax is to be paid in accordance with the "relevant tax law"

As pointed out by the Court of Appeal in Lim Tian Huat, Raja Arshad was not taken into account in three cases of the apex courts concerning receiverships of companies i.e. Anuarul Aini & Anor v Ketua Pengarah Kastam dan Eksais Di Raja, Johor Bahru [1991] 1 MLJ 360 ("Anuarul Aini"), Abdul Samad bin Hj Alias v The Government of Malaysia & Ors [1996] 3 MLJ 58 ("Abdul Samad") and Global Pacific Textiles.

Impact of the 1999 Amendment Acts on priority of indirect taxes in liquidation and receivership of companies

Prior to the 1999 Amendment Acts, it was settled law that the provisions of the indirect tax legislation on liquidators and receivers did not confer any priority of the indirect taxes over all other debts. The judicial developments are chronologically elaborated below.

Judicial developments before the 1999 Amendments Acts

First, the High Court case of Re Golden Palace [1988] 2 MLJ 634 decided that the legal provision on the duty of receivers (sec. 52 of the Service Tax Act 1975) gave priority to service tax over all other debts in a receivership. The learned judge, Peh Swee Chin J (as he then was) said:

"Section 52(1) is couched in peremptory language, such that the receiver must set aside, before disposing of any of the assets, such sum as to be sufficient to pay for the service tax. To set aside must, in my view, necessarily imply that such sum set aside will have to be paid out to the said department [i.e. Customs]." (Emphasis added.)

Peh Swee Chin J went on to hold that the Service Tax Act 1975, being an Act enacted subsequent to the Companies Act 1965, derogated from the order of priority under the Companies Act 1965, following the maxim lex posterior derogat priori (a later Act overrules an earlier one).

In the subsequent High Court case of Anuarul Aini which centred on sec. 70 of the Sales Tax Act 1972 (that is analogous to sec. 52 of the Service Tax Act 1975), Re Golden Palace was not followed. Instead, the

High Court decided that the provision of the Sales Tax 1972 on the duty of the receiver to set aside the sums was merely an administrative duty and did not confer priority of payment of sales tax over all other debts. The court in Anuarul Aini found support for its view in a decision of the apex court in Australia in Federal Commissioner of Taxation v Official Liquidator of EO Farley Ltd (1940) 63 CLR 278 ("EO Farley").

In EO Farley, the High Court of Australia had to construe 32 of the Sales Tax Assessment (No 1) 1930-1935, which the High Court in Anuarul Aini noted was "rather similar" to sec. 70 of the Sales Tax Act 1972. Starke J in EO Farley said:

"The first limb of s 59 of the Federal Act (identical with s 32 Sales Tax Act) merely directs the setting aside of moneys sufficient to provide for taxation. It does not provide in terms that Commonwealth taxation shall rank for payment in priority to all other claims and such a privilege should be conferred in clear and unequivocal words and not by mere implication." (Emphasis added.)

Further, Evatt J in EO Farley said:

"... it seems right to conclude that the sections are merely administrative provisions designed to secure the setting aside of the money pending final administration, all questions of priority and preference being determined by the law to be found elsewhere than in the section."

The above decision in Anuarul Aini was subsequently confirmed on appeal by the then highest court in Malaysia, the Supreme Court. [Note: the Supreme Court was renamed as the Federal Court, with effect from 24 June 1994, by virtue of the Court of Judicature (Amendment) Act 1994.]

(Although the High Court in Anuarul Aini decided that sec. 70 of the STA 1972 did not confer priority on the sales tax, yet priority was accorded to the sales tax, by virtue of the application of sec. 10 of the Government Proceedings Act 1956 to the facts of the case. As this article discusses whether the indirect tax provisions on duties of liquidators and receivers, as amended by the 1999 Amendment Acts, of themselves confer priority on the indirect taxes, the conferment of priority on the indirect taxes under sec. 10 of the Government Proceedings Act 1956 is not discussed herein.)

It is noteworthy that Customs had on three (3) occasions attempted to seek the Federal

Court to review the aforesaid decision of the High Court in Anuarul Aini (as confirmed by the then Supreme Court) in relation to the implications of the provisions of the relevant indirect tax legislation on the duties of liquidators and receivers. The three instances were in the cases of Director of Customs, Federal Territory v Ler Cheng Chye [1995] 2 MLJ 600 ("Ler Cheng Chye"), Abdul Samad and Global Pacific Textiles.

In the first of the three cases, the apex court did accede to the request by counsel for Customs and undertook such a review, with the result that the Federal Court in Ler Cheng Chye concluded that the provision on the duties of liquidators under sec. 69 of the STA 1972 (which was relevant to the liquidation scenario in Ler Cheng Chye), did not confer priority on the sales tax. The Federal Court followed the reasoning in Anuard Aini and the Australian High Court case of EO Farley. In the judgment of Latham CJ in EO Farley as set out in Ler Cheng Chye at pp.606-607:

"... the duty of the liquidator is to set aside such sum out of the assets of the company as appears to be sufficient to the commissioner to provide for tax. The statutes do not require the commissioner to specify some precise amount of tax as being due. Indeed, the sections relate not only to tax that then is payable but also to tax which 'will thereafter become payable'. It is, therefore, evident that the sum to be set aside in pursuance of the statutes may prove not to be the sum that is actually payable. If the section were dealing with priority of debts they would surely deal with the amounts which the liquidator would be justified in paying, and bound actually to pay, to the taxing authority in due course of the winding up. It can hardly be contended that the sections give priority to the Commonwealth over other creditors in respect of sums which the commissioner estimates as necessary to provide not only for taxation due, but also for taxation which may become payable. After the commissioner had fully complied with the section it would still be necessary for the commissioner to establish the amount and validity of any claim made. Thus the statutes do not give a right to the Commonwealth to receive the sum which is set aside." (Emphasis added.)

Further, in the words of Wan Yahya FCJ in Ler Cheng Chye at p. 607:

"...If at all the Custom has a prior right, it must be a right over a debt as a whole where the amount is specified. Section 69 of our Sales Tax Act 1972 does not, in terms of its construction, direct payment away of the money

so set aside nor does it instruct in any way how that money is to be applied, and yet the Sales Tax Act 1972 was enacted well after the Companies Act 1965. The only requirement contained in that section is for the liquidator to set aside a sum sufficient to provide for tax payable then or thereafter. The sum to be set aside pursuant to the statute may not be necessarily the same as what is actually payable. The Legislature could not have forgotten about the priority right as contained in s 292 of the Companies Act 1965 when it enacted that provision on the Sales Tax Act 1972. On the true construction of these two sections, we conclude that the omission to mention both matters, ie on payment out and priority were deliberate acts of the Legislature. We are firmly of the view that s 69 of the Sales Tax Act 1972 is merely directive in nature. It merely directs the setting aside of moneys sufficient to provide for taxation but does not provide that Government debts shall rank in priority to all other debts. If the Legislature had intended otherwise, it would have conferred that privilege in as clear and unequivocal words as possible." (Emphasis added.)

After Ler Cheng Chye, the Federal Court in Abdul Samad refused the request of counsel for Customs to review Anuarul Aini and decided that it should be regarded as "settled law" that the legal provision on the duty of receivers (which was the relevant provision on the facts in Abdul Samad case) and liquidators did not confer priority on the sales tax over all other debts.

In Global Pacific Textiles the Federal Court did not pay much heed to the "feeble attempt" by counsel for Customs to review the position of the Federal Court/Supreme Court on the issue.

From the persistence of Customs in seeking a review three times on the effect of the legal provisions on duties of liquidators/receivers, it seems clear that Customs strongly feels that the said provisions ought to confer priority on the indirect taxes over all other debts, as per the law as stated in Re Golden

It is in this context that the 1999 Amendment Acts' have been brought into focus, in particular the insertion of the words "shall pay such (the relevant indirect tax)", or words to the like effect, into the duties of liquidators and receivers under the relevant indirect tax legislation, plus the criminalisation of any non-compliance with such duties.

Have the 1999 Amendment Acts conferred priority on the indirect taxes over all other debts?

As stated by Peh Swee Chin J (as he then as) in Re Golden Palace, the "peremptory language" of sec. 52 of the Service Tax Act 1975 "necessarily implies" that the sum so set aside is to be paid over to Customs.

The 1999 Amendment Acts have converted that necessary implication into an unequivocal and express requirement, which seems to be in line with the requirement in Ler Cheng Chye and EO Farley for there to he a 'paying out' stipulation in the provisions on liquidators and receivers, before the sums so set aside can be paid out to the department (i.e. Customs).

We consider in greater detail the impact of the 1999 Amendment Acts under liquidation and receivership scenarios espectively.

#### Liquidation

is the view of this writer that the 1999 Amendment Acts may not have gone far enough to confer priority on indirect taxes in derogation of the order of priorities in the Companies Act 1965. This is because, as noted in Ler Cheng Chye and the Australian High Court case of EO Farley, the legal provision as to the duty of liquidators (which similar to that for receivers) refers to sums that are as yet not specified i.e. such sums to provide for the indirect taxes that "is or will thereafter be" payable in respect of the company.

The above view is fortified by the analysis of the 2001 Amendment Acts and the Excise (Amendment) (No.2) Act 2002.

The 2001 Amendment Acts (and the Excise Amendment (No.2) Act 2002) qualify the personal liability of a director of a company for the company's indirect taxes. The 2001 Amendment Acts and the Excise Amendment (No.2) Act 2002 contain a proviso whereby the directors of a company that is being wound up would only be personally liable for the company's indirect taxes to the extent that the assets of the company are insufficient to meet the indirect taxes "after paying any sums having priority over [the indirect taxes] under the Companies Act 1965".

The 2001 Amendment Acts and the Excise Amendment (No.2) 2002 indicate that, in a liquidation scenario, the 1999 Amendment Acts neither have the intent nor the effect of derogating from the order of priorities in the Companies Act 1965.

Any perceived conflict between the 1999 Amendment Acts' express requirement for the liquidator to pay out the sums so set aside and the 2001 Amendment Acts and the Excise (Amendment)(No. 2) Act 2002, may be resolved by the maxim lex posterior derogat priori.

