Malaysian Institute Of Taxation

Tax Nasional

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Is Withholding Tax "Regrossing" Out?

Property Development Activities - the proper treatment of borrowing cost

CCH

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From

Malaysian Institute Of Taxation

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

Heartiest Congratulations

Y. Bhg. Tan Sri Dato' Paduka Abdul Halil bin Abd. Mutalib

DIRECTOR GENERAL
ROYAL CUSTOMS MALAYSIA

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From

Malaysian Institute Of Taxation

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

President's Note

The world we live in is getting smaller by the day as technology advances. Gone are the days where we were not bothered by the happenings on the other side of the world or for that matter, our neighbouring countries. Even as the region reels from the effects of the terrorist bombing in Bali late last year, it is faced with new global crisis. Businesses now have to come to grip with the economic repercussions of the war in Iraq and the spread of the highly contagious Severe Acute Respiratory Syndrome ("SARS"), the economic consequences of which are likely to be immeasurable.

The swiftness of the spread of SARS disproves of the imaginary borders put up around us, it has affected every sector of the economy. And, the world of taxation has not been spared. The 4th World Tax Conference 2003, which was originally scheduled to be held in Sydney, Australia on 20th May 2003 to 22nd May 2003 has been postponed to the year 2004. The organisers, the Taxation Institute of Australia, cited the current situation in Iraq and the travel restrictions due to SARS as reasons for the postponement. Their reservation is largely due to the composition of the participants who come from the international arena.

Currently, our own 3rd National Tax Conference 2003 is slated to be held on the 5th and 6th of August 2003 at the Palace of Golden Horses, with the honourable Prime Minister being specially invited to officiate once again at the conference. Following the popularity and success of last year's event, this year's Conference is being organised as a two-day event. We are optimistic the conference will not be affected by the war or SARS, mainly due to the event attracting a predominantly local crowd and the fact that there are still some months to go before the Conference is held, by which time we should be hopeful of brighter news on all fronts. Nevertheless, the Institute will be proceeding with caution and we sincerely hope that conditions improve, and the Conference goes ahead as planned.

On the 2004 national budget, the Institute had once again been invited by the Treasury to participate in the annual budget dialogue. It was indeed an honour for the Treasury to have given the Institute its due recognition, by requesting the Institute for a presentation of its views on the state of the nation's economy and of fiscal proposals for progression of the country. The proposals in the budget memorandum are geared towards attracting and retaining Foreign Direct Investments, promoting internal growth and in building the local economy's resilience against external destabilising factors.

The Institute also presented on several operational issues to the Treasury, including those relating to the estimation of profits and refund of tax credits. It also mooted for the introduction of legislative requirements for the Institute to be recognised as the regulatory body to govern all tax practitioners, in the memorandum. This is to ensure that the rights and interest of all locally based tax practitioners are protected with the advent of the liberalisation of trade services under the ASEAN Framework Agreement on Services (AFAS) and the General Agreement on Trade and Services (GATS). The Institute appreciates and thanks those members involved, for their invaluable contributions in putting together the budget memorandum for submission to the Treasury.

While it is important that the Institute protects the rights and interest of all its members, we must also look into the interest of the profession as a whole. The increased recognition and acceptance of the Institute by the authorities is an essential component of safeguarding the interest of the profession and we must work harder to gain more recognition and acceptance at this level. The Institute gains strength through the active participation of its members and as such, I urge all members to be actively involved in the Institute's efforts and activities to promote the Institute.

Once again, it is that time of the year for us to gather at the Annual General Meeting to reflect upon our achievements and to fashion the roadmap for the year(s) to come. This year's Annual General Meeting will be held on 28th June 2003 and I hope to see all of you there in supporting our drive to push the Institute forward.

Thank you.

Ahmad Mustapha Ghazali
PRESIDENT

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Meeting Future Challenges of Tax Administration

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❍ LHDN officer / MIT member	RM 650.00	RM 750.00
❍ Non-member / others	RM 750.00	RM 850.00
❍ Overseas Delegate	USD 250.00	
Premier Plus	10 participants registered from the same organisation get 1 FREE seat	

3RD NATIONAL TAX CONFERENCE 2003
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IMPORTANT NOTES

- For Malaysian outstation cheque, a surcharge of RM0.50 is required to be included in the total cheque amount.
- Fee is made payable to MIT-CPD. Admission will only be permitted upon receipt of full payment.
- Registration can be made via fax. Followed by a cheque via mail.
- This registration form serves as our official invoice. No further invoice will be issued.

Registration
Reservation can be made by telephone / facsimile but will only be confirmed upon receipt of registration form and payment.

Payment
Please cross cheque made payable to MIT-CPD and mail payment together with registration form to **Conference Secretariat, Malaysian Institute of Taxation, 41A, 1st Floor, Jalan Wan Kadir 2, Taman Tun Dr Ismail, 60000 Kuala Lumpur.**

Conference Fee
All fees are inclusive of conference notes, refreshments and lunch.

Cancellation & Transfer
Conference fees are non-refundable once reservation has been confirmed. If you are unable to attend, a substitute delegate is welcomed when advised in writing prior to the conference. No refund is given for cancellations or withdrawals. Cancelled unpaid registrations will also be liable for full payment of the conference fees.

Disclaimer
The organiser reserves the right to change the speaker, date or to cancel the programme should unavoidable circumstances arise.

Accommodation
To enjoy special accommodation rates, please make your reservation direct with the hotel, indicating that you are a delegate of the 3rd National Tax Conference 2003. Hotel bills are to be settled by delegates directly with the hotel.

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Tel: (603) 8943 2333

For information, please contact Ms Ng / Cik Nur
Tel: (603) 7729 8989 Fax: (603) 7729 1631 E-mail: secretariat@mit.org.my

Editor's Note

The Budget section covers the Budget 2004 Memorandum which was recently submitted to the Ministry of Finance.

The Institute has had the honour of being invited by the Treasury to forward its fiscal propositions to assist in developing the budget policies of Government. This year's theme "Mitigating Destabilising External Environment and Ensuring Sustainable Growth" advances proposals to counteract the treat of the external factors affecting our local economy. Other articles of interest covered in this issue include:

Onshore and offshore services – developments on withholding tax
Payments for services rendered under paragraphs (a) and (b) of sec. 15A ITA will no longer be subject to withholding tax if the services are performed outside Malaysia. Elaine Lee Pei Sze asserts however, that due care and attention should be taken in invoicing to determine what is, and what is not, subject to withholding tax. General or ambiguous contracts or invoices may give rise to disputes with the DGIR.

Adventure in the nature of a trade
Dr Arjunan Subramaniam writes on the total effect of facts and circumstances which must be taken into account in addressing the concept of an "adventure in the nature of trade"

"...A monkey has one head, two eyes, nose, hands and feet. But a monkey is not a man... it is an adventure in the nature of a man!...".

Property development activities – the proper treatment of borrowing costs
A major feature of property development is that the development activities are carried out over more than one accounting period. The dispersal of costs and revenues over more than one accounting period gives rise to difficulties, where the time at which income is recognised, may be different from the time at which the costs were "incurred" or "payable", in finding the correct accounting and tax treatment to reflect the reality of a profit-making activity. Richard Thornton examines the issue of borrowing costs in relation to the taxing of a property developer. As ordinary principles of commercial accounting give developers a choice as to whether they "capitalise" borrowing costs or treat them as costs to be expensed as and when they are incurred or paid, the choice made will clearly affect the incidence of tax unless there is some compulsion to apply one method or the other.

Operational headquarters – Which is more attractive
The attention of many MNCs and investors has gradually been turning to China since its accession to the World Trade Organisation in 2001. Malaysia, has reacted to the increasing competition, from China as well as from other countries within the region, by introducing new strategies to attract more FDIs into the country. Adeline Wong and Karen Tan explore the available OHQ incentives offered by Malaysia, Singapore and Thailand respectively and seek to provide an objective assessment of the packages offered.

Consumption Taxes vs. Income Taxes – Which is more equitable?
"Fair" methods of taxation have always been the key to successful government. Patrick Chan finds it totally unsurprising that the struggle with the question of what constitutes "fair" taxation continues, be it with income tax, consumptions taxes or a mixture of both.

Republic of Singapore's 2003 Budget - A Budget for long term economic goals
Assoc. Prof. Lee Fook Hong puts forward the tax proposals read out by Singapore's Finance Minister, when presenting the Budget for 2003. Most of the measures and incentives introduced were aimed at restructuring Singapore's economy and developing new strategies for continued prosperity

Taxation and economic development in Malaysia
Taxation can encourage and stimulate economic growth or stifle it. Good taxation policies can draw businesses and investments or encourage their departure. Dr. A. Thillaisundaram examines the significant role of taxation in the economic development of Malaysia.

Transfer pricing in Malaysia: lessons from developed countries
Danielle Donovan and Yvonne Chan review the progress of transfer pricing in developed countries in order to provide an insight into how transfer pricing may develop within Malaysia.

Income tax rates
In this issue of the Learning Curve, Siva Nair takes a look at application of the relevant income tax rates to chargeable income, rebates and joint assessment, using excerpts from past examinations to help readers better understand the issues.

Harpal S. Dhillon
EDITOR OF TAX NASIONAL

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2nd Quarter 2003

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As a measure to attract MNCs to establish their OHQ in South East Asia

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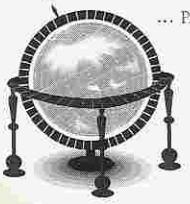


MEMBERS DIALOGUE IN PERAK

From left:
Mr. Chow Kee Kan (Honorary Secretary)
Mr. Lee Yat Kong (Council Member)
En. Ahmad Mustapha Ghazali (President)
Mr. Lam Weng Keat (Perak branch Chairman)

The Perak Branch under the chairmanship of Mr Lam Weng Keat recently organised a dialogue with the MIT members on 12 April 2003. The dialogue was held at the Heritage Hotel in Ipoh. The President, En Ahmad Mustapha Ghazali and Honorary Secretary, Mr Chow Kee Kan were present at the dialogue to personally meet the members, and to brief them on the activities of the Institute. Among the issues discussed at the dialogue were the proposals to increase the membership fees and the funding for the purpose of purchasing new premises for the Institute. The Chairman took the opportunity to introduce the Perak Branch Committee to the members present at the dialogue.

After which, members attending the dialogue were treated to refreshments.

En. Ahmad Mustapha presented the certificate to a newly admitted member, Mr. Chew Pete Chung at the dialogue.

SUNDAY MAIL, 20 APRIL 2003

54 LEARNING

Helping firms overcome their tax blues

By MARY CHEN

Career : Corporate tax consultant
Name : Veerinderjeet Singh
Education : BA Hons (1st Class) in Accountancy, Universiti Malaya
PhD from Universiti Putra Malaysia
Status : A certified public accountant and an approved tax agent under Section 153 of Income Tax Act (1967)
Member, Malaysian Institute of Accountants (MIA)
Member, CPA Australia
Council Member, Malaysian Institute of Taxation (MIT)
Current Position: Executive director, Ernst & Young Tax Consultants Sdn Bhd

WHEN Malaysia introduced the corporate self-assessment tax system in 2001, tax consultants found themselves assuming a more proactive role in their clients' businesses.

The tax consultants have to meet with clients regularly to understand the latter's core businesses and future plans to effectively assist in establishing sound tax-saving practices.

"The self-assessment programme for corporate tax requires business owners to file their estimated tax returns before the business year and make monthly tax instalments according to that estimate," says corporate tax consultant Dr Veerinderjeet Singh.

"Most local businesses only seek tax advice at the end of the financial year, so the new requirement has made companies aware of the need for tax assistance all year round to make sure they get it right and not open themselves to tax penalties."

A 22-year veteran in the industry, Singh says that traditionally, businesses would engage tax consultants to help them maintain adequate records and file proper tax returns within the stipulated deadlines and timeframes.

"With better understanding of our clients' businesses, we can help them plan ahead and structure marketing strategies and investments in a manner that tax impact.

"If we are only called in at the end of the financial year when the accounts are prepared and audit done, then it becomes just a mechanical process of calculating your taxes and filing your returns."

When tax consultants play a more proactive role in assisting their clients in planning major financial decisions, transactions can then be structured in a certain manner to minimise the tax payable.

Tax consultants have also expanded to offer more comprehensive services such as assisting clients in certain sectors apply for various investment incentives or tax exemptions.

Corporate tax practitioners must also be well-versed in providing indirect tax services such as custom duties and sales taxes.

Fine line between creativity and deviousness

The *Sunday Mail* features a new career every week.
If there's a particular profession that you'd like to know more about, or if you have an interesting job, CALL US at (03) 2282-3322, fax: (03) 2284-9133, or e-mail: email@nstp.com.my

What it entails
The tax professional must interpret the tax laws and regulations to ensure clients comply with the law, and at the same time give advice on the tax advantages of certain business decisions in order to minimise tax liabilities.

How to qualify for this profession
To practise as a tax agent in Malaysia, the individual must either have an approved licence to provide taxation services under Section 153 of the Income Tax Act, 1967, be a chartered accountant with an audit licence of the Malaysian Institute of Accountants (MIA), or an advocate and solicitor with sufficient tax experience.

Currently, there are two main routes to train as a corporate tax consultant. Fresh graduates with an accounting-related degree, including business administration and finance, can join a tax firm as a tax assistant or associate while pursuing their professional taxation qualification. An individual with 'A' levels or STPM can start working for a tax firm and take specific professional qualifications such as the ACCA, MIT or MICPA. For the MIT qualification, you need at least three years of practical experience.

Useful skills/personality traits
Good communication and presentation skills, ability to build rapport with clients and other related professionals. An inquisitive mind with the ability to analyse details and organise data. Also be able to work independently and discreetly as you would be handling confidential information. A good command of English and local languages to do research and to liaise with the Finance Ministry or Inland Revenue Department.

Job perks and benefits
Remunerations are excellent for the right candidates. Satisfaction on a personal level is when I helped resolve a client's tax problems or assisted him in minimising his tax liabilities. Also the challenge and opportunity to learn from each case, to improve your understanding about specific aspects of the pertinent laws and the ability to use the research and data in the Commonwealth, legal systems in the context of Malaysian law.

Job frustrations/occupational hazards
Meeting deadlines, especially during certain months which can mean overtime and late hours. But increasingly, I see less disadvantages and more in terms of benefits and positive growth for this profession in terms of personal satisfaction.

The main hazard is walking the fine line between creativity and deviousness. There are high penalties for tax evasion and a clause in the self-assessment programme states that anyone who assists another in understating their tax liabilities is guilty in the eyes of the law and can be legally charged.

The challenge of being creative as opposed to devious is that you need to be able to justify your actions to ensure there is no ambiguity or uncertainty in interpretation of the legal terms, and you must have valid business and commercial reasons for your advice.

Career prospects
Excellent. The traditional place of employment for tax consultants are accounting firms and the Inland Revenue Department, although in recent years, opportunities exist in the commercial sector as multinational companies realise the advantage of having an in-house tax unit with the qualified personnel to handle their internal taxation requirements.

Salary range expected
Fresh graduates may start from RM1,500 to RM2,000 as tax associates, and progress to three or four times higher when they become managers in the establishment. Should they attain directorship in the firm some years later, remunerations can be quite lucrative.

Professional bodies to join, if any
Malaysian Institute of Taxation (MIT), Malaysian Association of Certified Public Accountants (MICPA), Malaysian Institute of Accountants (MIA), and Chartered Association of Certified Accountants.

Significant changes in tax practices
Providing tax services is a challenging and dynamic career as certain facets of local tax are influenced by the resolutions of our Annual Budget. Our taxation services and requirements may change yearly in response to our annual budget. Work in terms of filing of tax reports may be routine, but it is never static. There is constant challenge as new changes test your creativity and research abilities.

Any personal advice?
Providing tax services is new more complex and you must always ensure that your knowledge is up-to-date, or else you may be liable to negligence should you not advise your clients appropriately.

Vice President of MIT, Dr Veerinderjeet Singh was recently featured under the Learning Column of Sunday Mail on 20 April 2003.

Profile

Lau Yaw Joo
Sarawak Branch Chairman

Mr. Lau Yaw Joo is an approved Company auditor. He has been practising for the past 20 years under Lau Yaw Joo & Co., Chartered Accountants in Kuching, Sarawak. He is a member of the Malaysian Institute of Taxation (MIT), Malaysian Institute of Accountants (MIA) and fellow member of the Association of Chartered Certified Accountants.

He was the Sarawak Branch Chairman for MIA and a member of the Practice Public Committee from 1994 to 1997. Currently he is a member of the Technical and Public Practice Committee of MIT.

FAREWELL LUNCH
IN HONOUR OF MR MICHAEL LOH

Mr Michael Loh, has been a personality synonymously associated with the rise of Malaysian Institute of Taxation ("the Institute") over the past 13 years, and with having the privilege of being one of the Institute's founding members back in 1991. Following a commendable period of office Mr Michael Loh recently resigned from his positions as Deputy President and Council Member in November 2002, after having served in this capacity since the Institute's inception in October 1991.

In honour of his invaluable services and unfailing commitment, the Institute hosted a farewell lunch on 3 April 2003 at the Oriental Pearl Restaurant, Bukit Kiara Equestrian & Country Resort, Kuala Lumpur.

In the span of his 13 years with the Institute, he played many instrumental roles, amongst which were as chairmanship of the Education & Training Committee and the Examinations Committee. He was one of the pioneer members involved in establishing the professional examination scheme for taxation in the country. Whilst on the Institute's Education & Training Committee, he helped steer the Committee in aggressively promoting both the examination scheme and the Institute to the tax fraternity. Under his stewardship, the Education & Training Committee organised many successful activities and seminars, primarily involving the promotion of the professional examination system and the continuing professional development programmes for members.

President, En. Ahmad Mustapha Ghazali presenting the souvenir to Mr. Michael Loh

When the Institute first started in 1991, it consisted of just 495 members trying to establish a firmer platform for the profession in Malaysia. It is now grown into the main representative body of the tax profession, boasting of more than 2,000 members. Thus, in less than 10 years the Institute has not only quadrupled in size but has built a firm reputation with both the local and international tax community, the success of which can in no small terms be attributable to the assiduous efforts of Mr Michael Loh and the Council Members of the Institute.

The President, En Ahmad Mustapha Ghazali during the souvenir presentation ceremony said, he believes the Institute can continue to count on Mr Michael Loh's support and guidance in everyway eventhough he may not be officiating with the Institute in a formal capacity.

We at the Institute will never forget the drive and passion he helped instill in all of us. We take this opportunity to thank and wish Mr Michael Loh all the best in his future endeavours and reiterate that his presence will be deeply missed by all of us at the Institute.

Council members at the farewell lunch

NOTICE

4th WORLD TAX CONFERENCE 2003

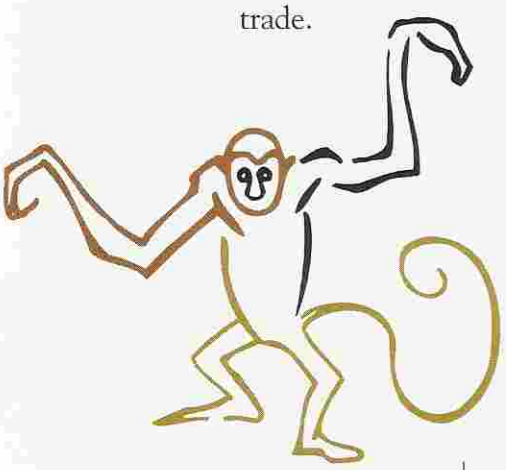
Due to the current unfortunate state of world affairs, the situation in Iraq and the travel restrictions imposed as a result of the Severe Acute Respiratory Syndrome ("SARS") in the region, the 4th World Tax Conference at Sydney, Australia from 20th to 22nd May 2003 has been postponed to 25th – 27th February 2004.

For further details contact the World Tax Conference team via e-mail at worldtax03@taxinstitute.com.au

Adventure in the Nature of a Trade

by Dr. Arjunan Subramaniam

Justice *Rowlatt*, in *Leeming v. Jones* (1930) 15 TC 333 ("*Leeming v. Jones*") promulgated the idea of a transaction, though not a "trade" per se, is an adventure or concern in the nature of a trade. The *Income Tax Act 1967*, has that term in sec. 2 under the definition of a "business". Transactions both in shares or land or any other commodity can be adventures in the nature of a trade.