Therefore, it is submitted that a liquidator is only bound to pay over to Customs any amount of the indirect taxes in accordance with the order of priority under the Companies Act 1965.

#### Receivership

As indicated above, the recent Court of Appeal decision in Lim Tian Huat voiced preference for the ratio of the Supreme Court in Raja Arshad which decided that, in a receivership scenario, federal tax is to be paid in accordance with the "relevant tax law".

The "relevant tax law" in a receivership situation involving the indirect taxes, may in all probability be the provisions on the duties of receivers under the indirect tax legislation, due to the "paying out" stipulation in the said provisions (as amended by the 1999 Amendment Acts).

Thus, with the 1999 Amendment Acts requiring receivers to pay out the indirect taxes after the setting aside of such sums to provide for the indirect taxes in respect of pre-receivership events, it would appear that there is a real possibility of indirect taxes being payable, in a receivership scenario, in accordance with the provisions of the indirect tax legislation on the duties of receivers.

Lim Tian Huat's preference for Raja Arshad may potentially bring into conflict the provisions of the indirect tax legislation on the duties of receivers (being likely the "relevant tax law" in the presence instance) and the provisions of secs. 191 and 292 of the Companies Act 1965 (as discussed above), on the determination of the priority of the indirect taxes in a receivership of companies. In such a conflict the maxim generalia specialibus non derogant (general statements or provisions do not derogate from special statements or provisions) may be applied to determine which law would prevail. It is pertinent to note that a conflict between two laws on priority of federal taxes in a liquidation scenario arose in Ler Cheng Chye, i.e. between sec. 10(1) of the Government Proceedings Act 1956 and sec. 292 of the Companies Act 1965. Ler Cheng Chye resolved the conflict by applying the above maxim and holding that the Companies Act 1965 was the more specific law and hence would prevail over sec. 10(1) of the Government Proceedings Act 1956.

If, as a result of Lim Tian Huat, the above potential conflict in a receivership context is perceived by the courts, it remains to be seen which law would be held by the courts to prevail.

In this regard, it would be interesting to see any relevant case law development including any appeal to the Federal Court from the Court of Appeal's decision in Lim Tian Huat and any case law directly in point as to the scope and extent of the duties of receivers, under the indirect tax legislation, to pay out the indirect taxes in relation to pre-receivership events before disposing of any assets of the company.

Whilst it seems clear that the provisions of the indirect tax legislation on the duties of liquidators (as amended by the 1999 Amendment Acts) have not of themselves conferred priority on the indirect taxes, the same cannot be said for the provisions of the indirect tax legislation on the duties of receivers. This is due to the Supreme Court's decision in Raja Arshad (as recently given preference by the Court of Appeal in Lim Tian Huat) that, in a receivership scenario, federal taxes are to be paid in accordance with the "relevant tax law", which, in the case of the indirect taxes, could possibly be the provisions of the indirect tax legislation on the duties of receivers.

The Author Mr Chandran Ramasamy is a Senior Consultant in the Indirect Tax Advisory Group of PricewaterhouseCoopers Taxation Services Sdn. Bhd. The views expressed in this article are the personal views of the author and may not be representative of the views of PricewaterhouseCoopers Taxation Services Sdn. Bhd.

## Tax Changes in CHINA

Impending upon Entry into the World Trade O

By Assoc. Prof. Lee Fook Hong

After many years of arduous negotiations, the People's Republic of China became the 143rd full member of the World Trade Organisation ("WTO") at the end of 2001. China's accession to the WTO has drawn the attention of investors worldwide, who see many business opportunities in China.

While first-time foreign investors start exploring the business opportunities in various parts of China, existing foreign investors are reviewing and restructuring their investments to yield maximum returns in anticipation of the changes to China's tax legislation and investment laws as a result of its entry into the WTO. Although the business costs relating to factories, labour, utilities, land, etc., have been inherently low, the tax exposure of foreign investors is an important consideration in their deliberations in view of the forthcoming changes.

The impact of China's admission to the WTO is significant, because of China's commitment to liberalise its markets by opening them to foreign investors. Not only will there be an increase in competition on a global basis, but the competition will also be more fierce. China has also committed itself to make its trade rules and customs duties consistent with WTO principles.

Following China's entry into the WTO, what are the tax planning and business opportunities available to foreign investors? To answer these questions and to take advantage of the opportunities, an investor must carefully examine China's current tax system and structure and various issues consequent upon the changes resulting from tax reforms and China's accession to the WTO.

When China was admitted to the WTO. China agreed to substantially reduce its trade tariffs in stages over the next few years. China will also significantly raise the taxes levied on foreign firms as from 2003. The steeper tax bills will come about when China eliminates most of the existing tax concessions granted to foreign investors.

At present, the overall corporation tax rate in China is 30%, plus a 3% local tax. Foreign investors, however, pay as little as 15% or even 10% because of the tax concessions currently available to specified industries or in specified districts.

After the impending tax changes have been enacted, the income tax rate for foreign companies and local companies will be uniform. This will be achieved by equalising the tax rates for all businesses whether domestic or foreign. It has been speculated the uniform tax rate will be around 25%.

Notwithstanding these tax changes, China's economy is more open to multinationals due to its entry into the WTO. With the influx of foreign competition, some of the industries, such as banking and insurance, will have to undergo extensive restructuring.

China will gradually have to liberalise the regional restrictions on foreign banks that want to operate in China. This will make way for foreign investors to operate banks in China. The influx of foreign banks will

allow China to benefit from the inflow of international capital and expertise and to raise the standard of the banking industry in China.

The medium-sized enterprises and stateowned companies in China will face tremendous challenges and competition as a result of WTO membership. On the other hand, WTO membership provides opportunities for small and medium-sized enterprises to team up with multinationals. As a result, understanding local market conditions will add value to both local and foreign enterprises.

The anticipated liberalisation of the capital markets will allow foreign banks to enter China's vast market and will also make it easier for small enterprises to raise capital.

As foreign investors position themselves to seize the opportunities offered by the expanded market in China, the foremost issues they have to consider are how best to structure their investments in light of their exposure to China's market and the tax planning opportunities now available.

#### China's Current Tax System

The current tax system in China is complex after some substantial tax reforms in the past. There are several major taxes, which foreign investors should bear in mind when formulating and deciding on an investment plan in China. The taxes that should be considered are discussed below.

#### Foreign enterprise income tax

Foreign enterprises and domestic enterprises have been subject to tax under two different regimes, although, with China's entry into the WTO, there are plans to unify the two regimes. At present, foreign enterprises are subject to the foreign enterprise income tax, which is levied at a flat rate of 30%; a local tax of 3% is also levied, making the total 33%. Domestic enterprises are subject to the enterprise income tax, which is also levied at a flat rate of 30%, with a 3% local tax.

Although the tax rate for foreign enterprises is 33%, more than 80% of the foreign investments in China are situated in special areas where, due to tax concessions, the applicable tax rates are either 15% or 24%. Some foreign investors in these areas are granted further tax incentives, such as tax holidays and tax reductions, which make the effective tax rate less than 15%.

#### Value, added tax

rw of

md to

stry

mate-

face

tion

the

ides

sized

with

nding

to.

the

mks

also

raise

ves

the

most

best

of

I the

lible.

ma is

TIMS

e on

wes

ussed

VAT applies to individuals and enterprises engaged in supplying goods and specified services. Currently, the standard rate is 17%, except on certain goods and services, which are taxed at 13% or are zero-rated. VAT does not apply to the sale of land, buildings and other immovable property. Such transactions are, however, subject to the business tax (see 2.3.).

The VAT on sales is computed by (a) multiplying the turnover (i.e. gross receipts less VAT) by the applicable VAT rate and (b) reducing the result by the credit for the VAT paid on purchases (input tax). Any excess credit (input tax) may be carried forward.

The VAT on imports is computed by (a) adding together the import price, c.i.f. (cost, insurance, freight), customs duty and consumption tax and (b) multiplying the result by the applicable VAT rate.

For taxpayers dealing in goods or providing taxable services subject to different VAT rates, the sales amount for goods and taxable services subject to different rates are computed separately. The tax payable is the balance of output max for the period after deducting the input ax for the same period, i.e. the tax payable

is equal to the output tax payable for the period, reduced by the input tax for the same period. If the output tax for the period is less than the input tax for the same period, the excess input tax may be carried forward to subsequent periods.

At present, the input tax on the following is not available as a credit against the output tax:

- purchases of fixed assets;
- goods purchased or taxable services used for non-taxable items;
- goods purchased or taxable services used for tax-exempt items (see the list below):
- goods purchased or taxable services used for group welfare;
- goods purchased which suffer abnormal losses; and
- goods purchased or taxable services consumed in the production of goods (work-in-progress or finished goods) which suffer abnormal losses.

For small-scale taxpayers engaged in supplying goods or providing taxable services, there is a simplified formula for calculating VAT, and the rate of VAT is 6%. The criteria for determining smallscale taxpayers are prescribed by the Ministry of Finance. Any adjustment to the rate applicable to such taxpavers is regulated by the State Council.

As to the exemptions from VAT, the following are currently exempt:

- self-produced agricultural products sold by agricultural producers;
- contraceptive medicines and devices;
- antique books;
- imported instruments and equipment used directly in scientific research, experiments and education;
- materials and equipment imported from foreign governments and international organisations which are provided as assistance free of charge;
- equipment and machinery required to be imported under contract processing, contract assembly and compensation trade;
- articles imported directly by organisations for the disabled for special use by the disabled; and
- sales of goods which have been used by the seller.

Except for these exemptions, the VAT exemptions and the items/activities subject to a reduced rate of VAT are regulated by the State Council. Other districts and departments are not authorised to regulate in these areas.

Regarding the minimum thresholds for VAT liability, there is a VAT exemption or a reduction of the VAT rate to 5% if the turnover does not exceed certain thresholds:

- a. sale of goods: there is a VAT exemption if the monthly turnover does not exceed CNY 600; the reduced 5% rate applies if the turnover is between CNY 600 and 2,000;
- b. sale of taxable services: there is a VAT exemption if the monthly turnover does not exceed CNY 200; the reduced 5% rate applies if the turnover is between CNY 200 and 800; and
- c. VAT on a transaction basis: there is a VAT exemption if the VAT does not exceed CNY 50 per day or per transaction; the reduced rate of 5% applies if the VAT is between CNY 50 and 80 per day or per transaction.

The time at which VAT arises is:

- in the case of sales of goods or taxable services, the date on which the entrepreneur receives the consideration for the sale or obtains the documentary evidence of the right to collect the consideration; and
- in the case of importation of goods, the date of the import declaration to the customs office.

Any changes in the VAT rules will have an impact on foreign investments. Thus, investors should monitor closely how and when VAT will change.

#### Business tax

The business tax is a local tax on business activities, including services not covered by VAT. The tax is levied on gross turnover, and no tax credit is allowed for the tax paid on business inputs. The current rates range from 3% to 20%. Most businesses are taxed at 3% to 6%, but the entertainment industry is taxed mostly at 20%.

The State Council is authorised to make changes to the taxable items and tax rates. The specific tax rates applicable to taxpayers engaged in the entertainment industry are determined by the governments of the provinces, autonomous regions and municipalities directly under the central government.

For taxpayers engaged in taxable activities that are subject to different tax rates, the business tax for each activity with respect to which a different tax rate applies must be determined separately. If this procedure is not followed, the higher tax rate applies.

For taxpayers providing taxable services, transferring intangible assets or selling immovable property, the tax is computed by reference to the turnover and the prescribed tax rate. The business tax payable is the turnover multiplied by the applicable tax rate.

The tax due is computed in China's currency, yuan renminbi (CNY). The taxpayer's turnover settled in foreign currencies are converted to yuan renminbi based on the exchange rate prevailing on the foreign exchange market.

The turnover of a taxpayer is the total consideration and all other charges receivable by him from buyers for providing taxable services, transferring intangible assets or selling immovable property, except in the following cases:

- a. for transport enterprises that carry passengers or cargoes from China to overseas locations or trans-ship passengers or cargoes to other transport enterprises abroad, the turnover is the balance of the transport charges for the whole journey less the transport charges paid to the subcontracted transport enterprises;
- for trade enterprises that organise tourist groups to travel outside China and subcontract to other travel enterprises abroad, the turnover is the balance of the tourist charges received less the amount paid to the subcontracted travel enterprises;
- for principal contractors in the construction industry who subcontract work to others, the turnover is the balance of the total contract amount



The preferential tariff rates apply to imported goods originating from countries with which China has a trade agreement. Such an agreement contains, among other things, reciprocal favourable tariff clauses for the contracting countries.

less the payments made to subcontractors;

- d. for lending businesses, the turnover is the balance of the interest received on loans less the interest paid on the amounts borrowed;
- e. for businesses buying and selling foreign currencies, marketable securities and futures, the turnover is the balance of the selling prices less the buying prices; and
- other specified situations, the turnover is as regulated by the Ministry of Finance.

The business tax regulations provide the following exemptions from the business tax:

- nursing services provided by nurseries, kindergartens, homes for the elderly and welfare institutions for the handicapped, and matchmaking and funeral services;
- personal services provided on an individual basis by a disabled person;
- medical services provided by hospitals, clinics and other medical institutions;
- educational services provided by schools and other educational institutions, and services provided by students participating in work-study programmes;
- certain agricultural services, e.g. mechanical ploughing, irrigation and drainage, prevention/treatment of plant diseases, insurance for farming and husbandry, related technical training, and prevention/treatment of

- diseases of poultry, livestock and aquatic animals; and
- admission fees for cultural activities organised by memorial halls, museums, cultural centres, art galleries, exhibition halls, etc., and admission fees for cultural and religious activities at places of religious worship.

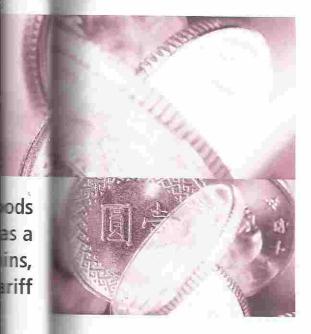
The State Council is authorised to make changes to the above list and to exempt any person or unit from the business tax. Local governments and departments are not authorised to regulate in these areas.

For taxpayers engaged in different types of activities which qualify for a tax exemption or tax reduction, each type of activity and the appropriate tax exemption or tax reduction must be declared separately. If this procedure is not followed, the tax exemption or tax reduction is not allowed.

Liability for the business tax arises on the date the taxpayer receives the business proceeds or obtains documentary evidence of right to collect the proceeds.

The business tax must be withheld by the purchaser of immovable or intangible property.

With China's entry into the WTO, investors should look for developments regarding changes to the structure of the business tax and its rates.



Consumption tax

and

rities

mms,

ries,

sion

ities

Take

mpt

tax.

reas.

pes

Type

tax

re is

r tax

the

⊓ess

ence

the

able

TO,

the

The consumption tax is a tax on the consumption of luxury items, and the rates vary from 3% to 50%. All units and individuals in China engaged in the production, subcontracting for processing, or the importation of taxable consumer goods are subject to the consumption tax. Those liable for the consumption tax, therefore, are manufacturers, importers and processing subcontractors.

The items on which the consumption tax is payable are specified in a list which includes tobacco, cigarettes, alcoholic drinks and alcohol, spirits, cosmetics, firecrackers and fireworks, gasoline and diesel oil, motor cars and motorcycles, and minibuses and vans.

In normal cases, the consumption tax is generally computed as: (a) the selling price, inclusive of all charges except VAT, multiplied by the applicable consumption tax rate or (b) the assessable quantity multiplied by the applicable consumption tax rate.

Special rules apply for determining the assessable value of goods for selfconsumption and for processing under subcontracts. For imported goods, the assessable value is determined by the c.i.f. and the import duty.

There are certain exemptions from the consumption tax. Goods manufactured for export are generally exempt, unless otherwise provided by the State Council. The procedures for the exemption for exported taxable consumer goods are regulated by the State Administration for Taxation.

As with other taxes, investors should closely monitor the possible changes to the consumption tax as a result of China's entry into the WTO.

#### Customs duties

Customs duties are levied on most imports and on a limited number of exports. The import duties consist of two categories: general tariff rates and preferential tariff rates.

The preferential tariff rates apply to imported goods originating from countries with which China has a trade agreement. Such an agreement contains, among other things, reciprocal favourable tariff clauses for the contracting countries. In this regard, as concerns international trade, China will retaliate against countries which impose discriminatory customs duties on goods originating from China.

With China's accession to the WTO, China will substantially reduce its import tariffs by 2006. Import tariffs on automobiles will be cut from the present 100% to about 25% by 2006. In its deals with European countries, China has agreed to reduce the tariffs on spirits and alcohol from 65% to 10%.

The impact of the changes to customs duties will have to be examined when the changes are officially announced.

#### Individual income tax

The individual income tax applies to both Chinese nationals and foreigners resident in China. Employment income is taxed at progressive rates ranging from 5% to 45%, while other income is taxed at a flat rate of 20%. The tax rate on rental income. however, has been reduced to a flat rate of 10% to promote the housing industry in China. An individual's business and production income (i.e. income from business activities in e.g. handicrafts, transportation, catering services, repairs and maintenance, education or consulting) is taxed at progressive tax rates ranging from 5% to 35%.

With the liberalisation of China's market, more and more foreign individuals are expected to come to China for business or employment purposes. At this time, the Chinese tax liability of foreign individuals depends on the length of their stay in China. Foreigners who stay in China for one year or more are generally regarded as tax resident in China and are subject to tax in China on their worldwide income.

In addition to the one-year rule, foreign individuals should know about the 183day rule, which is included in all of China's tax treaties. The 183-day rule provides that employment income is taxable in China if a foreign individual is present in China for more than 183 days and the employment income is paid by a resident of China or is deductible in China.

Foreigners who intend to stay in China for business or employment purposes should be aware of the current residence rules and the possible changes that may be introduced. It is still uncertain, however, whether these rules will be amended.

#### Other taxes

In addition to the taxes discussed above, there are other taxes that affect foreign investors in China. They include the resource tax, agriculture tax, stamp duty, land appreciation tax, urban property tax, vehicle and vessel use tax, slaughter tax and vehicle purchase tax.

#### Tax Incentives For Foreign Enterprise Current tax incentives

The tax incentives currently available to foreign enterprises must also be examined in light of the impending tax changes resulting from WTO membership. Generally, the tax incentives currently available are:

- tax holidays;
- reduced tax rates (10%, 15% or 24%);
- reduced rates (10% or 15%) for export-oriented enterprises and enterprise using advance technology;
- tax refund for reinvestment;
- exemption from withholding tax; and
- accelerated return of investments (accelerated depreciation).

Foreign enterprises granted a tax holiday or a reduced tax rate are either exempt from tax or taxed at a concessionary rate of 10%, 15% or 24%. These enterprises are usually found in special zones or areas where a preferential tax treatment applies.

For export-oriented enterprises, the applicable tax rate is either 10% or 15%, depending on the district in which the enterprise is located. If a foreign enterprise reinvests its profits in China in qualifying investments, it is entitled to a tax refund of 40% to 100% of the income tax already paid.

In addition to the reduced rates of withholding tax available under a tax treaty, a foreign enterprise may be entitled to an exemption or reduction of withholding tax under the tax concessions granted.

With the accelerated return of investments, investors are allowed to depreciate computer software in a shorter period, thus reducing their taxable profits.

#### Impact of WTO membership

China's entry into the WTO is expected to have a significant impact on the tax incentives granted to foreign enterprises. Most of the incentives were introduced more than ten years ago and are now incompatible with the restructured economy brought about by WTO membership.

Many of the tax incentives were initially granted to foreign investors to attract their investment funds to China. At the time, due consideration was not given to the types and nature of the industries which were fundamental to China's economic development. All the tax incentives granted are homogeneous: the same amount of tax is levied on taxpayers regardless of the level of investment risk they undertake or the level of technological sophistication at which they operate.