This article examines the parameters for this somewhat nebulous concept. Alexander the Great embarked on on a military adventure, Jason and his Argonauts sought the Golden Fleece. Then, there are adventures of Romance whilst yet others track in the Himalayas in search of God, vast expanses of sky, rugged peaks, dangerous glaciers and the emerald waters of the Ganges…

Taxpayers too, sometimes go on adventures – adventures in the nature of a trade. What does this phrase mean? It is a concept that is difficult to describe but when you see it, you will know it. Not so long ago, in an answer to a question from the audience, I remember saying the following or words to that effect...

"…A monkey has one head, two eyes, nose, hands and feet.
But a monkey is not a man…
it is an adventure in the nature of a man!…"

So is the idea of an adventure in the nature of a trade. It is not trade but has some of its distinct characteristics. But again the characteristics alone does not make a transaction an adventure in the nature of a trade. The facts and circumstances must be deliberated upon to see the total effect.

Leeming v. Jones

In *Leeming v. Jones* the facts were as follows: –

"The Appellant was a member of a syndicate of four persons formed to acquire an option over a rubber estate with a view to re-sale at a profit. The option was secured but the estate was considered too small for re-sale to a company for public flotation. An option over another adjoining estate was accordingly secured and it was decided to resell the two estates to a public company to be formed for the purpose. Another member of the syndicate undertook to arrange for the promotion of this company.

The vendors of the second estate gave an abatement of 5 % on the purchase price of that estate, this sum (£1, 750) being stated in the form of a commission for introducing a purchaser but being claimed by the Appellant to be a reality a deduction from the purchase price. The syndicate's rights were transferred to a company for £1,250. This company promoted a further company to which the properties were sold."

Against, the above background, the transaction was held not to be "an adventure" despite the acquisition and addition of the second estate. *Leeming v. Jones* is a case that is too near the bone. Surely the adding if the second estate led the whole transaction into the ambit of an adventure. However, *Rowlatt*, J refrained from overturning the commissions' decision on the ground that it was for the commissioners to make findings of fact.

The conditions for an adventure in the nature of a trade may be generally stated as –

a) The nature of organisation of the speculation,
b) maturing the property,
c) manner of disposing of the property [at page 341 and page 346].

Rowlatt, J highlighted some important principles. These are –

a) Repetition of transactions though each transaction by itself may not be an adventure, but may lead to an adventure in the nature of a trade or trade. His Lordship said:

"If you repeat it habitually it may become a trade..." (at page 339)

b) Isolated transactions may lead to an adventure in the nature of a trade or trades. "But even with regard to isolated transactions there are several cases in the books where they have been held to afford an income which is taxable". (Per *Rowlatt*, J at page 339/340).

c) Where a large asset is bought and subdivided and made more marketable and the subdivision is advertised, then you have an adventure (*Martin v. Lowry* (1927) 11 TC 297).

d) When a thing is altered, subdivided, treated and dealt in an expert way, there is an adventure (*Cape Brandy Syndicate*, (1921) 12 TC 358).

e) When a thing is repaired, converted into a new and better article, there is an adventure (*IRC v. Livingston*, (1927) 11 TC 538).

Rowlatt, J quotes the Lord President, *Lord Clyde* in setting out the test for an adventure, thus:

"I think the test, which must be used to determine whether a venture such as we are now considering is, or is not in the nature of trade, is whether the operations involved in it are the same kind and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made."

In other words, the characteristics of a transaction must bear similarities to the line of business. In the *Cape Brandy* case, the activity was in line with the ordinary business of brandy importers. In *Martin v. Lowry*, what was done was in line with ordinary merchants buying and advertising and disposing off their goods. In *IRC v. Livingston*, the activity of repairing and converting the steam drifter was in line with the activities of ship dealers and repairers.

The total effect of facts and circumstances must be taken in addressing the concept of "adventure in the nature of trade". In *C.Venkataswami Naida & Co. v. CIT* [1959] 35, ITR 594 [1959] Supp. 15 CR 646, the Supreme Court of India put the approach thus –

"What is important to consider is their distinctive character. In each case, it is the total effect of all relevant factors and circumstances that determines the character of the transaction."

It is clear – not all sales of land are "adventures" in the nature of a trade. Land itself lends itself to commercial transactions. But that test cannot be applied in isolation. The following circumstances indicate that sales of land cannot be an adventure in the nature of a trade: –

a) land purchased for purposes of an investment and acquired by the Government,

b) land inherited and subsequently sold,

c) land specifically purchased to build a school or for a particular purpose other than sale and subsequently sold in circumstances of advancing the initial purpose i.e. to build and run a school,

d) land purchased because it was going cheap and subsequently sold at a profit.

The following circumstances indicate an "adventure in the nature of a trade" –

a) land purchased from borrowed monies with a view to resell and pay off the loan and make a profit,

b) land purchased, subdivided and sold,

c) land purchased with a view of putting up a commercial building which plan is subsequently aborted and the land sold. But this could indicate a capital transaction too if the building was meant for investment purposes i.e. renting it out.

d) Land reclaimed from the sea and sold.

The above circumstances are not an exhaustive list of circumstances amounting to an adventure in the nature of a trade or otherwise. The surrounding circumstances must bear out the conclusion reached. In the end each case has to revolve on its own facts. And the arguments will go on...

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Onshore and Offshore services

– Developments on Withholding Tax

by Elaine Lee Pei Sze

In presenting the 2003 Budget on 20th September 2002, the honourable Minister of Finance announced that sec. 15A of the *Income Tax Act 1967* (hereinafter referred to as "ITA") would be amended to limit the scope of Malaysian withholding tax upon certain "special classes of income" received by non-residents.

Withholding tax on "special classes of income"

Under sec. 4A ITA read together with sec. 109B ITA, payments of "special classes of income" to non-residents are subject to withholding tax. Section 4A ITA provides as follows:

"Notwithstanding the provisions of section 4 and subject to this Act, ***the income of a person*** *not resident in Malaysia for the basis year for a year of assessment* ***in respect of*** *–*

i) amounts paid in consideration of services rendered by the person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such person;

ii) amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;

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

which is derived from Malaysia *is chargeable to tax under this Act." (emphasis added)*

While sec. 4A ITA enacts the charge to tax, sec. 109B ITA imposes an obligation upon a person ("the payer") to withhold tax on payments of special classes of income which the payer is liable to make to a non-resident if such payment is deemed to be derived from Malaysia under sec. 15A ITA.

If so, the payer is required to withhold tax, upon paying or crediting such payments, at the prevailing rate of 10% or a lower rate under any applicable Bilateral Agreement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion[1] (hereinafter referred to as "DTA"). The payer is required to remit the tax (whether such tax has been deducted or not) within one month (of paying or crediting the payee) to the Director General of Inland Revenue (hereinafter referred to as "DGIR"). Failure to comply with sec. 109B ITA could lead to severe penalties being imposed upon the payer.

The "special classes of income" are deemed to be derived from Malaysia if the requirements of sec. 15A ITA are satisfied. In this regard, the limitation introduced in Budget 2003 reduces the scope of such deemed derivation.

Section 15A ITA - Post-amendment

The amended sec. 15A ITA (with the amendments shown in bold) now reads as follows:

"Gross income in respect of –

a) amounts paid in consideration of services rendered by a person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such person;

b) amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;

[1] Pursuant to the decision of the Special Commissioners of Income Tax in SGSS (Pte) Ltd v. Ketua Pengarah Hasil Dalam Negeri (1998) MSTC 2,996 and the judgment of the High Court in SGSS (Pte Ltd) v. Ketua Pengarah Hasil Dalam Negeri (2000) MSTC 3,814, it is now settled law that the relief provisions of a DTA will prevail over sec. 4A ITA in the event of a conflict.

For tax compliance purposes, it is of the utmost importance that all invoices issued by non-residents should be specific and itemised, and should not be expressed in general terms.

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

shall be deemed to be derived from Malaysia –

i) if responsibility for payment of the above or other payments lies with the Government or a state Government;

ii) if responsibility for the payment of the above or other payments lies with a person who is a resident for that basis year; or

iii) if the payment of the above or other payments is charged as an outgoing or expense in the accounts of a business carried on in Malaysia:

Provided that in respect of paragraphs (a) and (b), this section shall apply to the amount attributable to services which are performed in Malaysia."

Under the pre-amendment sec. 15A ITA, payments under paragraphs (a) to (c) would be deemed derived from Malaysia if any one of paragraphs (i) to (iii) were satisfied and regardless of whether the services were performed by the non-resident onshore or offshore (that is, within Malaysia or outside Malaysia).

Following the amendment which introduces the proviso to sec. 15A ITA (the words in bold above), the scope of derivation of the income referred to in paragraphs (a) and (b) of sec. 15A ITA is now confined to services performed in Malaysia. Accordingly, payments for services rendered under paragraphs (a) and (b) of sec. 15A ITA will no longer be subject to withholding tax if the services are performed outside Malaysia.

However, payments to non-residents for services performed outside Malaysia before the coming into force of the amended sec. 15A ITA on 21st September 2002 would still be subject to withholding tax, even if payments for such services are made after 21st September 2002.

It is noteworthy that the new proviso does not apply to paragraph (c) of sec. 15A ITA. As such, rent paid to a non-resident for the use of moveable property would still be subject to withholding tax so long as any of paragraphs (i) to (iii) applies and regardless of whether such property is used in Malaysia or outside Malaysia.

Onshore and offshore service arrangements

It would be advisable for a non-resident who performs both onshore and offshore services to have either:

(a) separate contracts governing the onshore and offshore portions as well as separate invoicing arrangements; or

(b) if both onshore and offshore services are governed by the same contract, the invoicing should clearly distinguish between payments for onshore and offshore services. Ideally separate invoices should be issued.

If due care and attention is paid to this, it should be relatively straightforward to determine what is, and what is not, subject to withholding tax. For tax compliance purposes, it is of the utmost importance that all invoices issued by non-residents should be specific and itemised, and should not be expressed in general terms. General or ambiguous invoices may give rise to disputes with the DGIR.

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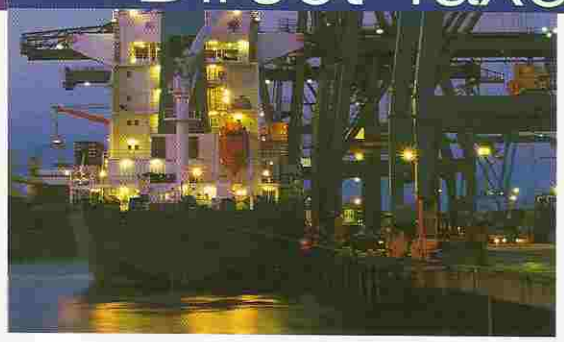
*The views of the author do not necessarily represent the views of the firm. Nothing herein contained should be construed as legal advice on the applicability of any provision of law to a given set of facts.



Is Withholding Tax "Regrossing" Out?

A CASE COMMENTARY ON ESSO PRODUCTION MALAYSIA INC. V KETUA PENGARAH HASIL DALAM NEGERI

By Kenneth Lim

The High Court delivered its judgement on the case of *Esso Production Malaysia Inc. v KPHDN*, on 20 March 2003. The case came before the High Court as an appeal by way of Case Stated against the Deciding Order of the Special Commissioners of Petroleum Income Tax ("SC") made on 28.1.2000 where the SC decided in favour of the Inland Revenue on all issues in contention.

This case is important as it is the first judicial pronouncement in Malaysia on the tax deductibility of payments which have been regrossed for withholding tax purposes, and it also touches on the interpretation and scope of section 4A, ITA. This article will focus on the regrossing issue, and only briefly discusses the other points.

In particular, the issues were:

1. Whether the regrossed amounts (on payments under sections 107A, 109 and 109B, ITA) were entirely tax deductible to EPMI
2. Whether certain service charges paid by EPMI to non-resident affiliates, fell within the scope of section 4A(ii), ITA
3. Whether head office restructuring costs were tax deductible to EPMI
4. Whether tax assessments raised by the Inland Revenue for YA 1984 and 1985 were barred by reason of section 39, PITA

Whilst the High Court upheld the decision of the SC on all issues, it is important to read this case in the context of its rather unique factual matrix.

The appellant, EPMI operated as a branch of a foreign company in Malaysia and carried on the business of exploration, development and production of petroleum in Malaysia. As a result of an investigation by the Inland Revenue, a series of additional assessments were raised for YA 1984 to 1992.

Issue 1

The High Court decision, in disallowing a deduction for the "increased amount" of the regrossed amounts, could potentially result in an increase in the cost of doing business. The Malaysian purchaser of services, know-how etc. who (in may cases) has little choice but to accept an arrangement whereby it is required to pay the non-resident recipient the full amount of its invoice (e.g. net of Malaysian taxes), will not be given a full tax break. To most, this is but a cost of entering into a transaction, and the additional cost to fulfill such a requirement is as good or the same as the non-resident having factored the Malaysian tax into its pricing in the first place.

It is therefore important that the scope of application of this case be critically examined, to assess whether the case creates a rule of general application, or whether the conclusion reached was due to its peculiar facts.

EPMI entered into contracts where the terms of payment require that the non-resident affiliates' invoices would have to be paid in full; to the extent that there was tax (other than US tax) which would need to be withheld by EPMI, the total amount by which EPMI was invoiced shall be increased by the non-resident to take into account those taxes so that the net amount shall equal what the non-resident would have invoiced had there been no withholding tax liability.

To achieve this, the bills of the service providers would grossed-up, for example, say the charge of services is RM100, and the applicable withholding tax (at the rate of 15%) would have been RM15. The non-resident would bill RM117.64, and EPMI would pay the non-resident RM100 and remit RM17.64 ***("the increased amount")*** to the Inland Revenue. In this example, EPMI would claim a tax deduction for RM117.64. The amount of RM17.64 would in this case, be disallowed by the Inland Revenue.

(In the SC decision it was noted that the increased amount (of RM17.64 in our example) was deliberately described as *"administrative fees"* instead of *"withholding tax"* to avoid the amount being viewed as a tax cost.)

In dismissing the appeal on Issue 1, the High Court made the following points:

- The judge found that in carrying out the terms of the contract, EPMI was able to reduce its tax liability in Malaysia.
- The judge said that the amount disallowed was *"not wholly and exclusively incurred"* by EPMI.
- The judge cited two documents (which set out the above arrangements) from which he deduced that the above arrangement was a method *"devised"* by EPMI and its non-resident affiliates.
- The judge concluded that EPMI and its non-resident affiliates were *"one enterprise"* notwithstanding they were separate entities, and said that although the agreements were not illegal or void as between the parties, it was unacceptable to expect the Inland Revenue to be bound by them.
- The judge also disagreed that the arrangement was in fact an indemnity.
- The Inland Revenue should refund the excess withholding tax (in our example this would be RM2.64).

It would appear that the judge thought that under this arrangement EPMI was able to reduce its Malaysian tax liability since it would be claiming a tax deduction of RM117.64, and not RM100. Further the judge took the view that the increase of RM17.64 was not wholly and exclusively incurred by EPMI, possibly since it partly represented taxes imposed on the non-resident (RM15) and partly an excess payment of withholding tax (RM2.64). Clearly, the judge did not accept the argument that the withholding tax formed part of the consideration for the services received by EPMI (therefore deductible).

One could attempt to confine this case within the compass of its facts; firstly, the assessments came about as a result of an investigation process (which the SC thought revealed certain false representations), and secondly, the arrangement was made between affiliated parties whereby the head office was the *"alter ego"*. Indeed the judge felt that the Inland Revenue should not be bound by the agreements since they were made between parties which could be regarded as *"one enterprise"*, suggesting that a different conclusion could have been possible otherwise.

In an appropriate case (perhaps involving unrelated parties), it may arguably still be possible to take the view that the increased amount (of RM17.64) is in effect the cost incurred in obtaining services, and would be entirely tax deductible. From the service recipient's perspective, the commercial reality is that the cost of purchasing such services is in fact the entire grossed up amount (of RM117.64). Alternatively, it may perhaps be arguable that the portion relating to withholding tax (of RM15) is an indemnity payment, which is deductible.

It was also interesting to note how the judge dealt with the argument that the case involved an "indemnity" given by EPMI. It may be recalled that in the Australian case of *Century Yuasa Batteries*[1] the deductibility of a payment pursuant to a contractual clause which

[1] *Commissioner of Taxation v Century Yuasa Batteries* (1998) 269 FCA. Although the case was not followed, the relevance of some of the principles therein may be worth considering.

effectively indemnified a lender for withholding taxes on interest payments (in our example the RM15), was not challenged.

The High Court's finding that the relevant clause did not amount to an "indemnity" seems to suggest that there may be scope to argue that payments under a clear indemnity clause may be treated differently.

Finally, it is also noted that the judge did not directly deal with EPMI's argument that as a matter of interpretation, section 18(1)(k), PITA covered only taxes which are imposed on the income of a chargeable person (such as EPMI) and not on withholding tax paid by EPMI since this represented taxes of the non-resident recipient. On this point it is useful to refer to the case of *Ashton Gas Co. v Attorney General* (1906) A.C. 10 where it was decided that tax of the company was not deductible since company tax is an appropriation of profits and not incurred for the purposes of producing income. It could be argued that section 18(1)(k), PITA is merely a statutory enactment of this common law principle.

This suggests that the interpretation of section 18(1)(k), PITA on this issue, is also left open by the High Court. It is noted that there is no equivalent provision in the ITA.

In the author's view, the reasoning in the judgement suggests that there may yet be room to permit a tax deduction for the increased amount of the regrossed amounts in appropriate cases, where circumstances are substantially different.

Depending on the analysis adopted, either the entire increased amount may be allowed as a tax deduction (where the entire regrossed amount is regarded as the cost of the service etc.), or only the portion relating to the withholding tax should be so deductible (where this portion is regarded as an indemnity on which withholding tax would not be applicable). Either way, it requires the recognition that such arrangements are common commercially, and technically, they do not result in the payment of "taxes" of the type that is non-deductible under PITA or under the common law.

Issue 2

EPMI had split the invoices for services it received from its non-resident affiliates into "technical" and "non-technical" categories whereby separate invoices are made for each category of services, and withholding tax was paid on the invoices for services considered to be "technical". EPMI was unable to produce supporting documentation requested by the Inland Revenue, and as a result, all service charges made by EPMI to its affiliates were regarded as being within the scope of section 4A(ii), ITA. In a letter from EPMI the reasons for using the affiliates' services included the fact that they were "specialized" activities.

The Inland Revenue submitted that the section covered both technical and non-technical services, but excluded the day to day administration expenses which are in no way related to the performance of any specialized services.

The judge applied the rule of interpretation that a disjunctive reading should be adopted where the word "or" is used in a provision of law or where a "," (comma) is used.

Applying this principle to section 4A(ii) and replacing the comma with "or", in his view, the relevant part of the section should read as *"technical advice* or *assistance or services – rendered in connection with technical management or administration – of any scientific, industrial or commercial undertaking or venture or project or scheme- "* (emphasis ours).

The judge thought that the word "specialized" (as used in that letter) *"clearly indicates specialization in certain technical advice, or assistance or services"*, thus falling within section 4A(ii). Consequently, the judge did not think the Special Commissioner was wrong in their finding on this issue.

The judge also adopted the meaning of the word "technical" as found in The Shorter Oxford Dictionary on Historical Principles – 3rd Edn. Vol. 11, that is *"Belonging or relating to an art or arts; appropriate or peculiar to, characteristic of, a particular science, profession or occupation, also of pertaining to the mechanical arts and general science generally...."*

It appears that the judge did not read the word "technical" (which first appears) as a common adjective for the words which follow i.e. "advice, assistance or services" i.e. only "advice" is qualified by the word "technical".

Whilst this decision should temporarily quell the lively debate on the scope of the section, it remains to be seen whether this interpretation will be upheld in the Court of Appeal.

Issue 3

The Exxon group, of which EPMI was a member, consolidated 6 regional head offices for oil and gas operations outside North America into a single division, and part of the costs associated with the restructuring was allocated to EPMI based on a formula. The restructuring costs consisted of employee separation costs, relocation expenses and facilities costs. The Inland Revenue did not allow a tax deduction for these expenses.

The judge found that the allocated expenses were not wholly or exclusively incurred by EPMI since it was the head office that decided to consolidate. The judge was of the opinion that only the *"actual costs"* to EPMI mattered and that the allocated expenses were too remotely connected with EPMI; hence the "wholly" test was not fulfilled.

Issue 4

The judge said that the head office in America was the alter ego, and there were many instances where the head office in America instructed the method to be adopted regarding the imposition of the withholding tax charges. The judge did not agree that the arrangement was not one to commit fraud, willful default, negligence or involved an erroneous view of the law. Consequently, the Inland Revenue was entitled to raise the assessments beyond the normal 12 years limitation period.