It is anticipated that the current tax incentives will be inconsistent with the new directions set by the WTO, unless the tax incentives are adjusted or modified. Adjustments or changes are therefore inevitable, and their impact on foreign investment must be studied carefully to ascertain the effective rate of return on investments.

Most of the tax incentives are in the form of direct incentives through a reduction or exemption of tax. So far, there have been insufficient indirect incentives given to foreign investors. Direct tax incentives appear prima facie to be attractive, but most investors are from a country that has a double taxation treaty with China. A reduction of Chinese income tax on Chinese-source profits will not really benefit an investor if the after-tax profits are remitted to his home country. In fact, with so many tax incentives, more investors will implement tax-saving plans to exploit the incentives for a maximum tax advantage.

If too many tax concessions are granted to foreign enterprises, this weakens the competitive strength of domestic enterprises because they have to bear a heavier tax burden. Under the existing rules, foreign enterprises are effectively taxed at a rate of 10%, while the rate for domestic enterprises is 33%. This obviously does not adhere to WTO requirements. Inevitable reforms and changes are expected sooner or later.

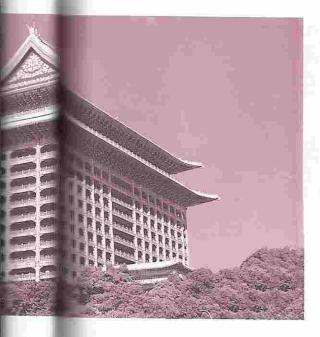
The terms and criteria currently used in granting tax concessions are not consistent. As a result, different provinces and districts have interpreted and applied the requirements for the incentives differently. It has become difficult, if not impossible, for the central authority to implement controls on investors. The provinces and the central government will eventually have different objectives. As a consequence, competition among the provinces will escalate. Some of the provinces may resort to undue tax reductions or exemptions in order to attract foreign investment to the province, but at the expense of China's economic development. Some of the investments lured into China by the tax incentives might not be compatible with China's requirements and may impede its economic development.

#### Strategies for change

Some have advocated changes to the current tax incentives in order to deal with the problems inherent in them. The strategies for change include those mentioned below.



- a. Compatibility: give tax incentives only to industries that are compatible with the China's economic strategy. The amount/extent of a tax incentive should depend on the level of risk undertaken and level of technological advances used by the various industries. The labour-intensive manufacturing industries need not be given special tax concessions. More tax incentives should be considered for those in the ecological and environmental protection industries.
- b. Indirect incentives: gradually reduce the quantum of direct tax incentives and, at the same time, introduce more types of indirect incentives for foreign investors. The introduction of the following measures have been advocated to attract more quality foreign investments:
  - make tax refunds for investments more quickly;
  - allow further tax deductions for certain expenditure in respect of technology and industries which are the most needed for China's economic development;
  - grant subsidies or cash incentives for projects which are crucial to fundamental economic development; and
  - allow tax deductions for special provisions (e.g. doubtful debt provisions).



only

The

tive

risk

gical

Tous

sive

o∉ be

More

of for

and

rries.

= the

and,

wpes.

eign

the

een

ality

ents

- for

et of

hich

na's

al to

mic

ecial

Bebt

These indirect measures are, to certain extent, similar to direct tax incentives because, with either direct or indirect incentives, foreign investors will ultimately pay less tax. With these indirect incentives as an alternative, China will not lose its competitive edge due to WTO membership after most of the direct incentives have been removed.

(c) Uniform tax system: make the corporation tax system for domestic enterprises and foreign enterprises uniform. Meanwhile, all the tax incentives granted in various districts and zones should be unified for easy administrative control. The provincial governments should not have too much autonomy in deciding on the tax incentives for foreign investors. Likewise, investors from Hong Kong, Macau and Taiwan should not be discriminated against. They should be treated and accorded the same status as investors from foreign countries.

China's entry into the WTO certainly paves the way for China to globalize its economy and, as a requirement, to shift emphasis from state enterprises to a more enlightened market economy. How does China intend to respond as a full member of the WTO? Basically, the changes in the economic landscape encompass the following, which need to be addressed and considered in the process.

- a. The emphasis is on China's market economy which must be in line with the global economy; thus, it is imperative that changes to China's tax system be introduced to make it more congruous with that of other WTO members. Moreover, as part of China's adherence to WTO principles, the tax system needs to be more sophisticated, efficient and transparent.
- b. Entry into the WTO means that China will be able to integrate its economy with other members under multilateral agreements. Both exports and imports are expected to increase. When the market is fully opened up, customs duties and import and export taxes may be more predominant than the taxes on income. Any changes made to the revenue collection system must take into account both WTO requirements and China's budgetary needs and economic development. A balance must be struck between the two aspects. Bias toward either one end will not be pragmatic in the long nın.
- c. Notwithstanding the foreseeable uniform tax rates, the tax system must not be so rigid and harsh that China eventually loses to other countries in attracting foreign investment. This can perhaps be achieved through discriminatory indirect tax incentives to different categories of industry.
- d. Now that China is a full member of the WTO, it is expected that China will revise its existing tax treaties and conclude new treaties and trade agreements with other members for avoiding double taxation and preventing tax evasion.

It is thought that China will adopt the OECD Model Tax Convention in negotiating/concluding tax treaties with other WTO members. Broadly speaking,

the OECD Model provides a clear allocation of the right to tax various types of income to the source country or the residence country. To what extent the treaties depart from OECD Model will depend on the negotiations and the spirit of "give and take" between China and the other country.

#### Final Remarks

To summarise, given the gigantic size of China's economy, the impact of WTO membership on China's tax system is enormous. The spirit of the WTO agreement is based largely on a fair trading system between partners. In addition to a uniform tax code, the prominent features of WTO principles are a reduction in customs duties, the removal of trade quotas and other restrictions, and transparency in the tax system. China needs to make many changes to its tax system in order to adhere to these principles.

Generally, there are advantages as well as problems with WTO membership for a country after its admission. Because of the large gap between China and other WTO member countries, however, China needs — more than other countries — a tremendous effort and determination to review and revise its policies, systems and procedures. Many observers foresee difficulties for China in the next few years, followed by an eventual win-win situation which, in the long run, will be a plus for both China and foreign investors. Initially, however, there may be confusion and turbulence in the shake-up of China's tax system. There will also be tremendous hardships, many obstacles and hassles in the process of integrating into the large trade organisation. But many are confident that these negative factors will be overcome and that China's entry into the WTO will be positive development for all countries concerned.

#### The Author

Assoc. Prof. Lee Fook Hong (PhD, FCIS) is presently the Principal Consultant of Lee Fook Hong & Co, Chartered Secretaries and Management Consultants, in Singapore. He was formerly an Adjunct Associate Professor at the School of Accountancy & Business, Nanyang Technological University, Singapore.

Note: This article was first published in the Bulletin for International Fiscal Documentation in Volume 56, Number 11, 2002.



## Driving Institute's Training Ground is plant.

This was an appeal by the taxpayer against the original notice of assessment raised by the Director-General under the *Income Tax Act 1967* ("the Act"). At the earlier hearing before the Special Commissioners ("Commissioners"), the issue was whether capital expenditure incurred in constructing the school building and the training ground used for the purpose of the taxpayer's business qualified for capital allowance under Sch. 3 of the Act.

The Commissioners found that the school building did not qualify for capital allowance. With regard to the training ground, it held that it was used for the purpose of the taxpayer's business and so, qualified for capital allowance. The Director-General therefore appealed against the decision on the training ground by way of a case stated.

The court dismissed the appeal. The Commissioners had not erred on point of law, as there is no statutory definition of "plant". Although permanence, and other test words such as "setting", "apparatus", and "functional" had been considered in various cases, there was no universal formula which could solve these puzzles. In the end, each case must be resolved by considering carefully the nature of the particular trade being carried on, and the relation of the expenditure to the promotion of the trade.

The Court considered the Commissioners as having rightly applied their minds to the proper initial and fundamental questions as to the meaning of "plant" in its statutory context and as applicable to the trade carried on by the taxpayer. The Commissioners further rightly affirmed the general definition of "plant" in *Yarmouth v. France*, [1887] 19 QBD 647, at 658.

The Court agreed with the Commissioners that whether an "apparatus" is plant has to be considered in relation to trading activities as a whole and/or all its constituent parts and appurtenances must be viewed as a whole. The fundamental test is that an apparatus will constitute plant if it fulfils the function of a plant, in that it is the means by which a trading operation is carried out. Here, the Commissioners were rightly satisfied that the taxpayer's training ground (i) prepared specially for carrying out the business of a driving institute played an essential part in the business and satisfied the functional test; (ii) was apparatus used in the conduct of the activities of the trade; (iii) was an integral part of the taxpayer's business; and (iv) was a plant within the meaning of Sch. 3 of the Act. It was quite obvious that without the training ground, the taxpayer would not be able to carry on their business of a driving institute.

Ketua Pengarah Hasil Dalam Negeri v. MSDC Sdn Bhd High Court Malaya (Kuala Lumpur). Civil Appeal No. R2-14-6 of 1999 Judgment delivered on 8 August 2000.

Avatar Singh (Messrs Mohd Latif & Asso) for the taxpayer. Khairuddin Abdullah (Inland Revenue Board) for the Revenue.

"Editorial Note: These cases will be reported in the forthcoming issue of Malaysia & Singapore Tax Cases."

## An administratrix is only "assessable and chargeable to tax" from out of the estate of the deceased

IN JUN 1989, THE 1ST DEFENDANT / THE DIRECTOR OF INLAND REVENUE OBTAINED JUDGMENT AGAINST THE PLAINTIFF, "AS ADMINISTRATRIX OF THE ESTATE OF LATE POLYCARP SOON ..." FOR INCOME TAX DUE FROM POLYCARP SOON. ALMOST TEN YEARS LATER, THE 1ST DEFENDANT ISSUED A CERTIFICATE UNDER SEC. 104 OF THE INCOME TAX ACT ("THE ACT") BARRING THE PLAINTIFF FROM LEAVING MALAYSIA ON ACCOUNT OF UNPAID TAX DUE FROM THE DECEASED.