He agreed with the SC's finding that certain documents were put in place to *"lend an aura of authenticity to inter affiliate service charges"* as this suggested that there was something to be hidden. However, a significant comment the judge made should not be lost upon us all - *"Whatever the [tax] planning that has to be done must be within the perimeter of the law...."*. This is a positive signal that tax planning continues to be a legitimate tool.

Conclusion

In the author's view the messages that are sent in this case include:

1. The conclusion on the regrossing issue may perhaps be specific to the facts of this case.
2. Section 4A(ii) embraces "non-technical" assistance and services.
3. Head office restructuring costs allocated and charged to an entity are not tax deductible
4. Tax planning continues to be a legitimate tool.
5. Proper and adequate documents should be retained.

The case is on appeal and it is hoped that the Court of Appeal would address the questions that still remain.

The Author

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The author would like to thank Yeo Eng Ping for her contribution to this commentary.

Note: The views expressed in the article are the personal views of the author.

Note

* These abbreviations were used:
"EPMI" - *Esso Production Malaysia Inc.*
"PITA" - *Petroleum Income Tax Act 1967*
"ITA" - *Income Tax Act 1967*
"YA" - year of assessment

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PROPERTY DEVELOPMENT ACTIVITIES

The proper treatment of borrowing costs

"To be absolutely certain about something, one must know everything or nothing about it"
– Olin Miller

1. INTRODUCTION – THE NATURE OF PROPERTY DEVELOPMENT ACTIVITIES

Property development activities involve the acquisition of land for the purposes of (a) the construction thereon and selling of completed residential, and/or commercial and industrial buildings whether as a whole or by parcels therein; and (b) development and sale of vacant lots for construction of such buildings thereon including homesteads, hobby farms, orchards or for other similar purposes. A major feature of property development is that the development activities are carried out over more than one accounting period. Furthermore, sales revenues may be received at varying points in time and quantity[1].

It is this latter aspect, the dispersal of costs and revenues over more than one accounting period, that gives rise to difficulties in finding the correct accounting and tax treatment to reflect the reality of a profit-making activity.

2. THE METHODS OF ACCOUNTING FOR THE PROFITS OF A PROPERTY DEVELOPER

For many years international accounting standards[2] have allowed two accounting methods to be used:

(i) The percentage of completion method ("PCM") under which profits are recognised year-by-year during the course of development activity; and

(ii) The completion of contract method ("CCM") under which recognition of profits is deferred until the development is completed.

However, beginning 1993, the Malaysian accounting bodies adopted and applied their own standard to bodies reporting within Malaysia[3]. Whilst not being significantly different from the international standards, it did recommend the use of the PCM and attempt to prohibit the use of the CCM. Subsequently, in June 2002, following the establishment of the Malaysian Accounting Standards Board ("MASB"), an MASB exposure draft[4], which was intended to supersede MAS 7, was introduced. This was revised later[5] but has still not become operative. As a consequence, the current standard in force is still MAS 7. In the confusion, the CCM has continued to be used by many Malaysian property development companies.

[1] Malaysian Accounting Standards Board ED27 (Revised).
[2] International Accounting Standards ("IAS") 1 and 11.
[3] Malaysia Accounting Standard 7, Accounting for Property Development. ("MAS 7")
[4] MASB Exposure Draft 27, Property Development Activities ("MASB ED 27")
[5] MASB ED 27 (Revised)

3. RECOGNITION OF A PROPERTY DEVELOPER'S PROFITS FOR TAX PURPOSES

Malaysian law imposes a charge to tax on "gains or profits from a business, for whatever period of time carried on"[6] and it is a well-established principle that profits must be ascertained in accordance with ordinary principles of commercial accounting[7]. In ascertaining the correct principles of commercial accounting, the courts have recourse to the evidence of accountants.[8] Using such principles and evidence, the courts have been willing to recognise the CCM as a valid method of taxing a property developer.[9]

On the other hand, the Inland Revenue Board ("IRB") practice, dating from about 1989, has been to accept developers' accounts based on the PCM but not on the CCM. Where a developer continued to use the CCM, they imposed their own method, the progress payments method ("PPM") in order to determine an estimated amount of gross profit and subject it to tax progressively, by reference to receipts and receivables, over the period of the development. As a result, there are currently three distinct methods to be considered in relation to the ascertainment of the profits of a property developer, only two of which are recognised accounting methods and only two, but a different two, are acceptable for tax purposes.

4. THE PERCENTAGE OF COMPLETION METHOD ("PCM")

This method, as expounded in MAS 7 and substantially followed by MASB ED 27, involves the recognition of profits prior to completion of a development activity by reference to the stage of completion reached but, it should be noted, only when the outcome of the development project can be estimated reliably. As a result of this "let-out" provision, there can still be cases where a developer will not recognise profits year-by-year even when the exposure draft is converted into a standard[10].

5. THE COMPLETION OF CONTRACT METHOD ("CCM")

Under the CCM, property development project costs, meaning all costs which are directly attributable to development activities or can be allocated thereto on a reasonable basis, are treated as an asset. The costs so capitalised are brought to account as an expense only on completion of the development.

6. THE PROGRESS PAYMENTS METHOD ("PPM")

This is not an accounting method. It is a method used by the IRB to facilitate the taxing of profits prior to completion of a development activity by spreading the estimated gross profit for the development over the period to completion by reference to estimated sales and actual payments received and receivable in each year.

7. BORROWING COSTS – ACCOUNTING TREATMENT

Borrowing costs are interest and other costs incurred in connection with the borrowing of funds[12]. Although we are considering mainly interest on borrowings, such costs could also include other types of cost such as exchange differences and incidental costs of borrowing.

From the words used, it is clear that both MAS 7 and MASB ED 27 take a similar attitude to the treatment of borrowing costs, stating that they may be capitalised as part of property development costs once development activity has commenced. MASB 27, Borrowing Costs, which is effective for accounting periods commencing on or after 1st July 2002, is similar to the comparable international standard, IAS 23. While stating that the benchmark treatment for borrowing costs is to recognise them as an expense in the period in which they are incurred, it permits an alternative treatment under which they may be capitalised. The latter would be appropriate for borrowing costs attributable to property development activity, whether for specific–purpose borrowings or for a proportion of general borrowings. Obviously though, capitalisation of borrowing costs is not mandatory. In fact the emphasis is the other way round. The norm is to expense them as they are incurred.

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[6] *Income Tax Act 1967* – Act 53 – sec. 4(a).
[7] *Whimster & Co v The Commissioners of Inland Revenue* 12 TC 813, 823.
[8] *Sir John Pennycuick V-C in Odeon Associated Theatres v Jones* 48 TC 257 at p.273.
[9] *Sarawak Properties Sdn Bhd v DGIR* (1998) MSTC 3,659, citing *Lord Templeman* in *Thomson Hill Ltd v Comptroller of Income Tax (Singapore)* STC (1984) 252.
[10] The indicated effective date is for accounting periods beginning on or after 1 January 2003.
[11] In a rider to their finding, the Special Commissioners urged that action be taken to "devise and gazette appropriate rates for the reckoning of profits or gains... under sec. 36 of the *Income Tax Act 1967*." (1998) MSTC 2,966 at p. 2982.
[12] MASB 27.

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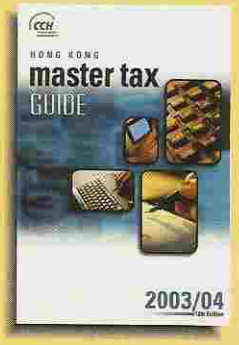

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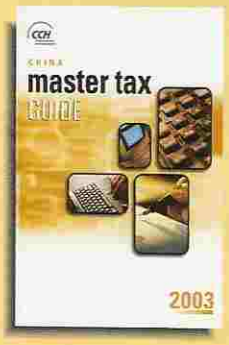

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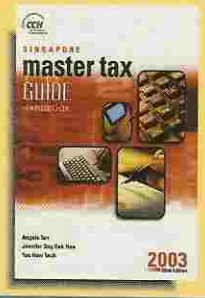

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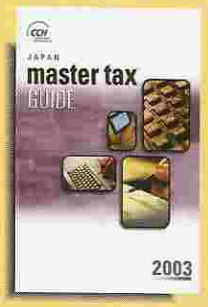

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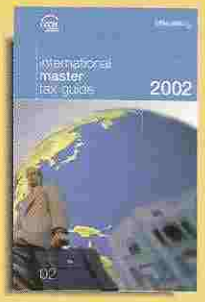

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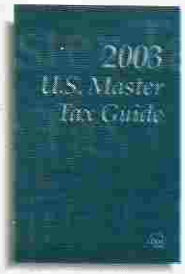

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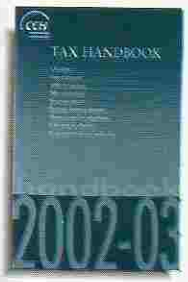

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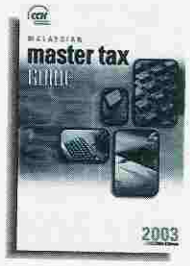

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As a property developer is, by definition, carrying on a business activity, it can be safely said that the "gross income" in question is the developer's sales revenue from that activity.

8. TAX TREATMENT OF BORROWING COSTS

A Statutory basis for deducting borrowing costs incurred when ascertaining adjusted income is provided for by sec. 33 of the *Income Tax Act 1967* ("ITA"). This may be either:

- generally, under sec. 33(1) as "...expenses wholly and exclusively incurred during that period ...in the production of gross income..."; or
- specifically, for interest on borrowings, under sec. 33(1)(a), as *interest payable for that period on money borrowed and employed in that period in the production of gross income.*

As a property developer is, by definition, carrying on a business activity, it can be safely said that the "gross income" in question is the developer's sales revenue from that activity. Thus, it is probably of little concern whether the borrowings are taken to finance specific development activity or as general borrowings, except that, in the case of the latter, use or deemed use for an extraneous purpose can impair the deductibility of an interest expense.

Subject to establishing eligibility of purpose therefore, borrowing costs should be deductible when "incurred" or "payable". On the other hand, a difficulty arises in applying this to the taxing of a property developer where the time at which income is recognised, under any one of the three methods referred to above, may be different from the time at which the costs were "incurred" or "payable". As ordinary principles of commercial accounting give developers a choice as to whether they "capitalise" borrowing costs or treat them as costs to be expensed as and when they are incurred or paid, the choice made will clearly affect the incidence of tax unless there is some compulsion to apply one method or the other.

The question of choice was considered in the Hong Kong case of *Commissioner of Inland Revenue v Secan Ltd and Another.*[13] It concerned a property developer using the CCM method of accounting who had capitalised the interest incurred in years before any sales took place but then, in the first year when such sales arose, restated its accounts to treat the interest incurred for all years as an expense of the current year. The central question was whether the Hong Kong Inland Revenue Ordinance, Cap 112, prohibits the capitalisation of interest. At issue was sec. 16 of the Ordinance which provides that "there *shall* be deducted *all outgoings and expenses* to the extent to which they are incurred during the basis period for that year of assessment ...including – (a) interest..." (emphasis added). The observant reader will note that this is sufficiently close to our sec. 33 as to be considered *in pari materia.*

Holding that "capitalisation of interest is not mandatory, but it is permitted ...where it is in accordance with accepted accounting principles" the Court of Final Appeal found that "Where the taxpayer may properly draw up its financial statements on either of two alternative bases, the Commissioner is both entitled and bound to ascertain the assessable profits on whichever basis the taxpayer has chosen to adopt".

Further support for the hypothesis that, where a taxpayer has a choice of method, his first choice will bind him is in the Court of Civil Appeal decision in the *Thomson Hill* case[14] where it was held that "where a particular method of accounting has been applied consistently in the past, the onus was on the person seeking a change of method to prove that there was good reason for the change ...".

In an interesting conclusion, after considering a number of landmark cases on the ascertainment of profits or losses, the Hong Kong Court put forward the view that "capitalising" interest, and indeed any other cost incurred in connection with the development, means that the developer is charging the cost as an expense in his trading or profit and loss account in the period in which it is incurred but, by also recognising the closing value of his work in progress at the same figure, nothing shows in the profit and loss account in a year in which there are no sales. This gets over the difficulty of identifying the charge for borrowing costs with the period in which it is incurred. MASB ED 27 (Revised) appears to support the view that such capitalised costs are work-in-progress and not some kind of deferred revenue expenditure.[15]

[13] Court of Final Appeal FACV000009/2000.
[14] *TH Ltd v The Comptroller of Income Tax* [1982] 1 MLJ 303.
[15] "Property development costs recognised as an asset should be carried at the lower of cost and net realisable value" MASB ED 27 (Revised).


In the end, the rightness or wrongness of the "expense" treatment revolves around the question of whether borrowing costs should properly be taken into account in arriving at the gross profit of a property developer.

On this basis, all expenses would be deductible as they are incurred and work in progress would be brought in, per MASB ED 27 (Revised), at the lower of cost and net realisable value. It should be noted, however, that tax law gives no choice over the valuation basis. The proviso to sec. 35(3)(a)(ii), ITA, prescribes that the value to be used, in the case of immovable properties, is cost.[16]

9. BORROWING COSTS AND THE PPM METHOD

The PPM method, which derives its authority from the IRB practice, concentrates on ascertaining the estimated gross profit (and estimated sales), which is then included as a component in arriving at the amount of adjusted income or adjusted loss. Although no guidance is available as to what this measure of gross profit is meant to be, it is assumed that it is to be understood in an accounting sense. Under normal principles of commercial accounting there is no compulsion to capitalise borrowing costs but there is a choice[17]. Therefore, it can be concluded that, in estimating his gross profit for the purposes of the PPM the taxpayer may capitalise or not, provided that he is consistent in his method from year to year.

Section 35 of the ITA states that cost is the cost of acquiring the item of stock concerned and of bringing it to its existing condition. As we have seen, the inclusion of interest cost is not mandatory. Consequently, the property developer who chooses not to capitalise borrowing costs but to take them straight to the profit and loss account in the period in which they are incurred would be able to obtain tax relief for such costs whether by reduction of the amount otherwise treated as adjusted income or by creating or augmenting an adjusted loss. It follows that the borrowing costs would not then be taken into account in ascertaining the estimated gross profit for the purposes of the PPM.

In the end, the rightness or wrongness of the "expense" treatment revolves around the question of whether borrowing costs should properly be taken into account in arriving at the gross profit of a property developer. It is suggested that they need not be, as such costs are not directly concerned in acquiring the assets concerned or in bringing them to their present condition. They are more in the nature of indirect costs. Where, however, the developer chooses to treat them as direct costs for accounting purposes, as permitted by the principles of commercial accounting, he commits himself to do so for tax purposes as well.

10. SUMMARY OF CONCLUSIONS

a) A property developer has a choice as to whether he capitalises borrowing costs during the progress of a development project or not.

b) If a developer chooses to capitalise borrowing costs, effective tax relief for such costs, regardless of whether the PCM method or the CCM method is in use, is likely to be later than it would be otherwise.

c) Tax consequences in relation to the treatment of borrowing costs will follow the choice made for accounting purposes, regardless of which of the three methods referred to is finally used to determine the adjusted income or adjusted loss for tax purposes.

d) There is not an option under which capitalisation or non-capitalisation may be chosen for accounting purposes, whilst the other choice is applied for tax purposes.

e) Once a choice of method has been made and applied for accounts purposes, a change to the other method would be difficult to justify.

The Author

Richard Thornton

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If readers have any comments to make on this article, he would be glad to receive them at ricton100@hotmail.com

[16] "... the value of any particular item of stock ...shall be taken to be (i) an amount equal to its market value; or (ii) if the relevant person so elects ... the total cost to him of acquiring that item. Provided that in the case of ...immovable properties ...shall be taken to be ...cost price".

[17] MASB 27, Borrowing Costs, states that the benchmark treatment is for borrowing costs to be treated as an expense in the period in which they are incurred. However, capitalisation in certain circumstances is an allowed alternative treatment.

Operational Headquarters

Which is more attractive?

by Adeline Wong & Karen Tan

As a measure to attract Multi National Corporations ("MNCs") to establish their operational or regional headquarters ("OHQ") in South East Asia, Malaysia, Singapore and Thailand have each offered attractive incentive packages to encourage companies to use their respective countries as a base for conducting headquarters management activities as well as coordinating their regional and global operations.

However, the attention of many MNCs and investors has gradually been turning to China since its accession to the World Trade Organisation ("WTO") in 2001. With its commitment to, amongst others, further liberalise its markets and align its trade practices in accordance with the WTO principles, China has established itself as a very strong competitor for foreign direct investment ("FDI") in the region.

Malaysia, in particular, has reacted to the increasing competition, from China as well as from other countries within the region, by taking steps to introduce new strategies to attract more inflow of FDI into the country. One of the significant changes to the Malaysian OHQ incentives includes, amongst others, 100% exemption of income received by an OHQ for 10 years. This incentive was effective 21 September 2002 following the announcement of the 2003 Budget.

Singapore and Thailand also, have in place, attractive OHQ incentives to encourage MNCs and other foreign companies to set up their OHQs within their borders.

This article explores the available OHQ incentives offered by Malaysia, Singapore and Thailand respectively and seeks to provide an objective assessment of the packages offered.

In Malaysia, the incentives are commonly referred to as the OHQ incentives. However, in Singapore and Thailand, they are generally referred to as regional headquarters or regional operating headquarters incentives respectively. For the purposes of this article, the incentives offered by the three countries will be referred collectively as OHQ incentives.

Operational headquarters incentives

I. General criteria

The general criteria table outlines the criteria and conditions which needs to be satisfied in order to enjoy the OHQ incentives. The minimum paid-up capital of the OHQ entity in Malaysia is approximately USD130,000. It is to be noted that this requirement is lower than that for both Thailand and Singapore . Singapore also has a specific condition for the paid-up capital of the OHQ entity to be increased to USD280,000 over a 3-year period.

Whilst Malaysia, Singapore and Thailand require the OHQ to be a locally incorporated company, Singapore has an additional condition whereby the applicant company must have been incorporated in Singapore for less than a year prior to the date of application. Where the foreign company had been incorporated in Singapore for more than a year prior to the date of application, it still qualifies provided it was conducting a different business from that which it will be conducting as its OHQ activities. This reflects the aims of the Singapore Economic Development Board ("SEDB") to encourage companies to set up OHQs in Singapore, where they had not done so previously.

The types of prescribed activities provided by the OHQ guidelines of the 3 countries are generally similar. Malaysia, Singapore and Thailand require that the services must be rendered to at least 3 entities outside the country. However, Malaysia and Singapore have an additional qualification in that the OHQ must render at least 3 of the qualifying services outlined to its related entities. Apart from the above qualification, Singapore further requires the OHQ to maintain this level of activity for the duration of the 3-years.

Whilst Malaysia requires the OHQ to appoint at least 3 management personnel, Singapore imposes the requirement of having at least 75% skilled work force throughout the 3-year incentive period and also an additional 10 professionals by the third year.

Apart from the minimum business spending per annum requirement, Singapore requires the OHQ entity to also undertake in complying with additional conditions including, amongst others, employing at least 75% skilled workers throughout the incentive period and incurring an average remuneration per worker of at least USD56,000 per annum by the end of the third year of the incentive period. If any of the additional conditions are not complied with accordingly, it appears that the tax incentives enjoyed by the OHQ company may be revoked and the OHQ company may have to repay its tax liabilities to the Inland Revenue Authority of Singapore.

With regard to exchange controls, Singapore does not have any such restrictions in place. Although Thailand has foreign exchange regulations, its regulations and restrictions have been considerably relaxed since 1990.

Whilst Malaysia has exchange controls, the Malaysian Central Bank i.e. Bank Negara Malaysia ("Bank Negara") has granted various exemptions to approved OHQs to facilitate the prescribed OHQ activities such as the conduct of treasury and fund management services undertaken by the OHQ. An OHQ is exempted from seeking the approval of Bank Negara in respect of the following facilities:

(a) Obtaining credit facilities in foreign currency from any licensed commercial banks and merchant banks in Malaysia (including the licensed offshore banks in Labuan) without the prior approval of Bank Negara Malaysia;

(b) Borrowing freely in Ringgit Malaysia ("RM") up to RM10 million from domestic sources for use in Malaysia;

(c) Investing freely in foreign securities and lending to related companies outside Malaysia even if they have obtained domestic borrowing provided that domestic borrowing in RM does not exceed RM10 million and remittances are made in foreign currency equivalent;

(d) Open one foreign currency account or one multi currency account with any of the designated banks to retain export proceeds in foreign currency subject to a limit and conditions specified from time to time by Bank Negara; and

(e) Open one or more foreign currency accounts with designated banks in Malaysia, the licensed offshore banks in Labuan or overseas banks for crediting foreign currency receivables other than export proceeds with no limit on overnight balances.

Bank Negara has also recently liberalized the exchange control regulations and has raised the overnight limit account for operational headquarters to US$70 million from US$10 million previously, effective 1 April 2003. With the various exemptions put in place by Malaysia, a company seeking to establish its OHQ in Malaysia is, in effect, able to conduct its activities as though no exchange control regulations are in place.

II. Tax incentives

For Malaysia, with effect from 21 September 2002, business income, interest and royalty payments arising from the services rendered to an OHQ's related company or office outside Malaysia ("Qualifying Income") are 100% exempt from tax for 10 years. Dividends paid from the exempt Qualifying Income will be exempted in the hands of the shareholders.

In Thailand, the Qualifying Income in respect of OHQ activities is subject to a concessionary tax rate of 10%. On the other hand, Singapore offers a 15% tax rate for 3 years on incremental Qualifying Income.

GENERAL CRITERIA

Details	MALAYSIA	SINGAPORE	THAILAND
Paid Up Capital	USD 130,000 (*RM0.5 million*)	USD 280,000 (*SGD0.5 million*) (*subject to an incremental increase over a 3-year period*)	USD 280,000 (*Baht 10 million*)
Incorporation requirement	Locally incorporated company	Locally incorporated company (*must be incorporated for less than a year before date of application*)	Locally incorporated company
Prescribed OHQ activities	The prescribed activities of the OHQ entity includes the following*: (a) General management and administration; (b) Business planning and co-ordination; (c) Technical support and maintenance; (d) Procurement of raw materials, components and finished products; (e) Marketing control and sales promotion planning; (f) Treasury and fund management services; (g) Corporate financial advisory services; (h) Research and development; or (i) Training and personnel management. * (*Although the exact wording used in the guidelines issued by the respective countries may differ, the scope of the activities remain substantially similar.*)		
Minimum spending per annum	Approximately USD400,000	• At least an ***additional*** USD 1.1 million business spending at the end of 3rd year; and • At least ***additional*** USD1.7 million in business spending cumulatively for the entire 3-year incentive period.	No minimum spending but at least 1/3 of income from the OHQ operations must constitute incomes arising from prescribed activities and royalty payments made to the OHQ for R&D activities carried out in Thailand.
Other criteria	Appointment of at least 3 senior management personnel.	• Employ at least 75% skilled workers throughout the incentive period; • Employ at least an additional 10 professionals based in Singapore at the end of 3rd Year of the incentive period; • Achieve a minimum value-added per worker of at least USD110,000 (S$200,000) per annum at the end of the 3rd Year of the incentive period; • Incur an average remuneration per worker of at least USD56,000 (S$100,000) per annum at the end of the 3rd Year of the incentive period.	No specific employment requirement stipulated.

GENERAL INCENTIVES

Details	MALAYSIA	SINGAPORE	THAILAND
Corporate tax rate	28%	22%	30%
Concessionary tax rate for the regional headquarters	0%	15% (*subject to further reductions under customised incentive packages.*)	10%
Concessionary period	10 years	3 years (*subject to customisation*)	Not available for confirmation
Processing Authority	Malaysian Industrial Development Authority (**"MIDA"**)	Economic Development Board (**"EDB"**)	Board of Investment (**"BOI"**)
Expatriate Incentive	Expatriates are taxed only on the portion of chargeable income attributable to the number of days the expatriates are in Malaysia.	Expatriates are taxed only on the portion of chargeable income attributable to the number of days they are in Singapore.	Tax breaks and incentives available to expatriates' with a minimum 2-year employment term with the OHQ.

Although there could be some differences in the types of OHQ services falling within Qualifying Income, Malaysia, Singapore and Thailand usually regard Qualifying Income as income derived from OHQ services such as administration, marketing and control, technical support and corporate advisory services. The income may be in the form of foreign management fees, service fees, sales, trading income and royalties.

From the perspective of the applicable concessionary tax rates, Malaysia has the most favourable tax rate when compared against Thailand and Singapore. Although Singapore does customise special incentive packages with lower concessionary tax rates for companies that substantially exceed the minimum criteria in the guidelines, Malaysia appears to have edged its neighbours by exempting 100% of Qualifying Income derived from OHQ activities from corporate tax.

Furthermore, expatriate posts will be approved based on the requirement of the OHQ and the expatriates will be subject to income tax only on the portion of income received during their stay in Malaysia i.e. on a days-in days-out basis. It is interesting to note that Singapore also adopts a similar tax treatment for its expatriates. Thailand also offers tax breaks and specific incentives to the expatriates' incomes provided that they fulfill a minimum 2-year employment term with the OHQ.

III. Which is most attractive?

At a quick glance, the incentive packages being offered by Malaysia, Singapore and Thailand appear somewhat similar, albeit some subtle differences in the criteria and tax incentives available. Singapore has evidently placed strong emphasis on the employment of skilled workers in the OHQ whilst Malaysia relaxes the criteria to encourage more MNCs to consider establishing its OHQ in the country.

Although the incentives on offer is a pertinent consideration for the MNCs in selecting a location for its OHQ within the region, there are understandably other factors which are also taken into account. Some of the key considerations include, amongst others, the standard of skilled workforce, political and economic stability, developed financial system, the transparency and accessibility of the legal and regulatory framework, supportive governmental policies, the standard of living and quality of life as well as infrastructural and information technology ("IT") support.

Singapore has emerged over the years and gained recognition as the premier financial centre in South East Asia. In its efforts to remain competitive, Singapore has also taken various initiatives to establish the necessary IT infrastructure to attract MNCs to its shores. It is obvious that its efforts have paid off as there are many MNCs who have established their OHQs in the island republic.

In recognising the importance of IT, Malaysia has also made serious effort to offer potential investors the opportunity to set up its OHQ in Malaysia and has stepped up efforts to improve on the IT facilities and infrastructure offered. Its telecommunications network has seen impressive expansion and upgrading during the past decade, providing high quality telecommunication services at competitive prices.

With the establishment of the Multimedia Super Corridor ("MSC") in 1996, Malaysia's rapid progress and development over the years have enabled it to achieve one of the most well-developed infrastructure among the newly industrialising countries of Asia. Today, with its market-oriented economy, combined with a skilled workforce and a well-developed infrastructure, Malaysia has become one of the largest recipients of FDI among the developing countries.

Although Thailand used to attract largely manufacturing operations due to its cheap and skilled workforce, Thailand is also becoming a more popular choice for MNCs who wish to consider establishing its OHQs in the country. With its ideal geographical location and a well-rounded incentives package, Thailand is clearly a serious competitor in the region.

It must be noted that Malaysia has come a long way in offering OHQ incentives to attract potential investors to its shores. Its present OHQ incentive package is arguably the most aggressive, particularly with the grant of 100% exemption on OHQ income for 10 years. With the 10-year tax exemption, Malaysia appears to have surpassed Thailand and Singapore respectively, from this perspective. Whilst other factors are usually taken into consideration alongside the tax incentives offered, it is evident that Malaysia stands out as offering the most attractive incentives package in comparison to its neighbours.

With the increased competition faced by countries in the region as well as from China, the success of each country in promoting themselves and attracting MNCs to set up their regional offices in South East Asia remains to be seen, especially amidst the present economic climate and the challenging times ahead.

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CONSUMPTION TAXES vs. INCOME TAXES

Which is more equitable?

by Patrick Chan

Most people view taxes on individuals as taxes on income, i.e. it is earned from employment, usually wages and salaries. However, there is an increasing number of economists who have advocated that consumption taxes should replace income tax, either wholly or at least partially. The fundamental difference between income tax and consumption tax is that consumption tax only taxes money when it is spent, i.e. people have a choice in the matter. People have to pay only if they choose to spend. In comparison, income tax taxes money when it is earned, including amounts put away by people as savings and therefore also including the amount of interest earned from those savings. As such, people have no choice in the matter but to pay taxes on savings and also interest from those savings indirectly.

Some examples of consumption taxes in Malaysia are in the form of sales tax, service tax, excise duty and gaming tax, import duty and entertainment tax. Sales tax is levied and charged on all taxable goods (unless exempt), which are manufactured locally or imported into Malaysia. Goods are defined as all kinds of moveable property. Sales tax must be based on "arm's length" transactions to ensure no under declaration of sale values of goods. Service tax is payable on prescribed services and prescribed goods sold or provided either by or in prescribed establishments. Service tax is chargeable on the actual price for which goods are sold and also for actual charge for services rendered.

So, is it as simple as having a choice being better than not having a choice? An important test to consider when evaluating any form of taxation is whether it is progressive or regressive. A system of taxation is considered to be progressive if the higher income group pays a higher proportion of their income in taxes (as is the case with the progressive rate of income tax on individuals in Malaysia). The supposed theory behind progressive taxation is that the lower income group of people must spend a higher proportion of their income on essentials than the higher income group. The higher income group has higher disposal income and can therefore afford to pay higher taxes. Therefore, a progressive tax system appears to be fairer to the lower income group.

A regressive system of taxation forces the lower income group to pay the same or even a higher proportion of their income in taxes than the higher income group. Consumption taxes are fundamentally regressive because the lower income group must spend more of their income than the higher income group who save (proportionately) more of their income. Consumption taxes are also sometimes argued to be less fair than income tax because the benefits of not taxing capital will mostly benefit the higher income group. It could be argued that, despite the common perception that, in a system of pure consumption taxes all taxes on capital are eliminated, consumption taxes and income taxes actually treat capital gains quite similarly. Compared to income tax, consumption taxes exempt only the tax on the opportunity cost of capital. Compared to pure income tax, consumption taxes replace capital depreciation with capital expensing. This change eliminates the tax on the opportunity cost of capital, but does not

The practical objection to consumption taxes used to be that it is too complicated to monitor the amounts that people save or not save each year.

change, relative to income tax, the tax treatment of capital gains arising from a risk premium or luck. As these components of capital gains will apply more to the higher income group, consumption taxes can be seen to be more progressive than would be concluded under more conventional assumptions.

Most of the debate in Malaysia over consumption taxes has centered on whether Malaysia should adopt a value-added tax ("VAT") similar to the ones that European countries have or a goods-and-service tax ("GST") similar to the one in Singapore. While a VAT or GST definitely is a tax on consumption, it is not the kind that most consumption tax supporters prefer. The debate over whether to add a VAT or GST in Malaysia has obscured the more basic issue of whether to tax income or consumption. Currently, Malaysia has a mixture of both. So, are some economists such strong supporters of consumption taxes, i.e. they have so much against income tax?

Consumption taxes, also called expenditures tax or consumed income tax are taxes on what people spend and not what they earn. A VAT or GST does that in the same way that a sales tax does. However, a pure consumption tax system is not just layering a VAT or GST on top of the existing income tax system. Some economists think of a consumption tax system as an income tax which allows unlimited deductions for savings and taxes all withdrawals from those savings, i.e. taxes them when people decide to consume instead of to save.

Supporters of consumption taxes argue that they are much superior to income tax because consumption taxes are neutral. This is because consumption taxes do not alter spending habits or patterns of behavior and therefore do not distort the allocation of resources. Any form of taxation cannot claim to be completely neutral, since taxing any kind of activity should cause people to do less of the activity and more of other activities that are not taxed. For example, income tax creates a difference between the value of people's work (for example, the amount their employers are actually paying) and what the individual receives net (i.e. the amount the individual receives after tax, ignoring EPF, SOCSO and other deductions). As a result, in theory anyway, people should work less (and choose to have more free time) than they would if taxes did not exist at all.

As such, it can be clearly seen that the arguments for consumption taxes are actually arguments against income tax. Supporters of consumption taxes argue that income tax damages the economy in the long run because it penalizes savings by taxing part of the amount that people would be saving (assuming everybody has some savings). This means that the amount of funds deposited in, say, a fixed deposit has already been taxed. For example, if the fixed deposit rate is 4% and the average rate of tax for an individual is 20%, his actual return is only 3.2%. This is because, for every RM100 deposited, he will get RM4. However, for every RM100 deposited, it would have been from gross income of RM125 (RM100/0.80). Therefore, the RM4 return is actually from RM125 (before tax) earned and not from RM100 (after tax). As such RM4 from RM125 represents a real rate of return of only 3.2%. This may result in less savings, less investments and lower standards of living than would be the case without the supposed tax on savings as shown above. Therefore, income tax creates a bias in favor of current consumption at the expense of savings and future consumption. In the above example, a 4% return without income tax would be RM5 (RM125 x 4%) instead of RM4. Without income tax, there may be increased savings. With income tax, there may be increased current consumption (this may be some governments' current policy but in this article, we are talking about people's choice, or the absence of it).

As a result, there is less savings than people would choose in the absence of income taxes. The value to people of savings is the market interest rate that borrowers are willing to pay for using the funds now. If each potential saver could collect that gross market interest rate, it should result in an optimal amount of savings. In this case, optimal means the amount of savings that people, deciding freely on the basis of market prices, would choose to do by themselves, rather than

Another objection to consumption taxes is that it would be regressive (i.e., it would have a heavier impact on the lower income groups).

the amount of savings that the government thinks they should do. However, income tax creates a difference, i.e. the after tax interest that savers receive (as the original amount has already been taxed) is less than the before tax market interest that borrowers pay. As such, we get less than the optimal amount of savings. Compared to the above situation, a properly set-up consumption tax system can be made to be neutral between consumption and savings. This is because taxes will apply only to income that is spent, not on any income which is saved. The results are that taxes on savings will be eliminated and that total savings in the economy as a whole would be much closer to the theoretical "optimal amount".

Despite its advantage of eliminating the current tax bias against savings, there are also other economists against consumption taxes. One objection to consumption taxes that is based on pure economics is that it would require a higher tax rate in order to raise the same revenue as income tax. This is because taxes on people's savings have been eliminated from the country's tax base. For this reason, consumption taxes would be less neutral between work and free time than income tax. Supporters of consumption taxes maintain that the gains from additional savings and investments would outweigh the losses from less work performed. However, we cannot tell for sure whether this is a realistic assumption.

The practical objection to consumption taxes used to be that it is too complicated to monitor the amounts that people save or not save each year. Another objection to consumption taxes is that it would be regressive (i.e., it would have a heavier impact on the lower income groups). The fear is that the tax burden would be shifted to the lower income group because savings and investments (which constitute a much larger share of the higher income group) would not be taxed. However, this can be partially addressed by zero-rating some items including much of the essential items. Then, there may not be enough revenue to replace income tax unless an enormous burden is placed on consumption of "non-essential" or "undesirable" items. Hence, a pure consumption tax system would require extremely careful administration to ensure that the advantages outweigh the disadvantages.

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Conclusion

A frequent constraint for governments is that all proposals to change the tax system are frequently flawed in one way or another and therefore usually lose attractiveness the more closely you look at them. In most cases, the person in the lower income group pays a higher proportion of their income than with the existing system. As these governments start refining their proposals say, to make them less regressive, the result may be effective tax rates that become so high that even some initial supporters would oppose them.

When it comes to which is the best system of taxation, low taxes will be what we all want and will undeniably win the support of a lot of taxpayers. However, polls in certain developed countries also show an increasing number of people who say that they are actually willing to pay more taxes if their governments spend the money on things that are fundamentally important to them, such as infrastructure, education and social welfare.

If Malaysia were to implement a pure consumption tax system what would be the costs of administering such a system? Would it render the Inland Revenue Board ("IRB") (almost) obsolete and (many) tax consultants also obsolete? Certainly, it would be much less complicated to administer as the system is already partially in place. Some people say that many of the benefits of consumption taxes could also be obtained through modifications of income tax. Income tax reform would generate much smaller transitional problems, so it may have to be considered first.

"Fair" methods of taxation have always been the key to successful government. So it is totally unsurprising that our struggle with the question of what constitutes "fair" taxation continues, be it with income tax, consumptions taxes or a mixture of both. So, which is more equitable – income taxes or consumption taxes? Herein lies the irony: the answer depends on who is asking, the lower income group or the higher income group.

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Taxation and Economic Development in Malaysia

by Dr. A. Thillaisundaram

"It is one of the empirical certainties of history that no structural society has ever arisen without taxation. The power of taxation is one which is particularly liable to abuse, either in the hands of an individual autocrat or of a sectional oligarchy such as may wield the scepter of authority even under the forms of a modern parliamentary system; but without that power no Government, as we understand the term, is possible. The power to tax is the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as is the air he breathes to a natural man. It is not only the power to destroy, but the power to keep alive." *Issacs* J in *R v Barger* [(1908) 6 CLR 41].

Thus it has long been noted that a government in order to govern effectively has to raise funds and an effective way of doing so is through taxation. Taxes can be levied on income earned, wealth, consumption (or expenditure transactionas) or on some other basis.

Taxation is the major source of funds for much of the operating and development activities carried out by governments throughout the world. It is part of the fiscal policy actions available to governments in the control and direction of their economies. Taxation can encourage and stimulate economic growth or can stifle them, depending on how they are employed.

Good taxation policies can draw businesses and investments into the country or encourage their departure to other countries. A well framed taxation policy is necessary for the economic development of any country [Yong (2002)].

Definitions

Taxation according to The Macmillan Dictionary of Modern Economics, represents compulsory levies on private individuals and organizations made by government to raise revenue to finance expenditure on public goods and services, and to control the volume of private expenditure in the economy.

The same dictionary defines economic development as being the process of improving the standard of living and well being of the population of developing countries by raising per capita income. This is usually achieved, it says, by an increase in industrialization relative to reliance on the agricultural sector.

Economic development involves a certain amount of economic planning which in a capitalistic system like ours, represents 'a series of goals by the government and indirect stimulation of certain economic activities through taxation or monetary policy to accomplish planning by inducement. The aim of these plans is to stimulate and direct economic growth using inducements such as access to finance, tax concessions and regional subsidies', [The Macmillan Dictionary of Modern Economics (1981) 1st Edition at pgs 123-4].

Economic Plans in Malaysia

In Malaysia there have been the five-year Malaysia Plans and the annual budgets since independence. Since 1971, the five-year plans have been guided initially by the New Economic Policy (NEP) and then from 1991 onwards, by the National Development Policy (NDP) and more recently i.e. beginning 2001, by the New Vision Policy (NVP). The annual budget is normally presented to Parliament in October of each year and its purpose is to provide a framework for the revenue and expenditure of the government for the year ahead and to institute necessary action in accordance with the proposed plan to fine tune the economy. Budgets are normally balanced, surplus or deficit in nature. A 'Balanced Budget' is one where the revenue and expenditure for the year are matched whereas a 'Surplus Budget' would indicate a situation where the revenue raised exceeds the expenditure planned and a 'Deficit Budget' is one where the expenditure planned exceeds the revenue. The government uses any one of these three possibilities depending on the economic conditions prevailing at the particular time. There have been deficit budgets during the last six years and this is likely to continue for the next few years until the economic problems have faded into the background.

Economic Development Policies of Malaysia

The Malaysian Government has favoured economic development that would involve and accrue to all citizens. Economic growth in its pure form would not guarantee social harmony, in the plural society found in Malaysia. Any economic development must be balanced by an emphasis on equitable distribution of the benefits of that development. This concept of development (growth with equity) is embodied in all national development policies that have been in place over the years.

The New Economic Policy (NEP) was conceived in 1971. It aimed for a new direction in national development i.e. growth with equity and active government participation in the economy. Maximum growth through a *laissez faire* or free market economic system per se was no longer desirable as it did not guarantee that the benefits would be distributed equitably. The NEP had an overall goal that was considerably bigger than economic or materialistic development. This special goal was national unity. To achieve this goal, two major strategies were identified [Raja Zaharaton (2001)] :

a. reducing absolute poverty with the intention of eventually eradicating it, by raising income levels and increasing employment opportunities for all Malaysians, irrespective of race; and

b. restructuring society to correct economic imbalances so as to reduce and eventually eliminate the identification of race with economic function.

Another feature of the NEP was that it was predicted upon a rapidly growing economy. This was deemed necessary so as to, *inter alia*:

a. provide increased employment or economic opportunities for the poor and other disadvantaged groups to enable them to get out of poverty and to participate in the mainstream of economic activities; and

b. ensure that distribution did not take place from the reallocation of existing wealth but from expanding and new sources of wealth.