The issues in the case were: (1) whether the term "payable by him" in sec. 104 of the Act includes an administratrix whose estate, and not her personally, owed tax; (2) whether the Plaintiff was barred by laches; and (3) whether the Sarawak Limitation Ordinance ("the Ordinance") applied to the Government of Malaysia to time-bar the 1st Defendant from enforcing the judgment debt against the estate.

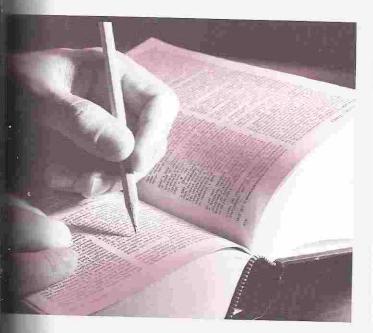
The court declared in part. By sec. 74 of the Act, an administratrix was made liable under the Act to be assessed and charged for tax due on the chargeable income of a deceased individual. However, by sec. 74(4), the tax payable was only "a debt due from and payable out of the estate of that deceased individual". An executor was therefore only "assessable and chargeable to tax" from out of the estate of the deceased. He therefore did not assume any personal liability for the payment of tax due from a deceased individual except, as provided under sec. 74(6), where he distributed the assets of the estate without making provision for the payment in full of the tax owing by the estate. Here, since no personal liability had attached by virtue of the excepting circumstances, the tax could not be said to be payable by the Plaintiff. The term "payable by him" in sec. 104 had in mind a person being personally liable for the payment of tax. As the Plaintiff did not personally owe the debt, it was unlawful to have issued the certificate to the Plaintiff. The letter issued by the 1st Defendant to the Plaintiff was therefore null and void and of no legal effect.

The Plaintiff had made the present application 2 years 5 months after the issue of the certificate. The certificate was, however, still current. Any application made during the currency of the certificate could not be labelled as being made late let alone the kind of delay to support an allegation of laches.

The Ordinance, by virtue of the doctrine of Crown immunity and by sec. 127 of the *Interpretation Act*, 1967, was not to be applied to the Government unless there was an express provision or by necessary implication that it applied. Here, there was no such express provision. There were also no provisions in the Ordinance that could be construed or that could be called in aid to imply that the Government was to be bound by the Ordinance. The Defendants were therefore not barred from enforcing the judgment.

Ong Bee Yam v. Pengarah Hasil Dalam Negeri, Sarawak & Anor High Court in Sabah & Sarawak at Kuching. Originating Summons No. 24-280-2001-1. Judgment delivered on 8 February 2002.

Lim Heng Choo (Miss Lim & Lim Advocates) for the taxpayer. Norhisham b. Ahmad (Inland Revenue Board) for the 1<sup>st</sup> Respondent; Hashim Hamzah & Mohd Taufik b. Mohd Yusoff (Senior Federal Counsel) for the 2<sup>nd</sup> Respondent.



ENERALLY, THE PROVISIONS IN SECTION 107A, 109, 109A AND 109B TATE THAT WHERE A PERSON IS LIABLE TO MAKE PAYMENTS TO A ON-RESIDENT IN RESPECT OF CONTRACT PAYMENTS, INTEREST, INT

The applicable rates of tax are listed in Part II and Part V of Schedule 1 of the Income Tax Act 1967 (as amended).

Unlike Section 108 (2), where the amount of dividends paid is Leemed to be net of tax, such a provision is absent in the withholding tax provisions listed above.

The question here is where a person does not deduct the relevant before making payment to a non-resident, should he be liable account to the DG (ignoring penalties) for the amount of tax that he should have deducted or would the amount paid to the non-resident be deemed to be "net of tax", and as such is the payer now liable to pay to the DG a increased amount as computed below.

In addition to involving readers more with the Institute's journal this section has been introduced to encourage readers to write in any tax issues or questions they have in order to secure possible solutions or other appropriate responses from the other readers.

Please send in your questions or answers, they are often a voice of inspiration for other readers. Please include your full name and correspondence address, to ensure the possibility of publishing your letters. A pseudonym maybe included.

Send your letters to:
The Editor of Tax Nasional, Secretariat,
The Malaysian Institute of Taxation, 41A 1st Floor,
Jalan Wan Kadir 2, Taman Tun Dr Ismail,
60000 Kuala Lumpur.
Email: secretariat@mit.org.my



Deemed tax on payment to non-resident:

For example if a person has to pay technical fees of RM 10,000 to a non-resident but does not deduct the tax at 10%, is the debt due to the government (ignoring penalties):

- a) 10% X RM 10,0000 = RM 1,000; or
- b) RM 10,000 X 10 = RM 1,111. 11.

Taxpayer Kuala Lumpur

DISCLAIMER: The Editorial Advisory Board reserves the right to select, edit and publish any answers or questions submitted. Neither the Editorial Advisory Board nor the Institute are responsible for the issues or views raised in this section.

## Personal Reliefs

As mentioned in an earlier article, one of the significant differences between a resident and non-resident individual is that the former would be eligible to claim personal reliefs. For resident individuals and Hindu joint families, the variance between total income and chargeable income is personal reliefs. By Siva Nair



	RM
Total income	XXX
Less: Personal reliefs	(xx)
Chargeable income	XXX

Section 51 of the Income Tax Act 1967, states that a claim must be made for the reliefs other than for personal relief under sec. 46. However, since there is no specific manner of claim prescribed in the Act, completion of the relevant sections of the return form relating to the claim for personal reliefs would suffice.

Where the total claim for reliefs exceed the total income of the resident individual, the unabsorbed portion can neither be refunded nor be carried forward.

#### INDIVIDUAL RELIEF - SECTION 46

#### • Self

A relief of RM8,000 is awarded for the basis year for a year of assessment. In the case of a married couple being assessed separately, both the husband and the wife will be able to claim a relief of RM8,000. There is no apportionment of the relief and full relief is available even in the year of death.

#### **EXAMPLE 1**

Mr. Taxwise and Mr. Taxfool both are terminally ill. Mr. Taxfool dies on 31/12/02 whereas Mr. Taxwise dies on 2/1/03.

Self Relief (RM)	Year of assessment	
	2002	2003
Mr. Taxfool	8,000	NIL
Mr. Taxwise	8,000	8,000

For Mr. Taxwise, although he is only alive for two days in 2003, he would be eligible for the full claim of RM8,000 which can be set off against his total income for the year of assessment 2003. Therefore, since death is in the hands of the Almighty, one should pray hard that his demise should be tax efficient!

#### Disabled Individual

A disabled person can make an additional claim of RM5.000 for the basis year for a year of assessment i.e. the total claim for self-relief would be RM13,000. This additional relief is available to both the husband and the wife in the case of a separate assessment.

A "disabled person" is defined to mean any individual certified in writing by the Department of Social Welfare to be a disabled person. Therefore, all handicapped persons should get themselves registered with the Department of Social Welfare, so that they can qualify for the additional relief, which would provide a maximum tax benefit of RM1,400 (if their marginal rate of tax is 28%)

#### Medical Expenses for Parents

A maximum claim of RM5,000 for a basis year for a year of assessment can be made in respect of medical expenses for the individual's parents. This also includes expenses incurred in respect of placing a parent in a nursing home. The claim must be evidenced by a receipt from a medical practitioner indicating that the payment was received from the claimant and it was in relation to medical treatment for his parents. However, if the receipt is in the name of the patient, an endorsement certifying that the payment was made by the taxpayer is needed. The Revenue may request a copy of your birth certificate to verify that the patient is indeed the parent of the taxpayer.

The word "parent" is not defined in the Act, but is generally taken to include both own parents and adopted parents. However, the relief is only for amounts paid in respect of the

claimant's own parents and therefore, payment of medical expenses of parents-in-law would not qualify even under a joint assessment.

#### **EXAMPLE 2**

Mrs. Chailful, a mother of eight children undergoes a bypass operation and the medical cost amounting toRM40,000 is fully settled by her eldest son, Mr. Wilpey and receives a receipt in his name.

For tax efficiency, since Mr. Wilpey can only claim a maximum of RM5,000, he should have requested for 8 separate receipts of RM5,000 each in the name of each of his siblings (assuming they are all taxpayers). In this way, not only will he still be able to claim the RM5,000 in respect of medical expenses for his parent, but his siblings will also be able to do so.

#### Purchase of Any Necessary Basic Equipment

A maximum claim of RM5,000 for a basis year for a year of assessment can be made in relation to the purchase of any necessary basic equipment for use of a disabled individual or his spouse, child or parents.

#### **EXAMPLE 3**

Mr. Kan Wok buys a wheelchair costing RM6,000 for his disabled wife on 2/8/03. He will be able to claim a relief of RM5,000 for the year of assessment 2003.

#### Study Relief

Expense incurred on a course of study undertaken at any Government-recognised institution in Malaysia for the purpose of acquiring technical, vocational, industrial, scientific and technological skills or qualifications are eligible for a maximum relief of RM5,000 for a basis year for a year of assessment. Unfortunately, professional, management, clerical, and marketing courses do not qualify for this relief. Documentary evidence attesting that payment had been made has to be submitted.

#### **EXAMPLE 4**

is not in Malaysia

Ms. Bookworm, a system analyst undertakes a advanced diploma

- a) in a Government- recognized institution in Ipoh paying RM7,000
  - She would qualify for a relief of RM5,000 (MAX)
- b) in a training institute in the Philippines incurring RM4,500 She would not qualify for the relief because the institution

#### Medical Expenses for Serious Diseases and Complete Medical Examination

A maximum claim of RM5,000 for a basis year for a year of assessment can be made in relation to medical expenses incurred by the taxpayer on himself, spouse or children suffering from a serious disease. Serious disease is defined as AIDS, Parkinson's disease, cancer, renal failure, leukemia, heart attack, accidental head injury, major burns, major organ transplants and other similar diseases. The claim must be evidenced by a receipt from a medical practitioner. An amount expended by the spouse is deemed to be expended by the individual.

## Invitation

## to write

Tax Nasional welcomes original and unpublished contributions which are of interest to tax professionals, lawyers and academicians. It may cover local or international tax development.

Articles contributed can be written in English or Bahasa Malaysia. It should be between 2,500 and 5,000 (double-spaced, typed pages).

They should be submitted in hardcopy and diskette (3.5 inches) form in Microsoft Word.

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

Contributions may be sent to the Editor of Tax Nasional, Malaysian Institute of Taxation.

For further information. please contact The Secretariat, Malaysian Institute of A maximum claim of RM500 for a basis year for a year of assessment can be made in relation to a complete medical examination. However, this is taken into account when ascertaining the maximum claim of RM5,000 in respect of serious diseases.

#### **EXAMPLE 5**

Assume Mr. K.R.O. Nick incurs the following expenditure

Scenario	Medical – Serious Diseases	Complete Medical Examination	Claim
	(RM)	(RM)	(RM)
1	5,400	300 5	(XAM) 000,
2	3,600	400	4,000
3	4,100	600	4,600*

\*His claim is restricted to RM4,600 (RM4,100 + RM500) and not RM4,700 because the claim for complete medical examination is restricted to a maximum of RM500.

#### MIT TAX I DEC 1995 Q3 (abstracted and updated to 2002)

On 30 November 2002, Abdul Ali met with a serious accident while driving to work. As a result of the accident, he resigned from his job on 31 December 2002, as he was disabled.

Supporting equipment for Abdul Ali	4,000
(due to his disablement)	

#### Medical expenses incurred in respect of:

Abdul Ali and his family	8,500 (by Abdul Ali)
Abdul's parents	1,000 (by Abdul Ali)
Puan Malang's parents	1,200 (by Puan Malang)

The sec. 46 reliefs that can be claimed are RM

المعاملات فيسمع	Abdul Ali	Puan Malang
Self	8,000*	8,000*
Disabled self	5,000	
Medical expenses for parents	1,000	1,200*
Supporting equipment	4,000*	

#### MIT TAX I DEC 1996 Q4 (abstracted and updated to 2002)

Mr. Geiger is a Malaysian resident employed by New World Sdn Bhd. Mrs. Geiger, a housewife, is handicapped. In the year 1995, Mr Geiger purchased basic supporting equipment costing RM5,500 for his wife's use. Mr. Geiger also paid medical expenses amounting to RM1,500 in 1995 in respect of his parents.

#### Solution:

The sec. 46 reliefs that can be claimed by Mr. Geiger are RM:

	10-11-11-11-11-11-11-11-11-11-11-11-11-1
Self	8,000*
Disabled self	5,000

Medical expenses for parents 1,500 Supporting equipment (Max) 5,000

Note that the solutions are different from the official answer for the respective questions due to subsequent amendments to the Income Tax Act 1967

#### Purchase Of Reading Materials

In line with the government's policy to encourage reading, a maximum claim of RM500 for a basis year for a year of assessment can be made for the purchase of books, journals, magazines and other similar types of publications (but excludes newspapers & subscription to internet-based information database) for the purpose of enhancing knowledge. These can be for the use of the individual, spouse or child. The claim must be evidenced by a receipt.

#### MIT TAX I DEC 2001 Q4 (abstract)

En Shahrul Nizam, a resident in Malaysia, [and his] wife, Puan Mariam, furnished the following information for preparation of his tax return for the Year of Assessment 2001.

S	Shahrul Nizam	Puan Mariam
Medical expenses incurred		
in respect:		ii.
Complete medical examination expenses	550	250
Youngest son (serious diseas	e) 4,800	=
Purchase of books and magaz	ines 900	=

The sec. 46 reliefs that can be claimed are RM:

<u></u>	Shahrul Nizam	Puan Mariam
Self	8,000	8,000
Medical expenses	5,000	250
(4,800 + 500) (Max)		
Reading materials (Max)	500	

#### SPOUSE Relief - SEC. 45A AND 47

An individual can claim either husband relief (sec. 45A) or wife relief (sec. 47), [collectively referred to as spouse relief], provided the couple are living together and did not cease to live together in the basis year for a year of assessment. The concept of living together is not a geographical concept but one of intention i.e. they must not be - divorced or separated by a court order or deed of separation. Therefore, even if the individual lives in Kuala Lumpur and the spouse in Kota Kinabalu, eligibility for the spouse relief is not lost.

The claim for spouse relief is RM3,000 for a basis year for a year of assessment A further RM2,500 is awarded if the spouse is disabled i.e. a total claim of RM5,500.

In addition, under sec. 47(2), maintenance payments also qualify (together with wife relief, if any) to a maximum of RM3,000. These include alimony payments to an ex-wife or maintenance payments to a former wife (pending the grant of a divorce) or payments in pursuance of a court order, deed or written agreement to a wife. However, this claim becomes redundant if the claimant is already making a claim for wife relief in respect of a current wife, i.e. the maximum an individual can claim for wife relief is RM3,000 or RM5,500. [sec. 47(3)] (this is illustrated in example 6 below).

Under a joint assessment, spouse relief is available to the assessed party. However, under separate assessment, if the wife has total income to aggregate with that of her husband, the husband does not get wife relief. Otherwise, the husband can still qualifies for wife relief. This is useful especially in the case of taxpayers whose wives do not receive any income but they do not understand the need for their wives to elect for joint assessment, which is more tax advantageous. Therefore, even without the election, the husband qualifies for the wife relief.

However, note that the important point is whether the wife has total income to aggregate with that of the husband and NOT whether she has any income at all. Therefore, even if a wife how has gross income from any source but this is eroded through: -

- allowable deductions,
- capital allowances,
- losses, either brought forward or current year or
- approved donations

thus resulting in a total income of NIL, her husband would be eligible to claim a wife relief of RM3,000 irrespective of whether she elects for joint assessment or not.

#### **EXAMPLE 6**

Alex is currently married to Amy but also pays alimony to Ashley, his ex-wife. His claim for wife relief under different scenarios is illustrated below.

- a. Amy elects for joint assessment & alimony payment is RM10,000.
  - Wife relief = RM3,000 (in respect of Amy)
- b. Amy elects for joint assessment & alimony payment is RM2,800
  - Wife relief = RM3,000 (in respect of Amy)
- c. Amy (having no total income) does not elect for joint assessment & alimony payment to Ashley is RM10,000 Wife relief = RM3,000 (in respect of Amy)
- d. Amy (having no total income) does not elect for joint assessment & alimony payment to Ashley is RM2,800 Wife relief = RM3,000 (in respect of Amy)

- e. Amy does not elect for joint assessment (having a total income) & alimony payment is RM10,000 Wife relief = RM3,000 (maximum claim for alimony paid to Ashlev)
- f. Amy does not elect for joint assessment (having a total income) & alimony payment is RM2,800 Wife relief = RM2,800 (claim for alimony paid to Ashley)

There is no time apportionment in the year of marriage, divorce or death i.e. the full claim of RM3,000 is awarded.

#### EXAMPLE 7

Marty, an eligible bachelor, popped the question on Christmas Day of 2001 to his childhood sweetheart, Mercy and having received an affirmative answer is now undecided as to whether he should marry on New Year's Eve or on New Year's Day itself. From a tax viewpoint, his claim for wife relief would be as follows:

Wedding on	Wife Relief (RM)	
	YA 2001	YA 2002
New Year's Eve 2001	3,000	3,000
New Year's Day 2002	NIL	3,000

Therefore, it looks like it is more tax advantageous for him to marry on 31/12/01, because he could have a maximum tax saving of RM840 for year of assessment 2002 (assuming he is on the highest tax bracket of 28%)

#### **EXAMPLE 8**

Assuming the romance and matrimonial joys in the lives of Marty and Mercy are subjected to a 100% accelerated depreciation rate and in the fading days of 2002 the hovering curtains of reconciliation crash with dismal failure, forever. Even in the midst of remorse, Marty should decide carefully whether the separation deed should be effected on New Year's Eve or on New Year's Day itself because his claim for wife relief will be gravely affected.

Wedding on	Wife Re	lief (RM)
	YA 2001	YA 2002
New Year's Eve 2002	3,000	NIL
New Year's Day 2003	3,000	3,000

Therefore, it looks like it is more tax advantageous for him to separate on 1/1/03, because he could have a maximum tax saving of RM840 for year of assessment 2003 (assuming he is on the highest tax bracket of 28%). In the same light, the date of demise of the spouse could influence the amount of tax payable!

In MIT TAX I DEC 1996 Q4 above, although the question does not state that Mrs. Geiger had elected for joint assessment, wife relief is still granted to Mr. Geiger.

#### CHILD RELIEF - SECTION 48

#### Definition

A child is defined as a legitimate child, a step-child of his or his wife or an adopted child provided the Director-General is satisfied that the adoption is in accordance with any law (not necessarily Malaysian). With effect from year of assessment 1996, a wife living together with her husband who is assessed separately on her income may elect in writing to claim child relief.

However, a mere statutory declaration of adoption is insufficient as decided in the case Re. R (1951) FB IV (4). An illegitimate child's status his status will be transformed to that of a legitimate child if subsequent to birth, the parents were to marry.

#### Conditions

#### a) Unmarried

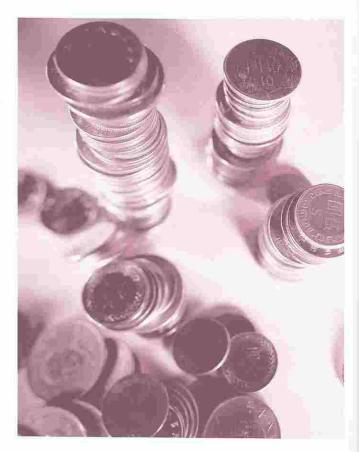
The child must be unmarried any time in the basis year therefore, the parent would still qualify for child relief in the year of marriage of the child. However, once a child is married he cannot revert to the status of "unmarried" again for tax purposes, despite the fact that he is divorced or the marriage is annulled. This was established in DGIR v T (1973) MSTC 358, a marriage annulled on the grounds of the spouse's wilful refusal to consummate the marriage could not be treated as void ab initio.