A new phase of development began in 1991 with the introduction of the National Development Policy (NDP) which again emphasised balanced development. However, under this policy the following shifts in strategies to eradicate poverty and restructure society were emphasised:

a. focus on eradication of hardcore poverty while at the same time reducing relative poverty;

b. focus on employment and the rapid development of an active Bumiputra commercial and industrial community as a more effective strategy to increase meaningful participation of Bumiputras in the modern sectors of the economy;

c. rely more on the private sector to be involved in the restructuring objective by creating greater opportunities for its growth; and

d. focus on human resource development as a fundamental requirement for achieving the objectives of growth and distribution.

The National Vision Policy (NVP) was launched in early 2001. This incorporated the development thrusts of the earlier development policies with the overriding objective of national unity. The NVP represents the consolidation of all past development efforts and is aimed at establishing a united, progressive and prosperous Bangsa Malaysia that lives in harmony and engages in full and fair partnership.

In addition to the development policies we have the Vision 2020, which is a vision of What Malaysia should be in the year 2020. This Vision has become the basis for planning Malaysia's future. This Vision calls for total development and envisages that [Raja Zaharaton (2001)]:

"By the year 2020, Malaysia can be a united nation, with a confident Malaysian society, infused by strong moral and ethical values, living in a society that is democratic, liberal and tolerant, caring, economically just and equitable, progressive and prosperous and in full possession of an economy that is competitive, dynamic, robust and resilient."

Role of taxation in financing economic development plans

Voting and paying taxes probably provide the two major opportunities for most citizens to relate to the government. Taxation, besides being a major source of revenue, is one of the most important instruments for implementing an egalitarian economic and social policy, and for redistributing income on a socially desirable pattern. Taxes act as an important means to finance development and play a major role in nation building and shaping economic policies. Agricultural, industrial and commercial advancement is largely achieved by capital expenditure financed through taxes.

Income tax is important to all countries, but especially so to developing countries like Malaysia, since it is a major source of government revenue. The law is used to assist in the carrying out of the fiscal and economic policies of the government. Income tax is one of the surest ways in which the Government of any country can obtain a source of revenue and from which the Government can budget its annual expenditure.

The role of taxation in a country is closely related to the objectives of tax policies. Since taxes have an important part to play in any government's economic and social policy, the following role and objectives can be highlighted [Veerinderjeet Singh (2003)]:

(a) Raising revenue to finance government expenditure.

(b) Ensuring that taxes are collected effectively and at minimum cost both to the government and taxpayers.

(c) Regulating the private sector of the economy to maintain the desired level of employment and increase economic development/growth.

(d) Regulating the activities of specific areas of the private sector so as to encourage activities which are beneficial to the country and to discourage those which are undesirable to the national interests.

(e) Regulating the distribution of income and wealth as between different types and classes of citizens.

(f) Regulating specific activities of citizens which are thought to be undesirable, e.g., drinking alcoholic drinks, smoking, gambling etc.

(g) Ensuring fairness and equity, i.e. the burden of tax is spread fairly and equitably among taxpayers.

(h) Ensuring that the government in power will continue to get the support of the voters.

To implement economic development plans requires substantial funds. Taxation has a role to play in the funding of such development plans. It also has other roles to play in encouraging economic development.

Taxation in Malaysia is imposed by federal legislation passed by Parliament. The main direct tax legislations are the *Income Tax Act 1967*, *Real Property Gains Tax Act, 1976*, *Promotion of Investments Act, 1986* and *Petroleum Income Tax Act, 1967*. Indirect tax legislations are *Customs Act, 1967*, *Excise Act, 1976*, *Sales Tax Act, 1972*, and *Service Tax Act, 1975*.

Table 1 (below) gives us an idea of the funds raised by the Federal Government yearly since 1994. From the table we can see that the federal government's revenue has increased from over 49 billion in 1994 to over 89 billion in 2003. Table 1 reveals that the revenue comes from direct taxes, indirect taxes and from non tax sources. In 1994 direct taxes represented about 54% of total tax revenue whereas indirect taxes were about 46%. Against total government revenue direct taxes were over 40% while indirect taxes were at 35%. Non tax revenue made up about 24%. In 2003 the proportions had changed somewhat. Direct taxes contributed more than 56% of total revenue whereas indirect taxes were about 25% and non tax revenue about 19%. Direct taxes are thus the more important source of revenue for the government.

Table 2 gives a breakdown in terms of percentage that each of the various types of direct and indirect taxes contributes to the total tax revenue. From this table, it can be noticed that income tax is the most significant of the direct taxes. In 2003 for instance, direct taxes contributed approximately 69% of total tax revenue and of this figure, income taxes alone formed nearly 66% leaving other direct taxes to make up the balance of 3%.

No particular indirect tax stands out in terms of contribution in 2003 except perhaps sales tax, which makes up slightly over 12% in the 31% contribution by indirect taxes. The other indirect taxes make smaller percentage contributions.

Table 3 gives a more detailed picture of the contribution made by the various components of income taxes. From this table, we can see that the biggest contributions of income tax come from petroleum and other companies (including co-operatives). These companies contributed nearly 76% of the government's income tax revenue.

Table 1. FEDERAL GOVERNMENT REVENUE (RM million)

Source: Veerinderjeet Singh, Malaysian Taxation: Administrative and Technical Aspects (2003)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total Direct Taxes **(A)**	20,160	22,699	25,851	30,432	30,016	27,247	29,156	42,098	46,125	50,587
$\frac{A}{C}$	53.8%	54.5%	54.7%	56.7%	66.2%	60.1%	61.8%	68.5%	68.4%	69.2%
$\frac{A}{E}$	40.8%	44.5%	44.3%	46.3%	52.9%	46.4%	47.2%	52.9%	55.2%	56.3%
Total Indirect Taxes **(B)**	17,327	18,972	21,421	23,195	15,320	18,100	18,017	19,393	21,347	22,527
$\frac{B}{C}$	46.2%	45.5%	45.3%	43.3%	33.8%	39.9%	38.2%	31.5%	31.6%	30.8%
$\frac{B}{E}$	35.0%	37.2%	36.8%	35.3%	27.0%	30.8%	29.1%	24.4%	25.5%	25.1%
Total Tax Revenue **(C)**	37,487	41,671	47,272	53,627	45,336	45,347	47,173	61,491	67,472	73,114
$\frac{C}{E}$	75.8%	81.8%	81.1%	81.6%	79.9%	77.2%	76.3%	77.3%	80.7%	81.4%
Total Non-Tax Revenue **(D)**	11,960	9,282	11,008	12,109	11,374	13,330	14,691	18,076	16,078	16,679
$\frac{D}{E}$	24.2%	18.2%	18.9%	18.4%	20.1%	22.8%	23.7%	22.7%	19.3%	18.6%
Total Revenue **(E)**	49,447	50,953	58,280	65,736	56,710	58,677	61,864	79,567	83,550	89,793

Table 2. MALAYSIA: TAX RELIANCE INDICATORS (1990 – 2003)

Source: Veerinderjeet Singh, Malaysian Taxation: Administrative and Technical Aspects (2003)

Year	Total Tax Revenue %	Total Direct Taxes %	Income Tax %	Other Direct Taxes %	Total Indirect Taxes %	Export Duty %	Import Duty & Surtax %	Excise Duty %	Sales Tax %	Service Tax %	Other Indirect Taxes %
1990	100	48.96	45.41	3.55	51.04	9.27	16.10	10.67	11.50	0.57	2.93
1991	100	51.30	47.98	3.32	48.70	7.85	15.90	11.03	10.70	0.52	2.70
1992	100	53.53	49.99	3.55	46.47	5.87	15.24	10.64	10.71	1.12	2.89
1993	100	53.51	49.08	4.43	46.49	4.59	14.31	11.64	10.87	1.92	3.16
1994	100	53.78	46.25	7.53	46.22	3.09	14.98	11.46	11.01	2.20	3.48
1995	100	54.47	48.22	6.25	45.53	2.05	13.49	12.67	11.68	2.44	3.20
1996	100	54.68	47.68	7.00	45.32	2.20	12.97	12.25	11.58	2.60	3.72
1997	100	56.75	50.41	6.44	43.25	1.96	12.17	11.29	11.50	2.75	3.58
1998	100	66.21	62.63	3.58	33.79	1.37	8.53	7.91	8.48	3.19	4.31
1999	100	60.09	55.48	4.61	39.91	1.48	10.41	10.41	9.90	3.22	4.49
2000	100	61.80	57.27	4.53	38.18	2.18	7.63	8.06	12.65	3.60	4.06
2001	100	68.50	65.30	3.20	31.53	1.41	5.19	6.71	11.96	3.13	3.13
2002	100	68.40	65.10	3.30	31.63	1.21	5.02	6.33	13.36	3.21	2.50
2003	100	69.20	65.70	3.50	30.80	1.18	4.80	5.95	12.70	3.35	2.82

Individuals though large in terms of numbers, contributed approximately 24% of the income tax revenue in 2003. Revenue from petroleum income tax has varied over the years. Its contribution was as low as 9.7% of the total income tax revenue in 1996 and was high as 32.69% in 1991. Its contribution to the national coffers has strengthened over the last 3 years due to the higher prices in the world market.

Federal Government Operating and Development Expenditure

Tables 4 to 9 present information on expenditure of the federal government. Table 10, however, gives revenue information. A glance at the expenditure tables reveals that a substantial portion of government revenue goes towards meeting the operating expenditure. Operating expenditure in 2000 was over RM56 billion and it is expected to exceed RM65 billion in 2002. Development expenditure in 2000 was over RM27 billion. Development expenditure increased in 2001 to over RM32 billion but was expected to decrease to about RM28 billion in 2002. The expenditure figures for 2002 is exclusive of tax measures introduced in the 2002 budget.

Social and Economic Services have the higher proportion in the development expenditure. Social Services alone accounted for nearly 40% of the development expenditure in year 2000 (see Table 5). Within Social Services, the highest proportion is for education which accounted for around 64% in 2000. Health and housing had lower proportions (see table 6).

Comparing the operating and development expenditure tables (tables 4 & 5) with the revenue table (table 10), it is notable that there is a substantial shortfall in revenue compared to the expenditure. This has been the trend for the last six years. What we are seeing is deficit budgeting in action. The government spends more than it raises through taxation and other usual means. Deficit budgeting as explained earlier is basically to help the economy get out of the doldrums in which it is mired. Our economy was hurt by the 1997 Asian financial crisis and also by events in September, 2001 in the USA which resulted in the USA going into an economic downturn and which consequently affects countries with trade relations with it. The recent war in Iraq and the SARS scare has further hurt our economy.

Government Actions to Support Social Development during periods of economic difficulties

Following the 1997 Asian financial crisis, the Government ensured that the

Table 3. INCOME TAX REVENUE (1990 – 2003)

Source: Veerinderjeet Singh, Malaysian Taxation: Administrative and Technical Aspects (2003)

Year	Income Tax Revenue	Percentage of total income tax revenue			
		Individuals	Petroleum	Companies (including co-operatives)	Petroleum & Companies
	(RM million)	%	%	%	%
1990	9,647	25.98	27.41	46.61	74.02
1991	12,393	24.12	32.69	43.19	75.88
1992	14,382	23.93	23.75	52.32	76.07
1993	15,658	27.13	18,26	54.61	72.87
1994	17,339	26.33	12.76	60.91	73.67
1995	20,095	30.87	10.87	58.26	69.13
1996	22,541	27.38	9.77	62.80	72.57
1997	27,121	23.70	14.24	62.06	76.30
1998	28,396	24.30	14.25	61.45	75.70
1999	25,159	25.50	11.35	63.15	74.50
2000	27,017	26.00	22.20	51.80	74.00
2001	40,136	23.50	24.60	51.90	76.50
2002	43,932	23.70	16.70	59.60	76.30
2003	48,043	24.40	15.90	59.70	75.60

Table 4. Federal Government Operating Expenditure by Object 2000-2002

	RM million 2000	RM million 2001	RM million 2002
Emoluments	16,357	16,921	17,581
Debt Service Charges	9,055	9,768	9,429
Grants to State Governments	2,077	2,161	1,959
Pensions and Gratuities	4,187	4,891	4,556
Supplies and Services	7,360	9,983	11,763
Subsidies	4,824	4,137	4,719
Grants to Statutory Bodies	4,016	5,196	5,749
Refunds	2,382	1,783	2,352
Others	6,289	6,292	7,234
Total	**56,547**	**61,132**	**65,342**

Source: Economic Report 2001/2002, Ministry of Finance

Table 5. Federal Government Development Expenditure by Sector 2000-2002

	RM million 2000	RM million 2001	RM million 2002
Social Services	11,076	14,618	10,992
Economic Services	11,639	11,614	11,798
Security	2,332	2,842	2,980
General Administration	2,894	2,984	2,612
Total	**27,941**	**32,058**	**28,382**

Source: Economic Report 2001/2002, Ministry of Finance

Table 6. Federal Government Development Expenditure for Social Services 2000-2002

	RM million 2000	RM million 2001	RM million 2002
Education	7,099	9,630	5,905
Health	1,272	1,098	1,273
Housing	1,194	1,922	1,820
Others	1,511	1,968	1,994
Total	**11,076**	**14,618**	**10,992**

Source: Economic Report 2001/2002, Ministry of Finance

Table 7. Federal Government Development Expenditure for Economic Services 2000-2002

	RM million 2000	RM million 2001	RM million 2002
Agriculture and Rural Development	1,183	2,314	2,942
Public Utilities	1,517	878	2,503
Trade and Industry	3,667	4,380	2,414
Transport	4,863	3,986	3,514
Communications	228	12	52
Others	181	44	373
Total	**11,639**	**11,614**	**11,798**

Source: Economic Report 2001/2002, Ministry of Finance

implementation of social development programmes were not affected, by continuing to provide sufficient budgetary allocations and further strengthening the delivery mechanisms for the provision of social services.

In the education sector, the allocation to the Higher Education Loan Fund was increased from RM605 million to RM1.5 billion to provide greater accessibility to tertiary education, especially in the lower income group. An additional 500 single-session schools at the primary and secondary levels were constructed to provide greater accessibility and improved facilities for quality education.

In the health sector, to cater for the increase in number of patients utilising public facilities, an additional allocation of RM1.5 billion was provided in 1997-98 for medical supplies while delivery mechanisms were further improved. The construction of 300 new health clinics and 21 new hospitals was expedited to assist in reviving the economy, while also providing greater access to health care.

In the housing sector, an integrated housing programme was instituted for the purpose of implementing squatter resettlement programmes in major towns. A home ownership campaign was introduced in 1998 with various incentives to provide more opportunities for the public to own homes. These incentives included, among others, a purchase discount of up to 15%, easy credit facilities, exemption from stamp duties and processing fees as well as discounted legal fees and insurance premiums. Access to bridging finance for the construction of low and low-medium cost housing was also made easier through the streamlining of procedures and speedier approval of applications. These measures contributed to increased economic activity, thus assisting in reviving the economy.

The financial crisis of mid 1997 resulted in an increasing number of workers being retrenched and under-employed. To minimize the social impact of the crisis, various measures were introduced. These

included the provision of retraining and skills upgrading programmes undertaken by the Human Resource Development Board as well as a retraining programme for small and medium scale enterprises undertaken by the Small and Medium Industries Development Corporation (SMIDEC). These initiatives contributed towards improved labour mobility and employability.

The current downturn in the global market due to the economic slowdown in the United States has resulted in a reduction in job opportunities, while the drop in production has led to more workers being retrenched. Employers are thus being encouraged to provide training for their workers so as to ensure that workers are equipped with the required skills to increase their productive capacity. These initiatives will contribute towards the establishment and creation of a human resource base that would be critical when the economy recovers.

Table 8. Federal Government Development Expenditure for Trade and Industry Programme 2000-2002

	RM million 2000	RM million 2001	RM million 2002
Industrial Development	37	1	1
Economic Services	2,346	1,445	1,389
Tourism	397	882	294
Industrial research	876	1,985	730
Others	11	67	Reclassified under other headings
Total	**3,667**	**4,380**	**2,414**

Source: Economic Report 2001/2002, Ministry of Finance

Table 9. Federal Government Development Expenditure for Agriculture and Rural Development Programme 2000-2002

	RM million 2000	RM million 2001	RM million 2002
Agriculture	277	458	900
Land Development	100	210	341
Drainage and Irrigation	472	988	1,260
Rubber Replanting	18	152	260
Fishing	109	220	95
Livestock	45	69	52
Forestry	42	29	34
Others	120	188	–
Total	**1,183**	**2,314**	**2,942**

Source: Economic Report 2001/2002, Ministry of Finance

Table 10. Federal Government Revenue 2000-2002

	RM million 2000	RM million 2001	RM million 2002
Tax Revenue	47,173	52,556	56,388
Direct Tax	29,156	34,256	36,801
Indirect Tax	18,017	18,300	19,587
Non-Tax Revenue	14,691	16,455	17,012
Total Revenue	**61,864**	**69,011**	**73,400**

Source: Economic Report 2001/2002, Ministry of Finance

Recent strategies to move the economy forward

We have seen that deficit budgeting has been used and may be used over the next few years to get the economy moving forward after the various hits it has received from the Asian Financial Crisis to the SARS scare. In deficit budgets, planned expenditure would be much greater than planned revenue. Lower tax revenue is raised with the intention of allowing more funds to remain in the hands of the tax payers so that consumption spending would increase and activate the economy. The shortfall in revenue needed to fund the government expenditure is usually raised by the government through domestic or international loans.

A tax measure taken in the 2002 budget, for instance, was the revision in the scale rates effective year of assessment 2002 as well as the slight widening of the chargeable income bands. The objective of this tax measure was to increase disposable income with the hope that individuals will increase their consumption expenditure.

The 2002 Budget had several strategies to get the economy moving. These strategies were:

(1) strengthening economic growth through increased domestic expenditure;

(2) enhancing the role of the private sector and increasing competitiveness;

(3) diversifying growth sources through trade and domestic activities while maintaining the role of foreign direct investment, as well as expanding exports; and

(4) ensuring an equitable distribution of wealth.

Tax incentives in economic development

Tax incentives have been used by many developing countries to attract foreign investment into their country. Home investors are also encouraged to establish production facilities in particular areas through tax related incentives.

A number of tax incentives have been introduced by the government to promote foreign investments and priority industries, particularly projects which are capital intensive, with high value added content and involving new and emerging technologies. These incentives are available to investors under the *Promotion of Investments Act, 1986*.

Offshore companies carrying on offshore business activities are granted preferential tax treatment under the *Labuan Offshore Business Activity Tax Act, 1990*.

To propel Malaysia into a developed nation status, the government has identified various sectors for special treatment, tax wise. The venture capital industry, the K-economy and Information and Communication Technology (ICT) sectors have been identified as new growth sectors which can lead the nation to economic prosperity [Thornton (2002)].

In the case of the venture capital industry, the new incentives offered take two distinct but mutually exclusive forms:

(a) exemption of income for a venture capital company,

(b) deduction available to any company or individual with a business income source

The intention of these exemptions or deductions is to provide incentive for investment in a venture company.

The Government has encouraged the development of the K-economy through various incentives. Companies that have been granted MSC-status are eligible for a bundle of financial and non-financial incentives. Under the financial incentives, a company with the MSC status can expect not to pay tax on its income for a maximum period of ten years. Or the company concerned can opt for 100 per cent investment tax allowance on new investments made in the MSC designated zones. Non-financial incentives include unrestricted employment of foreign knowledge workers, freedom to source capital globally and freedom of ownership.

Summary and Conclusion

Taxation supplies much of the funds necessary for the proper functioning of the government and for the economic development of the country. Through proper taxation, i.e. taxation which does not unduly burden the taxpayer, economic progress can be achieved and sustained.

Taxation is part of the fiscal policy tools available to the government in the management of the economy. Monetary policy is another significant tool of economic management. Governments use taxation not only to raise funds but by offering selective incentives they can foster economic growth in certain designated directions. Governments have also become reliant on foreign direct investment to foster economic growth and often offer attractive tax and other incentives to draw in foreign investment.

Our tax system has been found to have weaknesses in relation to compliance issues and actions have been taken to rectify these issues and to increase effectiveness. This has been done through the phased introduction of self-assessment system and other administrative machinery.

The government on its part has been stimulating the economy since the onset of the Asian financial crisis though fiscal and monetary policies as well as other approaches such as currency control. Basically, the government has had to do pump priming to keep the economy from declining and instead nudge it forward. Taxation's role in all these efforts has been significant.

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Transfer Pricing in Malaysia:
Lessons from developed countries

By Danielle Donovan & Yvonne Chan

1. Introduction

Over the past five years both multinationals and tax authorities globally have increased their focus on transfer pricing. Multinationals are focusing on tax efficient transfer pricing policies that allow them to comply with the national tax laws of the countries they operate within. Tax authorities, on the other hand are focusing on transfer prices to ensure that multinationals are reporting a 'fair share' of tax revenue from their operations in local countries. The underlying principle in securing this fair share is to ensure that the transfer price on traded goods and services within a multinational are set on an arm's length basis.

Many countries around the world have adopted specific transfer pricing legislation in their national tax regimes. This development started with the introduction of legislation in developed countries, such as the United States, and is now rapidly spreading to countries in South East Asia, including Malaysia. This article reviews the development of transfer pricing in developed countries in order to provide an insight into how transfer pricing may develop within Malaysia. This article addresses which companies and what types of transactions are being audited, the level of transfer pricing adjustments and the incidence of double taxation in developed countries.

Currently, in Malaysia, we understand the Ministry of Finance has drafted transfer pricing guidelines that are due to be formalized in the near future. This will especially impact Malaysian multinationals that trade with outbound subsidiaries or have subsidiaries that enjoy tax incentive status within Malaysia. It will also impact upon foreign subsidiaries operating in Malaysia. Furthermore, with the increased level of transfer pricing audits and adjustments in developed countries, more Malaysian companies will be subject to corresponding adjustments on the transactions they undertake with their related companies overseas. Malaysian businesses need to become more aware of the impact of transfer pricing on their operations – the opportunities as well as the cost implications that can arise from regulatory requirements.

2. The global development of transfer pricing

2.1 Why is transfer pricing a big issue?

The globalization of business means that more international trade flows between companies that are under common control than between independent firms. In the early 1990s, the Organisation for Economic Co-operation and Development ("OECD") estimated that more than 60 percent of world trade took place within multinational corporations. That proportion is likely to have increased with the large number of cross-border consolidations.

The transfer pricing set up within a multinational Group can have a very large influence on the profitability (and the taxability) of the Group as a whole. These basic principles are as clear to tax authorities around the world as they are to multinationals. The main interest of tax authorities is to ensure that companies operating in their jurisdiction record an arm's length rate of profit. This not only applies to multinational companies but also to related companies that operate within one national border. From the company's perspective, the transfer pricing set up, if designed appropriately, can ensure companies enjoy optimal operational and tax efficiencies while ensuring compliance with national transfer pricing laws.

2.2 The development of transfer pricing legislation

For many years, tax authorities in most countries, have had the legislative power to make adjustments based on incorrect transfer prices. However, there was a renewed focus on transfer pricing when, in 1995, the OECD published the 'Transfer Pricing Guidelines for Multinationals Enterprises and Tax Administrators'. The Guidelines were written to provide multinationals and tax authorities with a shared understanding of the principles of arm's length pricing on related party transactions and how this principle could be applied and tested in practice.

In the same year, the United States was the first country to introduce specific transfer pricing regulations. These regulations were largely based on the OECD Transfer Pricing Guidelines, however they still maintained important national differences. This has become a recurring pattern around the world, with most countries adopting transfer pricing legislation based on the OECD model.

After 1995, a wave of countries followed the United States example and introduced transfer-pricing legislation. Currently, there are around 20 countries that have adopted specific legislation and the number is growing. The diagram below shows the development of transfer pricing legislation around the world.

Development of Transfer Pricing Legislation[1]

1995	1996	1997	1998	1999	2000	2001	2002	2003
USA	USA Australia	USA Australia Brazil Mexico	USA Australia Brazil Mexico Korea France Canada	USA Australia Brazil Mexico Korea France Canada UK Denmark	USA Australia Brazil Mexico Korea France Canada UK Denmark Belgium	USA Australia Brazil Mexico Korea France Canada UK Denmark Belgium Japan India Argentine	USA Australia Brazil Mexico Korea France Canada UK Denmark Belgium Japan India Argentine Netherlands Poland China Portugal Thailand Indonesia	USA Australia Brazil Mexico Korea France Canada UK Denmark Belgium Japan India Argentine Netherlands Poland China Portugal Thailand Indonesia Germany

It is mainly developed countries, which have moved forward on this issue. Over the past two years however, countries such as India, Thailand and China have introduced transfer pricing legislation. The manufacturing activities of many multinationals are based in countries such as these and governments keen to protect their tax base have introduced these laws for fear that profits are being unfairly distributed to the multinational home country. The major thrust of new legislation is expected to come from the developing world, including South East Asian countries, such as Malaysia.

In most countries, the transfer pricing legislation generally requires that all related party transactions take place on an arm's length basis, and, in most cases, that documentation is prepared that proves that arms length prices are being used. This law can be applicable to transactions with related parties that are both cross border and on shore (within the same country). However, it is observed that the focus of most tax authorities is the cross border transactions.

On a world wide level, for both parent companies and subsidiaries alike, transfer pricing is ranked as the most important international tax issue. This is reported in the 2001 Global Transfer Pricing Survey, a bi-annual publication from Ernst & Young. The survey covers 22 countries[2] and includes 638 interviews with the tax and finance directors from multinational parent companies and 176 interviews with subsidiaries of leading multinational companies. Transfer pricing was ranked above other cross border tax issues such as double tax relief, value added taxes (VAT) and controlled foreign corporation (CFC) rules. This is the effect of new laws being introduced around the world and the increasing incidence of transfer pricing audits.

2.3 Common targets for transfer pricing audits

The observations described in this and the ensuing sections are drawn from the extensive experience of Ernst & Young's Global Transfer Pricing Practice whilst working with clients in countries where the transfer pricing regime is mature as well as those with developing regimes. These observations are also supported by the findings in Ernst & Young's Global Transfer Pricing Survey.

In those countries that have adopted specific legislation, the rule of thumb is, the larger the multinational, the more likely a transfer pricing audit. In most countries, tax authorities have started their auditsby looking at the big name multinationals because it is immediately obvious that they will have a high degree of cross border transactions. Also, the large turnover within these companies means that transfer pricing adjustments can be very lucrative for tax authorities.

In general, targets for transfer pricing audits, fall into one of four categories:

1. Parent Multinationals – these are targeted for audits in their country of residence. Tax authorities scrutinize profit distribution to subsidiaries in relatively low tax jurisdictions. Tax authorities are also interested in how the Head Quarter costs of these companies are being allocated to subsidiaries.

2. Foreign subsidiaries of large multinationals – these are targeted for audits by the local tax authorities, especially those that have a high level of related party transactions. Local tax authorities want to make sure that the local subsidiary is being rewarded appropriately for the role that it plays in generating the Group's profit.

3. Multinational companies that are consistently loss making – these are targeted for audits as tax authorities suspect that the transfer pricing set up is causing the loss. In particular, tax authorities do not look kindly on loss making subsidiaries that carry out routine functions, such as buy-sell distributors.

4. Foreign subsidiaries with volatile profit earnings – these are targeted for audits as tax authorities suspect that it is caused by overly aggressive tax planning within the Group.

In 2001, fifty-nine percent of respondents in Ernst & Young's Global Transfer Pricing Survey, report having suffered a transfer pricing audit somewhere in their global organization. In the countries where the transfer pricing regime is relatively mature, companies face almost a two in three chance of having a transfer pricing audit.

In countries such as the United States, the United Kingdom, Australia and Denmark the attention is still on large multinationals but the focus is increasingly shifting to small to medium sized multinationals. These are companies, which, a few years ago thought transfer pricing was not an important issue; however, they can no longer afford this complacency. For example, the Australian Taxation Office has a dedicated transfer pricing team looking only at small companies with a significant level of related party transactions.

[1] Ernst & Young Global Transfer Pricing Practice
[2] Argentina, Australia, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Italy, the Republic of Ireland, Japan, Korea, Mexico, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States

2.4 *Which transactions are under the most scrutiny?*

The initial focus from tax authorities around the world has been first to look at the over-all profitability of the company and then to concentrate on certain groups of transactions. The transactions that are scrutinized the most by tax authorities are:

1. Management and technical services – these services are provided to most subsidiaries either from the parent or from another subsidiary. Tax authorities in the parent country want to ensure that part of the head quarter cost is being charged out to subsidiaries. For subsidiaries receiving the services, local tax authorities are keen to deny deductions if they do not agree with the charges made to the subsidiary. Management and technical services are so frequently questioned because tax authorities understand how they work and often they are reported as separate items in the tax return or audited accounts.

2. Sale of goods – this is a very common transaction between related companies. Local tax authorities of foreign subsidiaries are very interested in how much income is left in the sales subsidiary after goods have been purchased from a related company and resold to customers. Tax authorities become suspicious that transfer prices are too high if the sales subsidiary is earning only a nominal profit. In general, large amounts of money are at stake if tax authorities make a successful transfer pricing adjustment on the sale of goods. This is because the turnover on the sale of goods is normally quite large.

3. Royalties – these are generally paid to parent companies by subsidiaries, for the use of trade names or technology transfers. The royalties applied to these intangibles are often levied as a percentage on turnover and therefore can represent quite large flows. This is the reason why tax authorities take a special interest in royalty payments. Tax authorities are suspicious of royalties that take out a lot of income from foreign subsidiaries. Conversely, tax authorities in the parent country want to ensure that the intangibles developed by the parent and used by subsidiaries result in a flow of income back to the parent country.

Transfer pricing legislation usually applies to all kinds of related party transactions, including financing, contract services and manufacturing. The three categories listed above are the first areas tax authorities generally scrutinize. The more sophisticated tax authorities become in transfer pricing, the wider the scope of their audit.

2.5 *Transfer pricing assessments and penalties*

If a transfer pricing tax assessment is made, in most countries this assessment will incur penalties. Penalties imposed vary around the world. For example, in Denmark the penalty is a small fee plus a nominal rate of interest for the tax undercharged. However, in the United Kingdom, the penalty can be up to 100 per cent of the tax undercharged. In other countries, it can even be higher. Over recent years there has been an increased number of examinations on transfer pricing issues resulting in adjustments in countries such as Australia, Germany, Japan, Korea, the United Kingdom, and the United States[3].

Not surprisingly, transfer pricing assessments have become a healthy source of income for tax authorities in developed countries. For example, in the United Kingdom the yield is around GBP95 for every GBP1 invested in transfer pricing tax and penalty assessments[4]. The Australian Tax Office has had similar success. In the three years up to 2002, transfer pricing tax and penalty assessments of A$655 million and disallowed losses of A$796 million have been recorded.

Tax authorities are responding to the globalization of business by becoming more global themselves. Tax officials from the countries where transfer pricing was first introduced most notably, the United States, have been training their counterparts in other countries. Training is also being undertaken at an OECD level and a regional level. Tax officials in the Nordic countries such as Norway, Sweden and Denmark are attending the same training sessions and building up relationships with their professional counterparts in neighbouring countries. This kind of practice has two implications. Firstly, the tax authorities are learning to deal with transfer pricing faster than they normally would without such global networking, and, secondly it has created a network for the sharing of information between one tax authority and another. For example, it is not unlikely that a transfer pricing adjustment in a Norwegian subsidiary may soon be followed by a transfer pricing audit in its sister company in Sweden. Tax authorities do talk to each other.

2.6 *Double taxation*

When a country suffers a transfer pricing adjustment in one country, a corresponding adjustment is required in the counterpart country to escape double taxation on the same income. A feature of transfer pricing adjustments, however, is that often companies do not escape double taxation.

According to the Ernst & Young Global Transfer Pricing Survey, of those companies suffering a transfer pricing adjustment in 2001, double taxation resulted in 47 per cent of cases. The countries in which the incidence of double taxation is reported to be highest are Canada, the United States and the United Kingdom. Some companies are not even entering the Mutual Agreement Procedure in order to eliminate double taxation, as they believe it can be too expensive and take too long.

[3] Ernst & Young Transfer Pricing 2001 Global Survey

[4] This figure also includes and thin capitalization tax and penalty assessments. Inland Revenue Annual Report 2002.

2.7 The future

The future for countries that have a relatively mature transfer pricing regime, is an environment of increased audits and more intensive investigations from tax authorities. Tax authorities have invested substantial resources in training their transfer pricing teams and that investment is paying off many times over from earnings on transfer pricing tax and penalty assessments. As tax authorities become more sophisticated, greater scrutiny will be placed on multinational companies.

3. Malaysian expectations

3.1 The current state of play

The Malaysian Inland Revenue Board ("MIRB") is increasingly interested in ensuring that Malaysia secures its fair share of the multinational Group profit. The existing anti-avoidance provision of the Income Tax Act ("ITA"), 1967 empowers the Director General to disregard or vary any transaction undertaken inter alia to avoid or alter the incidence of tax, or hinder or prevent the operation of the ITA and raise additional assessments where he deems fit. In this context, related party transactions are required to be conducted at arm's length. In an effort to address transfer pricing concerns in Malaysia, the authorities have drafted a set of transfer pricing guidelines in late 2001 but have not issued them in its final form. The OECD Transfer Pricing Guidelines will form the basis of the national transfer pricing legislation in Malaysia, just as they have done in most of the developed world.

Under the Malaysian Self-Assessment regime, it is estimated that corporate taxpayers have a one in five chance of being audited by the tax authorities where transfer pricing issues may well be the main focus. Taxpayers bear the onus of ensuring that their related party transactions are reported at arm's length values in their annual tax return, regardless of their treatment in the accounts and the actual price transacted. An understatement of tax may, in a worst case scenario, lead to imprisonment and/or penalties of up to three times the tax undercharged.

3.2 Targeted transactions

Generally, the higher the level of related party transactions disclosed in the tax return (i.e. the Form C), the more attention will be paid to transfer pricing.

Many multinational companies carry on business via manufacturing facilities in Malaysia due to the availability of a wide range of tax incentives available for manufacturing projects in Malaysia. While the tax audits/investigation activities cover all aspects of corporate income tax, there has been an increasing focus on related party purchases and sales of these manufacturing companies. Other targeted areas are head office allocation of costs, management as well as technical services.

3.3 The future of transfer pricing in Malaysia

It is anticipated that the transfer pricing landscape in Malaysia will be developing along similar lines as those of countries such as Australia, on which coincidentally, the Malaysian Self Assessment regime was modelled. Malaysian companies and the MIRB will have to react to build their respective defences when these companies are counter parties to transfer pricing adjustments made in other countries which have more mature or sophisticated regimes.

The Ernst & Young Annual Tax Survey 2002 conducted on a cross section of Malaysian businesses reports that the top three tax issues faced by Malaysian businesses in a global economy were indirect tax (32%), withholding tax (24%) and transfer pricing (22%). Additionally, only a mere 8% of respondents had actually conducted a transfer pricing study of any sort. This contrasts significantly with the 2001 Global Transfer Pricing Survey published by Ernst & Young where transfer pricing was ranked as the top international tax issue faced by multinationals. This disparity is disturbing and perhaps indicates that Malaysian businesses need to become more aware of the impact of transfer pricing on their operations – the opportunities as well as the cost implications which can arise from regulatory requirements.

The Prime Minister concluded in his Budget 2003 Speech that the MIRB would intensify compliance and enforcement efforts to ensure the government's revenue base is not depleted. The experience of developed countries tells us that transfer pricing adjustments are a significant source of revenue for tax authorities and, allowing for some learning curve, the incidence of transfer pricing adjustments in Malaysia is expected to increase over the next few years. Once again the message to corporate taxpayers in Malaysia is subtle and yet clear – be prepared - just as the authorities are increasing their attention to transfer pricing policies, the corporate world must be proactive in focusing their own resources to ensure their affairs are in place.

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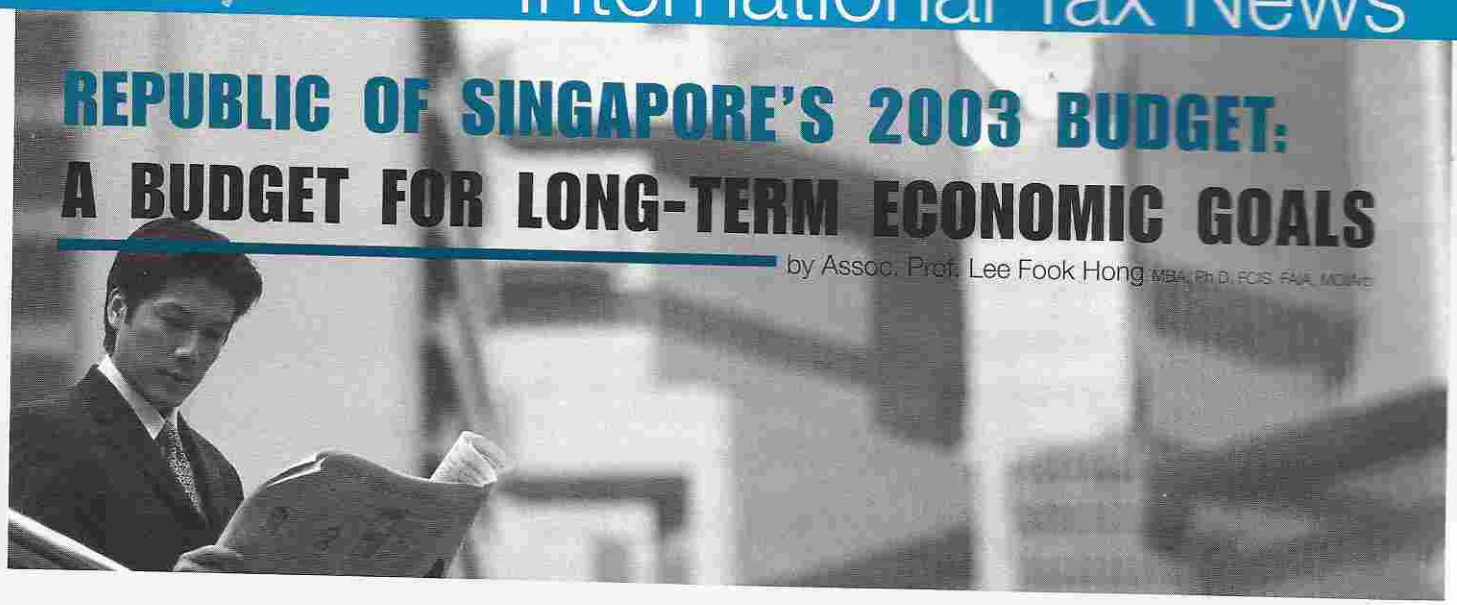
Note: The views expressed in the article are the personal views of the authors.

REPUBLIC OF SINGAPORE'S 2003 BUDGET: A BUDGET FOR LONG-TERM ECONOMIC GOALS

by Assoc. Prof. Lee Fook Hong MBA, Ph.D, FCIS, FAIA, MCIArb



The Finance Minister, Lee Hsien Loong, presented Singapore's Budget for the year 2003 in Parliament on 28 February 2003.

The Minister reported that the Singapore economy had grown by 2.2% in 2002 despite the prevailing unfavourable conditions. However, the unemployment problem has not improved very much, and particularly vulnerable will be those older and less educated workers who fail to upgrade their skills.

The Minister said that the cause of the major uncertainty hanging over the world economy at present, was the prospect of war in Iraq. As a result, consumers are holding back their spending, and companies are delaying investment plans because of the instability of oil prices.

With regard to the global economy, the Minister pointed out that growth in Europe and Japan is expected to remain sluggish in 2003, while the US may register better growth than in 2002. On the regional prospects, he said the economic demand in East Asia should stay robust especially in the large and rapidly growing market in China.

Given the external conditions, the Minister expected Singapore's economy to continue to grow slowly in the first half of 2003 and then pace a quicker rate in the second half if the US economy and the global electronics industry strengthen.

In addition to the external factors, the Minister cautioned that the Singapore economy faced not just economic volatility but also political and security uncertainties. In order to embrace the keener competition and faster coming changes, economic restructuring will be inevitable to stay in the race, said the Minister.

Looking ahead, the Minister had expected the Singapore economy to grow more slowly after the present economic slowdown. He emphasised that the Singapore economy must stay flexible, adapt quickly to changing conditions and technologies and continue to upgrade its economic capabilities. The budget, according to the Minister, is designed to tackle the pressing economic challenges at hand, as well as to set the stage for the countries long-term goals.

TAX CHANGES

In his announcement on the proposed tax changes, the Minister explained that most of the measures and incentives introduced were aimed at restructuring Singapore economy and developing new strategies for continued prosperity.