Of course if the marriage is void ab initio as stated by Sir John Nichol in Elliot v Garr (1962) 1 All E.R. (362) due to "child disabilities, such as a prior marriage, want of age, idiocy, and the like...they render the parties incapable of contracting at all." and therefore, the question of reverting to the status of "unmarried" does not arise since they were never married. A marriage, which is prohibited by law such as marriage between siblings, would maintain the "unmarried" status of the "groom" and "bride."

In countries where polygamy is illegal, the parent, of a child marrying a married person would still be entitled to claim child relief because there is no marriage in the first place. However, if the country of domicile of the parties concerned recognises the marriage as valid, then the child will be considered married.

#### b) Maintained by the parent

The claimant must illustrate that he is maintaining the child especially so in the case where the parents are separated. Where two or more individuals are each entitled to claim a deduction for a year of assessment in respect of the same child (e.g. where the parents are separated or divorced and are submitting separate returns), the appropriate relief is apportioned based on their contribution towards the maintenance of the child.



#### **EXAMPLE 9**

Jon and Sofia are the divorced parents of Marvin who is studying in Universiti Putra Malaysia. Jon and Sofia contributed RM38,400 and RM25,600 respectively towards his maintenance for the year ended 31/12/2002.

The child relief granted to each of them for the year of assessment 2002 is as follows

 $38,400 / (38,400 + 25,600) \times (800 \times 4) = 1,920$ Sofia 25,600 / (38,400 + 25,600) X (800 X 4) = 1,280

3,200

Note that the Income Tax (Amendment) Act 2002 (which is already gazetted) states that each contributor to the child's maintenance will claim 50% of the available relief. However, this is only applicable from year of assessment 2004.

#### c) Child's total income - Child relief

Where the child's total income, wherever derived or accruing, exceeds the child relief "otherwise due" to the parent, no child relief is granted to the parent. Therefore, we must first compute the "relevant" child relief before comparing with the child's income, i.e. if the parents is entitled to an increased relief (as explained below), that figure should be used for comparison and not the general relief of RM800

#### **EXAMPLE 10**

Mr. Savetax is eligible to claim RM3,200 in respect of his son

He entitlement to child relief in respect of Slogboy under different scenarios is as follows:

Slogboy's Income	Child relief for Mr. Savetax (RM)	
per annum (RM)		
3,199	3,200	
3,200	3,200	
3,201	NIL	

The child's income is computed on a world scope basis since the term used is "wherever derived or accruing." Therefore, he is no necessity for the income to be received in Malaysia. So, what constitutes total income and what is not total income?

Income regarded as child's total income	Income regarded as child's total income
• Employment income	<ul> <li>Scholarship, bursaries or other educational endowments</li> </ul>
<ul> <li>Maintenance payments from a separated parent to which the child is legally entitled to</li> </ul>	<ul> <li>Income from property settled on a child but for tax purposes it is deemed to be that of the parent</li> </ul>
• Income from a trust or estate	<ul> <li>Payments received are returns of a premium paid for articles or apprenticeship</li> </ul>

#### Mechanics of the relief

A relief of RM800 for a basis year for a year of assessment is available in respect of the maintenance of an unmarried child who at any time in that basis year is under the age of eighteen. In the case of a unmarried child who is mentally or physically disabled, the relief is RM5,000 irrespective of age.

However, if an unmarried child being maintained by the parent is above eighteen years of age and the child is:

- receiving full-time instruction in school a child relief of RM800 is granted to the parent, or
- b. receiving full-time instruction in any university, college or other similar educational establishment, or serving under articles or indentures with a view to qualifying in a trade or profession

the parent is entitled to an increased relief computed as follows:

In Malaysia a claim for actual expense to a maximum of RM800 X 4 = RM3,200

#### Outside Malaysia

a claim for actual expense to a maximum of: If the commencement of education

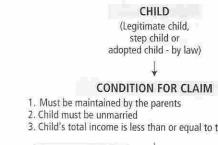
was before 1.1.94 RM800 X 4 = RM3,200between 1.1.94 - 16.10.97  $RM800 \times 2 = RM1,600$ 

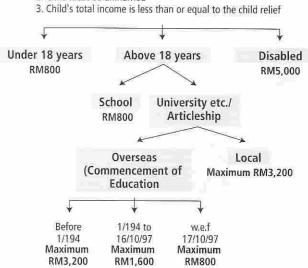
With effect from 17.10.97, a claim for RM800 can be made

Where the taxpayer is resident in East Malaysia and the child commenced receiving full-time education at a school or other educational institution in West Malaysia before 1.1.94, a claim for actual expenses up to a maximum of RM800 X 4 = RM3,200 can be made. In determining whether a person is resident in East Malaysia, the provisions in sec. 7 (other than subsec. (1)(c)) shall apply with the modification that reference to Malaysia in that section shall be taken to be a reference to East Malaysia.

The following diagram summarises the steps in determining the eligibility and quantum of child relief that can be claimed:

#### Child Relief - Section 48





#### MIT TAX I DEC 2001 Q41

Mr Leong has 3 unmarried children. The first child is studying in a local university. The second child is in his first year at a university in London and the third child, aged 10 is in a private school in Kuala Lumpur. Mr. Leong's employer paid the tuition fees for the second child studying in London. The total amount paid in the year 2000 amounted to RM15,000.

#### Solution:

	RM
1st child	3,200 (Probably above 18 - university - local
	- no mention of amount spent)
2nd child	800 (Probably above 18 - university - overseas
	- since he is in 1st year he probably commenced
	after 17/10/97)
3rd child	800 (Under 18)

#### MIT TAX I DEC 2001 Q4

Payment for maintenance and education made by En Shahrul Nizam:

Name of child	Age	Educational Establishment	Amount (RM)
Shahzan	22	Malaya University	2,500
Shazmir	19	UiTM	1,800
Shazwina	17	Hull University (UK)	3,600
Shahriz (mentally disabled)	15	Spastic School	3,200

#### Solution:

	Child relief (RM)	
Shahzan	2,500 (amount spent is less than 3,200)	
Shazmir	1,800 (amount spent is less than 3,200)	
Shazwina	800 (under 18 years of age)	
Shahriz	5,000 (disabled)	

#### MIT TAX I DEC 1996 Q4

He (Mr. Geiger) is married with three children. The relevant facts for the basis year 1995 are: -

- Esther, aged 24, is married and studying at University in USA
- Evelyn, aged 20, is studying at University Malaya
- Ethan, aged 16, is studying at St John's Institution, Kuala Lumpur

#### Solution:

	RM
Esther	NIL (married)
Evelyn	3,200 (Above 18, - university - local- local
	<ul> <li>no mention of amount spent)</li> </ul>
Ethan	800 (Under 18)

#### CONTRIBUTION TO APPROVED SCHEMES AND INSURANCE **PREMIUMS**

A maximum claim of RM5,000 can be made for a basis year for a year of assessment in respect of:

- payment of any premium for any insurance or deferred annuity [other than that under S49 (1C)] contracted for with an insurance company for securing on death either a capital sum or a deferred annuity or both or with a government, a public body or the controlling authority of any nationalised insurance business on the life of the individual, spouse/(s) or their joint lives
- contributions to EPF or any approved schemes whereby the contributions must be obligatory by reason of any contract of employment or any provision in the rules, regulations, bylaws or constitution of the scheme

contribution under any written law relating to widows' and orphans' pensions or under any approved scheme within the meaning of any such law.

#### **Education or Medical Insurance Premiums**

A maximum claim of RM3,000 can be made for a basis year for a year of assessment in respect of insurance contracted for the individual, spouse or children

#### Premiums on EPF annuity scheme – Section 49 (1C)

A maximum claim of RM1,000 can be made for a basis year for a year of assessment in respect of a resident individual who utilizes any amount standing to his credit in EPF to purchase an insurance policy determined by the EPF Board

Note that in all the above situations, any payment by the spouse is deemed to be paid by the assessed party under joint assessment.

#### **EXAMPLE 11**

Alex takes home a monthly salary of RM2,670, after a 11% deduction for EPF. He has taken the following insurance policies:

Person insured		Premium	p.a.
	Life	Medical	
Alex	950		
Alex & Son	140		
Wife	200	2,074	
Alex, wife & son	250	556	
Daughter		2000	500

He also paid a premium of RM1,250 on an approved EPF annuity

Alex would be able to claim the following reliefs:

	Restri	cted Claim (RM)
EPF <u>2,670</u> X 11 X 12 =	3,960	
Policies		
950	950	NIL (not qualifying
200 + 2,074 = 2,274		(life 90 + medical 2,074)
250 + 556 = 806		(only medical qualifies)
500		(130 has exceeded the limit)
EPF annuity scheme	1,000	24
	8,910	

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

#### PRACTICAL EXERCISE

Calculate the total personal reliefs available to Encik Zamani and Pun Zakiah in the following scenario.

Mr. Zamani is a supervisor with the FTMS College Group earning RM2,500 per month with EPF of 11%. He is living with his second wife Zakiah and his eight children plus Zakiah's two children from a previous marriage. In his spare time he attends a mechanic apprentice course costing RM350 p.m. at ITM with the hope of earning some extra money since his divorce from his first wife is has been finalised and he has to pay an alimony of RM250 p.m. from 1st March 2002. Zakiah who is blind in one eye & registered as a disabled person with the Department of Social Welfare, has opted that her salary as a telephone operator be assessed separately for YA 2002. Her EPF was RM2,050 for 2002.

In September 2002, Zamani injured himself very badly and lost the use of his left leg. He registered as a disabled person with the Department of Social Welfare so that he would received a monthly allowance. His mother-in-law needed a by-pass operation for which Zamani contributed RM4,600 and obtained a valid receipt in his name.

Details of his children for the year 2002 are as follows:

Zaiton	26	A fifth year student at Cardiff University. He repeated both his first two years because he had to go for frequent dialysis treatment for which his father incurred the equivalent of RM6,000
Zaiman	25	Articled clerk with a legal firm in Kota Kinabalu earning RM3,200 p.a.
7.:1.1	22	Ô~~

Commenced a degree programme at Zaiful Kansas University on 15.10.97. His father spent RM1,200 on his fees in 2002.