The tax changes announced are as follows:

I. TAX CHANGES FOR COMPANIES AND BUSINESSES

Foreign Income

As more companies globalise and earn a larger share of their income from overseas operations, simplifying the tax treatment of foreign income will make Singapore a more attractive business hub.

With effect from 1 June 2003, all foreign income in the form of dividends, branch profits and services income will be exempt from tax when remitted into Singapore.

The exemption will be available to both corporate and individual taxpayers but will only apply to income earned from jurisdictions with a headline tax rate of at least 15%.

Concession for Enterprise Development

Some of the expenses incurred by businesses before trade revenue is earned may not be eligible for tax deduction. With effect from the Year of Assessment 2004, the first day of the accounting year in which a business earns its first trade revenue will be regarded as the point at which the business starts trading.

All revenue expenses incurred during the accounting year will qualify for tax deduction.

Revised Overseas Investment Incentive

At present, the Overseas Investment Incentive allows an approved company to deduct losses arising from the sale of investments or liquidation of an approved overseas investment against its statutory income.

To encourage companies to expand overseas, the incentive will be revamped to allow an approved company to defer its income taxes for two years if its approved overseas investment incurs operating losses during the first three years of investment.

The revised incentive will apply to all new investments made from 1 January 2004.

Intellectual Property

a) *Royalty Income*

To encourage firms to hold their Intellectual Property rights in Singapore, the Unilateral Tax Credit Scheme will be extended to royalties remitted from all non-treaty countries with effect from the Year of Assessment 2004.

b) *Intellectual Property Acquisition*

At present, companies can apply to the Economic Development Board or the Infocomm Development Authority of Singapore for writing-down allowances over a five-year period for capital expenditure incurred in acquiring intellectual property.

To promote international intellectual property holding in Singapore, writing-down allowances for Intellectual Property acquired on or after 1 November 2003 will be granted automatically, conditional however, upon the legal and economic ownership of the Intellectual Property resting with a Singapore entity.

c) *Patenting Costs*
To further encourage more companies to patent their inventions and make Singapore an attractive base for Intellectual Property management, the costs incurred on or after 1 June 2003 for patenting an invention will qualify for tax deductions.

d) *Foreign Income for R&D*
To increase the stockpile of funds for R&D activities conducted in Singapore or controlled from Singapore, a new R&D incentive will be introduced with effect from 1 June 2003. Under the new incentive, companies will be granted tax exemption on foreign sourced royalties and interest income, that are used for R&D purposes.

e) *Provision of Information and Digitised Goods*
With effect from 28 February 2003, payments made by end-users to non-resident persons for online information and digitised goods will be exempt from withholding tax.

Integrated Industrial Capital Allowance
Corporate groups increasingly split their activities across geographical boundaries. To accommodate this business model, an "Integrated Industrial Capital Allowance" incentive has been introduced from 1 March 2003.

Under the incentive, companies will be allowed to claim capital allowances on equipment that is used by their subsidiaries outside Singapore.

Upfront Land Premium for Lease Land
Currently, tax deductions are granted for the upfront land premium paid by lessee in respect of designated lease provided the lease tenure is not more than 30 years.

To encourage companies to undertake investments in Singapore over longer periods, the current 30-year lease tenure restriction will be extended to a 60-year limit with effect from the Year of Assessment 2004.

Private Wealth Management
To encourage further development of world-class trustee and custodian services in Singapore, the following changes will be introduced:

a) Income tax exemption will be extended to foreign trusts administered by all trust companies in Singapore, and not just those administered by the Approved Trustee Companies (ATC), from Year of Assessment 2004.

b) By 1 June 2003, the existing list of designated investments and specified income under the Approved Trustee Companies Scheme will be replaced with an exclusion list.

c) To reduce compliance costs for trust companies currently having to comply with different sets of foreign trusts and the zero-rating of trustee services provided to foreign trusts, the set of conditions will be aligned for both from 1 June 2003.

d) The current GST relief provision in respect of trustee services will be extended to trust administration services provided by a Singapore trust company to a foreign trust of which it is not the trustee from 1 June 2003.

Approved Marine Hull and Liability Insurer Scheme
The Approved Marine Hull and Liability Insurer Scheme currently provides tax exemption for income derived by approved marine hull and liability insurers from writing offshore marine hull and liability insurance business for a period of ten years.

To further encourage the development of marine expertise in Singapore, the Scheme will be extended to cover income derived from writing onshore marine hull and liability insurance business with effect from Year of Assessment 2004.

Approved Third Party Logistic Company Scheme
The Approved Third Party Logistic Company Scheme will be introduced from 1 January 2004. Under the scheme qualifying companies can import goods belonging to them or to foreign principals without payment of GST.

In addition, these companies can also move goods to their customers who are under the Major Exporter Scheme, and other qualifying companies under the same scheme, without charging GST. This scheme will take effect from 1 January 2004.

Enhanced Global Trader Programme
All qualifying trade income under the Global Trader Programme is currently taxed at a 10% concessionary tax rate.

To further encourage international trading in Singapore, the present incentive will be enhanced and expanded from 28 February 2003. Under the enhanced scheme, an approved global trading company would be granted concessionary tax rates of between 5% to 10% on qualifying offshore trade income, depending on the company's turnover and business spending.

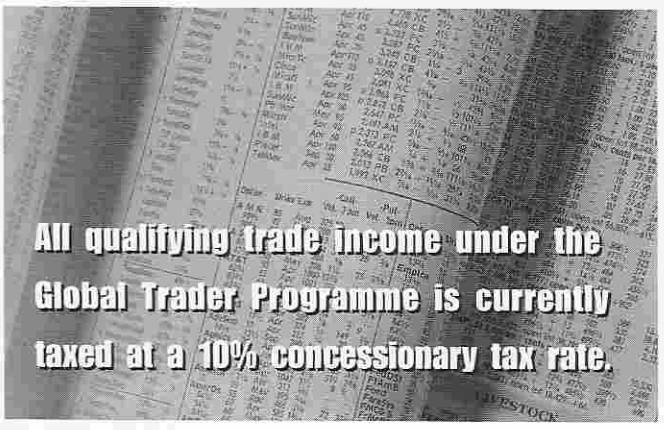
Extension of Tax Holiday for the Singapore Commodity Exchange (SICOM)
To enable SICOM to compete with other emerging exchanges in the region, the tax holiday for SICOM will be extended for another five years with effect from the Year of Assessment 2004.

Submarine Cable Capacity
To encourage telecommunication operators to provide international connectivity, payments for the use of submarine cable capacity operated by non-resident persons will be exempt from withholding tax from 28 February 2003.

In addition, writing-down allowance will be available for payments for the purchase of Indefeasible Rights of Use on submarine cable system with effect from the Year of Assessment 2004.

Overseas Talent Recruitment
To encourage employers support the additional cost of relocating top talent together with their family, the further tax deduction limit will be increased from $15,000 to $25,000 for P1 employment pass holders, and from $5,000 to $15,000 for P2 employment pass holders.

The cap of the total tax deduction an employer can claim for qualifying relocating expenses has been revised upwards, from $150,000 to $275,000 with effect from 28 February 2003.



The Approved Marine Hull and Liability Insurer Scheme currently provides tax exemption for income derived by approved marine hull and liability insurers from writing offshore marine hull and liability insurance business for a period of ten years.

TAX CHANGES FOR INDIVIDUALS

Interest Income

With effect from Year of Assessment 2004, interest income from POSBank deposits earned by individuals will be exempt from income tax.

Course Fee Relief

The course fee relief will be increased from the present $2,500 to $3,500 with effect from the Year of Assessment 2004.

In addition, the scope of the relief has been expanded to include seminars and conferences. Courses that are not directly related to taxpayer's current profession can still qualify for the relief provided the taxpayer can establish that the courses resulted in a career switch to a relevant job within a period of two years.

OTHER TAX CHANGES

Tax Deduction for more donations

With effect from 1 April 2003, donations of buildings and parcels of land to Institutions of a Public Character (IPCs) will qualify for tax deductions.

All donations of immovable properties and shares to IPCs have been exempt from stamp duties from 28 February 2003.

In addition, three enhancements will be made to Public Sculpture Donation Scheme from 1 July 2003.

Property Tax & Rental Rebates

The existing property tax and rental rebates have been extended to cover the period from 1 July 2003 to 31 December 2003. The amount of the property tax rebate has been revised to $2,000 plus 15% of the balance payable for the period.

Duties on Tobacco and Liquor

The excise duty on cigarettes has been increased from $210 to $255 per kilogram with effect from 28 February 2003.

The excise duty on different types of liquor has also been adjusted with effect from 28 February 2003.

Reduction in Motor Vehicle Taxes

Due to a change in basis for valuing motor vehicles, the Additional Registration Fee (ARF) and excise duty payable for most vehicles will be decreased by 3% to 5%.

The change will take effect from 1 April 2003.

Excise Duties on Petrol

With effect from 28 February 2003, the excise duties on petrol have been imposed at a specific rate which would no longer fluctuate with oil prices.

Diesel Tax for Taxis

The reduction on the diesel tax for taxis announced in 2001 has been extended by another six months.

Stamp Duties

With effect from 1 April 2003, leases with annual rents that do not exceed $1,000 will be exempted from stamp duties.

The seller's stamp duty imposed on the sale of residential properties within three years of purchase has been abolished.

Rebates for Service & Conservancy Charges (S&CC) and Utilities Save Scheme

As part of measures to offset the GST increase, the rebates on S&CC have been enhanced.

The Utilities Save Scheme has also been extended for one more year.

Childcare Benefits

In line with the government's effort to promote pro-family practices in the workplace, all employer-subsidised childcare benefits paid to licenced childcare centres will be exempt from income tax with effect from the Year of Assessment 2004.

CONCLUSION

In his conclusion, the Minister pointed out that in a rapidly unfolding world situation, it was necessary to adjust some of the economic policies and to restructure the economy so as to better face a changed world order. He said the purpose of restructuring was to find new growth sectors and create new jobs and this Budget would help to overcome the new challenges and to set fresh goals for the long term.

The Author

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Malaysian Institute of Taxation
Budget Memorandum 2004

In response to the invitation of the Ministry of Finance, the Malaysian Institute of Taxation (MIT) is pleased to submit this Memorandum which we hope will contribute to achieving this year's theme of "**Mitigating Destabilising External Environment and Ensuring Sustainable Growth**"

This year's theme shows that the Malaysian Government is acutely aware of the external factors that affect our local economy and the MIT applauds the Malaysian Government for initiating steps to counter any detrimental effect on the economy.

MIT would like to forward our proposals which are broadly categorised into the following headings:

A) Attracting Investments
- A1. One Stop Centre for Group Activities
- A2. Malaysian Corporate Tax Rate
- A3. Strengthening the Fundamentals of the K-Economy and E-Commerce
- A4. Group Relief
- A5. Deduction of Promotional Expenses
- A6. Promoting Growth in Small and Medium Enterprises (SMEs)
- A7. Measures to Revitalise the Construction Sector
- A8. Deduction of Expenditure to Provide Child Care Facilities in the Work Place

B) Operational issues
- B1. Excess Income Tax Paid
- B2. Service Tax Payable on Amounts Received
- B3. Electronic Filing of Tax Returns
- B4. Real Property Gains Tax (RPGT)
- B5. Withholding Tax on Reimbursements

C) Streamlining the self assessment regime
- C1. Estimation of Tax Payable
- C2. Revision of Estimation of Tax Payable

D) Regulation of tax agents

A) ATTRACTING INVESTMENTS

With the ever increasing competition for Foreign Direct Investment (FDI) and the opening up of investment regimes by other neighbouring countries and China, the government must continue to fine-tune investment policies and strategies to attract the right kind of FDI from both new and existing investors.

Compared to other tax regimes, the current Malaysian tax legislation generally provides comprehensive and wide ranging incentives (double deductions, pioneer status, etc.) for investment in Malaysia. In order to fine tune our investment climate, MIT offers the following proposals to make Malaysia an attractive location for investors.

A1. One Stop Centre for Group Activities

We are of the opinion that the incentives in Malaysia are not reflective of global changes in business trends as companies are beginning to seek places of business which are able to cater to the needs of the **entire activities of a group of companies**.

Potential investors no longer approach a country based on selective tax breaks but instead review a prospective place of investment based on tax incentives that will benefit the entire group operations to be relocated, i.e. the manufacturing activity as well as, the marketing activity, distribution activity, after-sales activity, etc. of the entire group.

Although, Malaysia does provide comprehensive tax incentives, potential investors are only able to enjoy the tax benefits provided the potential investor is able to "fit in" the investment into one of the pre-set "pigeon holes" or criteria for such incentives. Any other activity outside the pre-set criteria for incentives will be rejected, irrespective of whether the activity concerned was part and parcel of a huge group investment into the country.

In certain neighbouring countries, tax incentives are not only granted based on pre-set criteria, but also given as a holistic tax break for the entire investment, irrespective of the eligibility of each separate i.e. the whole range of activities are treated as qualifying for the incentive.

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

In short, there should be a single authority to grant tax incentives to all companies which are part of a conglomerate investing in Malaysia, without having to segregate each activity.

This will allow global conglomerates to consider Malaysia as an attractive place of business for the **entire operations**, rather than, attracting *piece meal* investments which are mainly manufacturing based.

A2. Malaysian Corporate Tax Rate

We wish to highlight that under globalisation, capital and skilled labour are more mobile and therefore more inclined to locating to lower tax environments. Studies have found that the average effective tax rates of countries have an influence over multinational corporations' choice of investment location.

The last reduction in the corporate tax rate in Malaysia was for the year of assessment 1998. Since then, many nations around the world have been actively reducing their corporate tax rates in order to compete for Foreign Direct Investments (FDIs).

In recent years, the OECD and European Union countries have been leading the drive for lower tax rates, as they seek to narrow the tax rate "gap" between themselves and the less developed countries. For example, the average corporate tax rate for OECD and EU countries was reduced by about 5 percentage points from 1997 to 2002.

Lowering of the corporate tax rate will improve the competitiveness of the country as well as provide more funds to the private corporate sector which can be reinvested into the economy, thereby generating internal growth. Internal growth will spur the local economy and with the multiplier effect, more funds will become available locally.

Therefore, the lowering of corporate tax rates can provide the impetus for locally driven growth. This growth will lead to the collection of more taxes by the Government and in time to come, the nation will be more self reliant and the sustainable growth will be less dependent on external factors. This is in line with the Government's aspirations to be less dependent on FDIs for generating growth in Malaysia.

To this effect, we propose that our corporate tax rate be reduced from 28% to 25%.

We acknowledge that the Government is concerned about the impact on revenue collection if there is a reduction in tax rates.

In the mid-1990s, there was a significant reduction in the corporate tax rate by 4% within a time-frame of two years. Yet, statistics have shown that there was an improvement in the total Federal Government revenue collected from corporations and an increase in Gross Domestic Product (GDP) in the context of a growing economy.

Year	Corporate Tax Rates	Percentage Increase in Revenue	GDP Growth
1993	34%	13.6%	8.3%
1994	32%	23.5%	9.2%
1995	30%	10.8%	9.5%

It is evident from past experience that a reduction in the corporate tax rates has had a positive impact on the nation's GDP growth and tax revenue.

Thus, a reduction in the corporate tax rates will directly or indirectly:

- Spur new investment expenditure as the rate of return on investment increases, and importantly, it will improve the competitiveness of Malaysian businesses in the world market.
- Attract new investments and significantly improve price competitiveness, which has fallen due to factors such as increased labour costs, etc.
- Leave more money in the hands of corporations and individuals for re-investment and consumption spending.

A3. Strengthening the Fundamentals of the K-Economy and E-Commerce

The vision of Malaysia being a fully developed, matured and knowledge rich society by the year 2020 has lead to the creation of the Malaysian Multimedia Supercorridor (MSC).

Being an open economy, Malaysian's future prospects will be influenced greatly by the developments in the international arena.

Generally, our future macroeconomic strategies to be adopted will aim at promoting sustainable growth, developing economic resilience as well as, increasing productivity and competitiveness. Hence, the Government will be increasing efforts to position Malaysia as a competitive knowledge-based economy, with Information and communications technology (ICT) facilitating future development.

MIT proposes that, as part of the move to ensure continuous growth in the private sector in the years to come, the Ministry take into consideration the current effect of electronic commerce (e-commerce) on domestic businesses.

The Internet has opened a gateway for enterprises around the world to trade via e-commerce. The e-commerce market was estimated to have increased from USD 1 billion in 1998 to USD 6 billion in 2000 in the Asia Pacific region. E-commerce has not only affected business and individual consumers, but it has also reshaped market places, trading relationships and even international tax boundaries.

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i) Framework on E-Commerce and its taxation

E-commerce in Malaysia is still very much in its infancy and its related tax issues are still relatively unexplored and there are no guidelines locally on the tax treatment of e-commerce transactions. Businesses loath such uncertainties and the lack of a proper tax framework creates a situation where investors from local and foreign institutions alike are not willing to undertake e-commerce activities without some degree of certainty.

A timely, simple and consistent domestic tax framework basically encompassing the tax treatment of e-commerce transactions will greatly assist in promoting a dynamic private sector.

Hence, in order to promote the growth of e-commerce in Malaysia, **MIT proposes that a working group or task force be instituted to deal with domestic tax issues relating to e-commerce in Malaysia, and to prepare an initial paper or framework on taxation of e-commerce**

MIT is willing to contribute its services to such a working group.

ii) Attracting foreign Knowledge Workers

Akin with the incentives to attract essential managerial personnel to Labuan, MIT would like to propose that similar incentives be introduced for knowledge workers in the MSC.

It is proposed that foreign knowledge workers employed in the MSC be granted an **exemption of 50% of their income** from such employment exercised in the MSC. The incentive could be granted to employment income in relation to the years of assessment 2004 to 2009.

This incentive is aimed at increasing the number of foreign knowledge workers in Malaysia and in particular, the MSC. The presence of foreign knowledge workers will inevitably lead to a transfer of knowledge and technology to local knowledge workers. In turn, Malaysia will then possess its own pool of local knowledge workers that are able to compete internationally.

iii) Personal Rebates for Purchase of Personal Computers (PCs)

In 1998, as a means to promote the acquisition of personal computers and computer literacy, the Government allowed an individual a single tax rebate of RM400, once every 5 years. In addition, the government aspired to a 'one home, one PC' policy and had allowed individuals to withdraw from the Employee Provident Fund (EPF) to purchase a PC.

PC's qualify for capital allowances for a business concern and the capital expenditure is expensed off by way of initial allowances and annual allowances within a 2 year period. The logic for allowing a business entity to claim the expenditure within 2 years is due to the rapid obsolescence of PCs. Moore's theorem states that the computing power doubles every 18 months and the development in computer technology has thus far proven this theory. In 2001, the average processing speed of the computer chip was 200 to 350 megahertz. The current most powerful computer chip is capable of well in excess of 3 gigahertz or 3000 megahertz. The advancement of information technology rapidly makes PCs obsolete within 2 years.

However, an individual is only allowed to claim the rebate once every 5 years and this is inconsistent with the treatment granted to business concerns. Individuals should be quipping themselves with the latest technology. Thus, greater incentives and promotions should be enacted by the Government to promote the acquisition and use of computers in Malaysia.

As such, **MIT proposes that the tax rebate be increased to RM1,000** and an individual be allowed **to claim the rebate once every 2 years.**

iv) Rebate and Deduction for Computer Software

The rate of piracy of computer software remains high in Malaysia despite the Government's efforts to crackdown on offenders. The high rate of piracy does not reflect well on the nation and as such, the Government must concentrate is efforts in promoting the use of original software.

Therefore, MIT proposes that the cost of purchasing **shrink-wrapped software** or its licences (cost of developing proprietary and custom software excluded) **be allowed as outright deduction** against income in one year, as compared to the present situation where they will be claimed as capital allowances in 2 years. This is merely an accelerated claim for deduction of an expenditure incurred and is therefore, inconsequential to the tax revenue collected by the Government.

The promotion to use original software should also extended beyond the business circle to the homes of individuals. Therefore, MIT proposes that a **rebate of RM500 be granted to individuals for the purchase of original software** and in line with our proposal on the rebates for purchase of PCs, be **granted once every 2 years.**

The deduction and rebate will induce businesses and individuals to purchase original software and reduce the domestic demand for pirated goods. It will demonstrate to the international community Malaysia's resolve to stem out software piracy.

A4. Group Relief

Under current tax law, (with the exception of a company undertaking an approved food production project) each company within a group is considered as a separate tax legal entity and is taxed independently. The losses from one company cannot be used to offset the taxable profits of another company within the same group.