Zairul 22 He and his wife are 2nd year students at Massachusetts Institute of Technology.

Zaki 21 Studying at USM since July 1999. Though a polio victim registered with the Department of Social Welfare, he

gives tuition on a part-time basis and made RM4,500 in 2002.

Zaili 17 A brilliant student is pursuing a degree in Engineering at UKM due two double promotions that he has received.

Others <18 All schooling

#### SOLUTION TO PRACTICAL EXERCISES ON **EMPLOYMENT INCOME**

V		
for	YA	2002
		v for YA

Section 13(1)(a)		RM	
Salary		60,000	
Leave pay		6,000	
Bonus		9,000	
Travelling allowance		10,800	
Entertainment allowance		8,400	
Servant		6,000	
Gratuity		10,000	110,200
Section 13(1)(b)			
Medical expense for wife		Decree	
Gardener		Exempt 3,000	
Car		2,500	
Fuel		1,500	
Driver		3,600	
Furniture		2,800	
Holiday		9,000	22.400
<i>"</i>		9,000	22,400
Section 13(1)(c)			
Hotel			
3% of sec. 13(1)(a)			
X 2/12	551		
Accomodation			
Defined value			
(RM900 X 12)	10,800		
30% of sec. 13(1)(a)	33,060		
Lower of: 10,800 X 10/12		9,000	9,551
Santian 12/1\//1\			
Section 13(1)(d)			
Refund from unapproved			12.400
fund - employer's portion			12,400
Section 13(1)(e)			
Compensation for loss of			
employment		60,000	
Less: Exemption under			
Para.15 Sch. 6		28,000	32,000
		20,000	32,000
Gross income from			
employment			186,551
Less: Allowable expenses:			
Travelling expenses		9,000	
Entertainment			
expenses		8,400	
Rent paid		1,500	18,900
Adjusted income			167,651

Veerinderjeet Singh (2001), Malaysian Taxation - Administrative and Technical Aspects 5th Ed, Kuala Lumpur; Longman Malaysia.

## Professional Xaminations

# Be Among The Best

The principle objective of the Malaysian Institute of Taxation (MIT) is to train and build up a pool of qualified tax personnel as well as to foster and maintain the highest standard of professional ethics and competency among its members.

One avenue of producing qualified tax personnel is through professional examinations. As such, MIT conducted its first professional examination in December 1995. To date, the MIT has successfully conducted eight examinations. The professional examination also seeks to overcome the present shortage of qualified tax practitioners in the country.

#### How to Register

You can contact the Institute's Secretariat for a copy of the Student's Guide. The Guide contains general information on the examinations. Interested applicants must submit a set of registration forms as well as the necessary documents to the Secretariat.

#### **Entrance Requirements**

- a) Minimum 17 years old
  - At least 17 years old
  - At least two principal level passes of the HSC/STPM examination (excluding Kertas Am/Pengajian Am) or equivalent
  - Credits in English Language and Mathematics and an ordinary pass in Bahasa Malaysia at MCE/SPM
- b) Degrees, diplomas and professional qualifications (local/overseas) recognised by the MIT to supersede minimum requirements in (a)
- c) Full Members of local and overseas accounting bodies

#### Exemption

Exemption from specific papers in the professional examinations is available and the extent of exemption granted will depend on qualifications attained and course contents as determined by the MIT Council.



#### **Exemption Fees**

Foundation	RM 50.00
Intermediate	RM 60.00
Final	RM 70.00

#### **Examination Fees**

Foundation	RM 50.00
Intermediate	RM 60.00
Final	RM 70.00

#### **Examination Structure**

The professional examinations are currently held annually and comprises of three levels:

COME:

#### Foundation Level

- · Taxation I
- · Economics & Business Statistics
- · Financial Accounting 1

#### Intermediate Level

- Taxation II
- Taxation III
- · Company & Business Law

#### Final Level

- · Taxation IV
- Taxation V
- · Business & Financial Management
- Financial Accounting II

#### MIT Professional Examinations

#### CALENDAR FOR YEAR 2003

January 1	Annual Subscription for 2003 payable.	
February	Release of the 2002 Examinations results. Students are notified by post. No telephone enquiries will be entertained.	
March 31	Last date for payment of annual subscription fee for the year 2003 without penalty (RM50).	
April 30	Last date for payment of annual subscription for year 2003 with penalty (RM100).	
April 30	Question & Answer Booklets available for sale.	
September 1	Closing date for registration of new students who wish to sit for the December 2003 examination sitting.	
September 15	Examination Entry Forms will be posted to all registered students.	
W 2 22	Closing date for submission of Examinations Entry Forms. Students have to return	

October 15 the Examinations Entry Form together with the relevant payments to the Examinations Department.

November 30 Despatch of Examinations Notification Letter.

December MIT Examinations.

## The facts you should know...

Contents:

Individuals

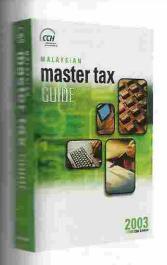
Companies

about the Malaysian Tax System



#### **The 20th Edition**

The first with the foremost facts available in the market.



Be the first to know the facts of the 2003 Budget and all the changes and developments over the past 12 months. It is an indispensable guide to the structure, features details Malaysian income tax law, and is filled with

working examples to help you understand how the is applied in practice. Not only is the guide essential tool for advising local clients, it also wovides valuable insights for foreign companies boking to invest in Malaysia.

latest edition incorporates changes effected the 2003 Budget, the Finance (No.2) Act 2002 with recent exemption orders, rules and the mest public rulings, and is an excellent resource professionals and academics alike.

- Mutual Concerns Partners & Partnerships
- Estates/Trusts/Beneficiaries/ Settlements
- Basis of Assessment and Tax Accounting
- What is included in Assessable
- Exemptions and Exclusions from Assessable Income
- Business Deductions
- Non-business Deductions

- Capital Allowances
- Non-residents and Special Cases
- Investment Incentives
- Administrative Provisions
- Tax Treaties Double Taxation Relief
- Tax Avoidance and Tax Evasion
- Real Property Gains Tax
- Preparation of Tax Computations

#### This Edition Special Features:

- Tax changes announced in the 2003 Budget and effected by the Finance (No. 2) Act 2002 as well as recently issued exemption orders
- \* Include latest Public Rulings
- \* Tax rate tables
- Tax calendar
- Income items and deductions checklist

Books will only be delivered upon receipt of payment.

Goods sold are not returnable.

#### The Consultant Editors:

Dr Veerinderjeet Singh

(The Executive Director of Ernst & Young Tax Consultants Sdn Bhd)

(Formerly a Tax Director of KPMG Tax Services Sdn Bhd)

REPLY SLIP	Fax: 603.2	6dn Bhd" for RM Cheque No.:			
TES! I would like to order copy/ies of <b>The 200</b> ;  I enclose a cheque payable to "Commerce Clearing He	ouse (M) Sdn Bhd" for RM				
Please debit my: Visa Mastercard Card N	umber:/	7	Expiry Date:/		
Card Holder's Name:	Card Holder's Signat	ture:			
Company Name :	Name :				
lob Title :	Business Nature:		No. of Employees : _		
Address :		aalaysian ii	NSTITUTE OF TAXATION		
[el : Fax :			225750-T		
O I would like to make bulk order.	rested to receive more	Company Stamp	& Signature :		
Please contact me immediately informati	on on CCH Executive Events,		•		
on the special packages available. Please pu	ut me on the mailing list.				
9 C (19)					



Order subject to acceptance by CCH.

Price is valid in Malaysia only.

Price is subject to change without prior notice.

Commerce Clearing House (M) Sdn Bhd (216303-M)

Suite 9.3, 9th Floor, Menara Weld, No. 76, Jalan Raja Chulan, 50200 Kuala Lumpur, Malaysia Tel: (03) 2026 6003 Fax: (03) 2026 7003 Customer Service Hotline: (03) 2026 2003 Web Site; http://www.cch.com.my Email: support@cch.com.my

# How to become a member of the Malaysian Institute of Taxation



#### BENEFITS AND PRIVILEGES MEMBERSHIP

The Principal benefits to be derived from membership are:

- Members enjoy full membership status and may elect representatives to the Council of the Institute.
- The status attaching to membership of a professional body dealing solely with the subject of taxation.
- Obtain of technical articles, current tax notes and news from the Institute.
- Obtain of the Annual Tax Review together with the Finance Act.
- Opportunity to take part in the technical and social activities organised by the Institute.

#### CLASSES OF MEMBERSHIP

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

#### Qualification required for Associate Membership

- 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.
- Any person whether in practice or in employment who is an advocate or solicitor of the High Court of Malaya, Sabah and Sarawak and who has had not less than three (3) years practical experience in practice or employment relating to taxation matters approved by the Council.
- 3. Any person who has passed the Advanced Course examination conducted by the Department of Inland Revenue and who has not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
- Any person who is registered with MIA as a Chartered Accountant and who holds a Practising Certificate and an audit licence issued pursuant to the Section 8 of the Companies Act, 1965.
- 5. Any person who is registered with MIA as a Chartered Accountant with Practising Certificate only and has had not less than two (2) years practical experience in practice or employment relating to taxation matters approved by the Council.

- Any person who is registered with MIA as a Chartered Accountant without Practising Certificate and has had not less than three (3) years practical experience in practice or employment relating to taxation matters approved by the Council.
- 7. Any person who is registered with MIA as a Licensed Accountant and who has had not less than five (5) years practical experience in practice relating to taxation matters approved by the Council after admission as a licensed accountant of the MIA under the Accountants Act, 1967.
- Any person who is an approved Tax Agent under Section 153 of the Income Tax Act, 1967.

#### Fellow Membership

A Fellow may be elected by the Council provided the applicant has been an Associate Member for not less than five (5) years and in the opinion of the Council he is a fit and proper person to be admitted as a Fellow.

#### APPLICATION FOR MEMBERSHIP

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

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

	reliow
(a) Upgrading Fee	RM300
(b) Annual Subscription	RM145

Associate RM200

(a) Admission Fee (b) Annual Subscription

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 admission and thereafter annually before January 31 of each year.