As the Malaysian economy develops and in light of the ever encroaching effects of globalisation, group entities will become more prevalent and it is now essential for our tax regime to acknowledge the economic reality of group companies.

In fact, our economic planners have recognized the viability of an integrated group entity, as seen in the Second Industrial Master Plan (1995-2005) which sets out a more integrated approach to industrial development in the use of the "cluster-based" paradigm. Essentially, instead of distinct industries, seven industrial clusters or groups of related industries have been identified for further development in totality, namely :

(a) Electrical & electronics industry
(b) Transportation industry
(c) Chemicals industry
(d) Textiles & apparel industry
(e) Resource-based industry
(f) Materials & advanced materials industry
(g) Agro-based & food products group

The cluster-based approach focuses on supplies of raw material, distribution, packaging and marketing to move industries from original equipment manufacturing to higher value-added activities that include indigenous design and branding.

Fundamental to this approach is the recognition of a "group of companies" as a single interacting-cohesive entity, so as to enhance the competitiveness of the above selected clusters.

Furthermore, under the 8th Malaysian Plan efforts will continue to focus on achieving higher *business-linkage* effects between the distributive trade and other sectors, which results in a greater variety of goods and services produced locally.

In particular, the *linkages* with the agricultural and manufacturing sectors will continue to be emphasised as the marketing and distribution activities account for a significant portion of consumer price and make a major contribution to national employment and income.

To effect the above cluster/linkages concept and improve group competitiveness, MIT proposes that **Schedule 4C (i.e. group relief) of the Income Tax Act, 1967 be extended to all Malaysian companies.**

This will entail an amendment of sch. 4C of the *Income Tax Act, 1967* as follows:

> Subject to this Schedule, a company resident in Malaysia in the basis year for a year of assessment may surrender its adjusted loss, in full or in part, in the basis period for that year of assessment, to one or more related companies resident in Malaysia in the basis year for that year of assessment.

It is therefore recommended that group relief in our corporate tax system be extended to allow corporate groups to utilise the losses of one company against the profits of another company within the same group. This will give companies flexibility to start new activities through subsidiaries and contribute to a more supportive environment for new ventures.

A5. Deduction of Promotional Expenses

In the recent Budgets, the Government has been aggressively advocating Malaysian brands and exports in the international market by way of tax incentives and double deductions for advertisements, promotions, etc.

However, current Malaysia tax legislation appears to be contradictory to the above policy by its definition of "entertainment expenses".

Currently "entertainment" under sec. 34 of the *Income Tax Act, 1967* is defined to include:

i) the provision of food, drink, recreation or hospitality of any kind; and

ii) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in (a) above.

With effect from year of assessment 1995, the *Income Tax Act, 1967* was amended to *exclude from the definition of entertainment promotional gifts* consisting of articles incorporating the conspicuous advertisement or logo of the company.

However, the *Income Tax Act 1967*, is silent on the tax deductibility of domestic advertising and promotion expenses.

Since the introduction of non-deductibility of entertainment expenses, the Inland Revenue Board has adopted a wide interpretation of entertainment with the result that certain advertising or promotion expenses incurred for the purposes of business have been regarded as "entertainment" and not allowed for tax deductions.

Non-deductibility of these advertising and promotion expenses (such as the provision of incentives to dealers/salesmen who meet sales targets, etc) has increased the cost of doing business for companies as these expenses are necessarily incurred to increase sales of products or services.

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

A6. Promoting Growth in Small and Medium Enterprises (SMEs)

The 2003 Budget recognised the need to make the Malaysian economy more resilient to external factors by promoting the growth of local SMEs. The corporate tax rate was reduced to 20% on the first RM100,000 of chargeable income for SMEs with a paid-up capital of less than RM2.5 million.

To this effect, the global development in the first few months of this year, namely the war in Iraq and the spread of SARS, demonstrated the importance of promoting internal growth and becoming less reliant on external sources.

In order to further promote the growth of the SMEs sector, MIT proposes that the threshold for the 20% tax rate be increased to **RM500,000.**

A7. Measures to Revitalise the Construction Sector

The construction sector is arguably one of the most important sectors as it possesses a multiplier effect on the economy.

Therefore, MIT proposes the following measures to boost the construction sector:

i) Extend building allowances to the commercial sector

Currently, industrial building allowance and building allowances are granted for selected industries and purposes such as child care facilities, manufacturing business, hotel or tourism business, old folks centre and for educational institutions.

The allowance is offered at a rate of 3% per annum on the cost of construction or purchase. However, other buildings including office building do not qualify for the allowance.

MIT proposes that **building allowance be granted to all buildings used by businesses** in order to encourage businesses to purchase their own premises and indirectly **reduce the overhang and surplus in the property market.**

ii) Deduction of interest on home loans for individuals

With regard to residential properties, it is proposed that individuals be allowed to **deduct interest that they incur on home loans against their chargeable income.** The deduction could be limited to the taxpayer's own home. In addition, this deduction should apply only to a household, i.e., where a husband and wife are assessed separately, only one of them will be entitled to the deduction.

A8. Deduction of Expenditure to Provide Child Care Facilities in the Work Place

The cost of labour is continuing to rise in Malaysia. This has indirectly affected Malaysia's competitive cost advantage in the international arena. Therefore measures must be taken to arrest the rise in the cost of labour, if not reduce it, in order to maintain Malaysia's competitiveness and this can be partly achieved through increasing our workforce to cope with the demand for workers.

Women comprise a large percentage of the work force. Unfortunately, women often leave the workforce upon giving birth to a child. The main reason behind their leaving is the need to take care of their children and the lack of child care facilities in the workplace.

Employers in Malaysia are reluctant provide child care facilities due to the restrictive regulatory requirements and the high costs involved. As a result, the workforce loses the services of these women who leave the workforce to take care of their children. This affects the entire spectrum of the workforce, from the unskilled to the semi-skilled and skilled workers.

MIT proposes that in order to attract these women back into the workforce, the following measures could be adopted:

i) Create a **one-stop approval centre** for employers to seek approval to set up an in-house child care facilities for their employees. A **clear set of guidelines** must be drawn in order that the employers are clear on the requirements to set up such facilities for their employees. While these guidelines are meant to protect the interest and welfare of mother and child, they must not be too restrictive as it will then become a deterrent for employers to provide child care facilities in the workplace.

ii) Grant a **double deduction for the expenditure incurred** to set up these facilities and the expenditure incurred in operating such facilities.

MIT believes that the promotion of child care facilities in the workplace will attract women with children to remain in the workforce, thereby reducing the strain of the rising cost of labour which will affect Malaysia's competitiveness internationally.

B. OPERATIONAL ISSUES

B1. Excess Income Tax Paid

Under self assessment and sec. 107C of the *Income Tax Act 1967*, a taxpayer would submit an estimation of the tax payable and pay that amount in instalments during the basis period. In essence, the taxpayer is making tax payments as the applicable profits are derived.

Section 107C(3) provides that the estimation of tax payable may not be lower than the tax payable for the immediate preceding year of assessment. In situations of economic downturn, the estimated tax payable is often lower than the immediate preceding year. However, due to the proviso in sec. 107C(3), a taxpayer is often compelled to pay instalments based on the tax payable for the immediate preceding year which is higher. As a result, the taxpayer will have overpaid it tax.

Such excess payments are funds which would have been available to the taxpayer for reinvestment to generate more income. These funds would have been funds used by the taxpayer to generate the much needed internal growth that is desired by the Malaysian Government. Unfortunately, these funds are unavailable to the taxpayer. They are funds that are locked up and are non-productive and derive no economic benefit for the taxpayer nor generate any growth for the Government.

In practice, there is a certain period of time taken to confirm and verify the amount of tax credit and subsequent to that, additional time taken to process the refund. In the past the additional time taken to process the refund can be shortened, if the taxpayer requests for the tax credit to be set off against some other tax liability.

However, the Inland Revenue Board has recently changed the administrative procedures whereby the set off against tax liability would be allowed only in very limited circumstances. An anomaly arises because the taxpayer has tax credit available, but is required to pay other tax liabilities whilst the tax credit is being processed to be refunded. The refund could take 9 months to more than a year before the taxpayer will receive it. In the meantime, the taxpayer loses interest on these funds which could be utilised to generate growth for the taxpayer.

The Inland Revenue Board has a charter to refund overpayments within 3 months upon the request of taxpayers. MIT proposes that the **taxpayer is compensated for the loss of the use of the funds by way of 5% tax rebate on the overpayment**. The rebate is proposed to be **levied after the expiration of the 3-month period**. This proposal is also intended to encourage efficiency in the Inland Revenue Board in processing refunds.

B2. Service Tax Payable on Amounts Received

Currently, sec. 14 (2) of the *Service Tax Act 1975*, states that where the whole or part of the payment for the taxable service provided is not received by the service provider within 12 months from the date of the invoice, the service tax shall be due on the day following that period of twelve calendar months.

In essence, a service provider is under an obligation to pay the service tax within 12 months from the issuance of the invoice, irrespective whether the payment has been received or not. It is inequitable to require a service provider to pay the service tax before receiving any payment for the services rendered.

The service provider is already encountering difficulties by having to absorb the total cost incurred by the services rendered to the defaulting client and is further burdened by having to pay, a 5% fee irrespective of the amount outstanding.

Furthermore, the likelihood of recovering the payment in circumstances where the payment has been outstanding after a 12 month period is low. Therefore, there is a very high chance that a service provider may have to write off the debt. In such a situation where the service tax has been paid pursuant to sec. 14(2) of the *Service Tax Act 1975*, the service provider has to seek a refund of service tax paid. This is onerous, time consuming and places additional burden and administrative work for both the service provider and the Government.

Therefore, MIT would like to recommend that sec. 14(2) of the *Service Tax Act 1975* be deleted and service tax should be due and payable when the service provider receives the payment for the services rendered.

B3. Electronic Filing of Tax Returns

Electronic filing of income taxes has yet to be introduced in Malaysia. Based on the responses we have received from our members, we have drawn the following conclusions:

- the general public has the perception that electronic filing is not secured and confidential data may hacked and retrieved
- there is no incentive to file electronically as there are no benefits from electronic filing
- unstable software and fear of being subjected to penalties for non-filing resulting from failure of software through no fault of the taxpayer

Electronic filing of tax returns, when it is introduced, could experience an extremely slow take up rate. This could be detrimental to the Government's intention to promote electronic government. Electronic filing could be very efficient and effective if introduced and if it is accepted by the taxpayers.

In order to ensure that electronic filing is a success, MIT proposes that a detailed study be undertaken to offer some form of incentive for taxpayers who file their tax returns electronically and to promote its usage.

B4. Real Property Gains Tax (RPGT)

Presently, RPGT is imposed on companies at the rate of 5% on the gains on disposal of real property in the 5th year of acquisition and thereafter. RPGT is imposed on the capital gains of companies regardless of the time that the real property is held. Individual taxpayers, on the other hand, are subjected to RPGT on gains on disposal of real property up to the 5th year after the date of acquisition. Gains on disposal for real property disposed by individuals in the 6th year after the date of acquisition are not subjected to RPGT.

One of the objectives of RPGT is to curb speculation in real properties. Properties purchased and disposed after 5 years are unlikely to have been acquired for speculation. As such, MIT proposes that **RPGT imposed on companies to be in line with RPGT imposed on individuals and should not be subjected to RPGT for properties disposed in the 6th year after the date of acquisition.**

B5. Withholding Tax on Reimbursements

The Inland Revenue Board has taken the position that reimbursements of out-of-pocket expenses made to a non-resident would be subject to withholding tax under sec. 109B.

It is submitted that such a situation should not be applicable:

(i) where the Malaysian taxpayer directly bears/pays the out-of-pocket expenses instead of the non-resident; and

(ii) where the non-resident bears/pays the out-of-pocket expenses which are later reimbursed by the local entity, provided that such expenses can be substantiated by documentary evidence such as receipts, invoices, etc.

We would like to reiterate that if the Government intends to enhance Malaysia's competitiveness and to encourage the setting up of hubs, it is essential that the cost of doing business not be increased through insisting that such reimbursements be subjected to withholding tax.

Hence, MIT would like to propose that the reimbursements of expenses be excluded from the ambit of withholding tax under sec. 109B of the Income Tax Act, 1967 as the objective of sec. 109B(1)(b) is to tax the fees for "technical services" rendered by a non-resident consultant and to tax disbursements will only add to the total cost of the entire project. Alternatively, it is suggested that 'gross income' be defined to exclude disbursements/reimbursements.

C) STREAMLINING SELF ASSESSMENT REGIME

The self assessment system is essentially a process which requires taxpayers to determine their own taxable income, compute the tax liability, submit their tax returns and pay their taxes to the Inland Revenue Board.

MIT wishes to propose the following measures to streamline the current provisions of the self assessment regime:

C1. Estimation of Tax Payable

Section 107C(1) and (2) of the *Income Tax Act, 1967* (the Act) provides that every company shall for each year of assessment furnish to the Director General of Inland Revenue (DGIR), an estimate of its tax liability not later than 30 days before the beginning of the basis period. Section 107C(3) goes further to state that the estimate of tax payable ("ETP") for a particular year cannot be lower than the tax payable for the immediately preceding year of assessment.

In practice, the DGIR has granted concessions (on a case to case basis) on the appeal of the taxpayer, for an ETP which is lower

than the tax payable of the immediately preceding year of assessment. The DGIR, by virtue of the powers granted in sec. 107C(8), issues a directive to the taxpayer to make instalment payments in such amounts that the DGIR sees fit.

Section 107C(7) provides that an ETP submitted to the DGIR under sec. 107C(1) and (2) may be revised once in the sixth month of the company's financial year. However, sec. 107C(7) is silent on a directive issued by the DGIR under sec. 107C(8). Therefore, where a taxpayer submits an ETP that is lower than the tax payable of the immediately preceding year of assessment, and the DGIR issues a directive under sec. 107C(8), the taxpayer is legally precluded from further revising the estimate in the sixth month of its basis period (which is inequitable).

In short, the taxpayer appears to have the option of either:

a. Estimating a tax liability that is equal to the tax payable of the immediately preceding year of assessment, irrespective of the financial position of the company, make a minimum of 4 tax instalment payments and then revise the ETP in the 6th month;

   or

b. Request for a lower estimate and be compelled to make 12 instalment payments without any further opportunity to revise the ETP.

We would like to highlight that the uncertainties of doing business does not always guarantee that a taxpayer will earn more profit from the immediately preceding year and in reality, it often does not. In an economic downturn, the performance of a business can be expected to be worse than the immediately preceding year and the corresponding tax payable is assured will be lower than that in the immediately preceding year. The recent economic scenario proves this to be very true and many taxpayers in such situations are then faced with the above predicament. Therefore, **MIT proposes that the provision in sec. 107C(3) is removed** so as to be able to reflect economic reality. After all, there are penalties for any under-estimation of tax payable when compared to the actual tax payable.

C2. Revision of Estimation of Tax Payable

The purpose of the change from the Official Assessment System to the self assessment tax regime was to empower the taxpayer to quantify as closely as possible the amount of tax liability in the basis period. The self assessment tax regime however, compels taxpayers to make estimations of their tax payable a full 13 months in advance. Whilst a taxpayer is able to make revision in the sixth month of its basis period, the cyclical nature of business activities still makes it extremely difficult to accurately estimate the tax payable at the end of the basis period.

Due to requests and submissions by various professional bodies/ organisations, the Ministry of Finance, by administrative concession, had allowed (for year of assessment 2001 only) two additional revisions of the estimate of tax payable ("ETP"), whereby a company had the option to choose to revise the estimate in either the 3rd month, 9th month or 12th month of the basis period of a year of assessment. The concession was then changed for year of assessment 2002 onwards, to allow for the additional revision to be made in the 9th month of the basis period. The concession is however, not incorporated into Income Tax Act, 1967 and remains an administrative concession.

We are of the view that the current provisions of the Income *Tax Act, 1967* and the concession are too rigid in that it allows the taxpayer to make a legal revision only once and then by concession, another revision in the 9th month of the basis period. The current provision and concession are inequitable in essence as they force a company to comply with an instalment payment scheme that it may not be able to sustain, due to unforeseeable factors which may have an adverse impact on the company's liquidity subsequent to the 9th month.

We wish to reiterate that most companies are not able to furnish a fairly accurate estimate of their tax payable for each year of assessment, as business/trading conditions are normally subjected to various unforeseen factors and an estimate based on the preceding year is certainly not reflective of current circumstances and business conditions.

The spirit of self assessment is self governance and the companies are permitted to assess themselves as accurately as possible. The provisions of the Act however, seems to go against the spirit of self assessment by imposing rather inequitable and restrictive conditions on the taxpayers and inhibiting them from making accurate estimations of their tax payable.

Therefore, we propose that the taxpayers are given the opportunity to exercise greater control in their estimation of the tax payable by permitting them to revise their ETP **twice** in a basis period **without a fixed timing**. We propose that sec. 107C(7) be amended as follows:

> A company, trust body or co-operative society may for a year of assessment furnish to the Director General **a up to a maximum of two** revised estimates of its tax payable....

The proposed amendment is to allow taxpayers facing fluctuating income flows to make more accurate estimates and revise them accordingly when the need arises.

We are conscious that the Government is wary of abuses should the above proposal be implemented and as such, wish to highlight that there are existing provisions in the *Income Tax Act, 1967* that will curtail any abuse. Under sec. 107C of the *Income Tax Act, 1967*, where the tax payable under an assessment for a year of assessment exceeds the revised estimate of tax payable or the estimate of tax payable (where no revision was made) by an amount of more that 30% of the tax payable under the assessment, the difference will be liable to a penalty of 10%.

E. REGULATION OF TAX AGENTS

Currently, MIT is the only professional body representing the interests of tax practitioners in Malaysia. While the majority of tax practitioners are members of MIT, there are still some tax practitioners who have yet to become members MIT, solely because there is no statutory requirement to be a member of MIT to practice tax.

Whist MIT is able to regulate the ethics and professional practices of its members, it is not able to exercise control over non-members who are also offering tax services. We are unable to introduce and enforce rules of professional practice and conduct on non-members. With self assessment to be introduced to all taxpayers in the year of assessment 2004, it is essential that there is a national body or institute recognised by the Government, as the main organisation to regulate the profession.

Further, one of the terms contained in the General Agreement on Trade and Services (GATS) is the reciprocal recognition of professionals and cross-border practices. It is essential that Malaysia possess a single regulatory organisation to regulate the tax profession.

In addition, the ASEAN Framework Agreement on Services (AFAS) is committed to liberalise the services sector and it is envisioned that tax practitioners may be able to practice across borders in the near future. This adds to a need for a single body such as the MIT to represent and safeguard the interests of domestic tax practitioners. MIT has been in operation since 1991 and is well-placed to take on the challenge of regulating adapted be the organisation to regulate the tax profession.

Therefore, MIT proposes that legislation be drafted to set up statutory and regulatory requirement for individuals who holds themselves tax professionals or offer taxation services, to be members of MIT. This will enable MIT to enforce professional practices and conduct on tax professionals and assist in the growth of the tax profession.

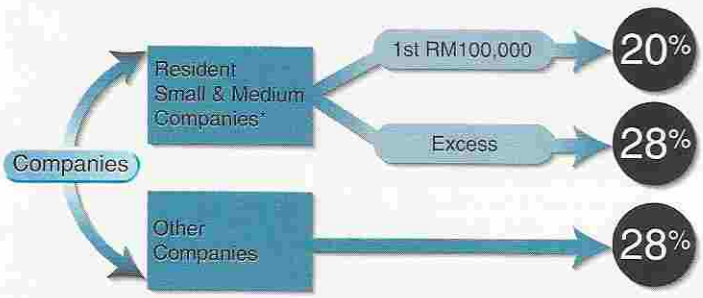
CONCLUSION

MIT wishes to thank the Ministry for granting us the opportunity to present our views and proposals to the 2004 Budget.

Income Tax Rates

Having ascertained the chargeable income, we now proceed towards computing the tax payable, which is basically the application of relevant rates to the chargeable income. Candidates need not memorise these rates as they are usually provided in the examination question paper. Note that normally up to chargeable income, the figures are rounded to the nearest dollar, but for tax payable, the figure is rounded to the nearest sen.

The relevant rates applicable can be illustrated as follows, for:



* Companies with a paid-up ordinary share capital NOT exceeding RM2.5 million at the beginning of the basis period for a year of assessment.

Example 1

Tempest S/B, a Malaysian resident company has a chargeable income of RM250,000 for the year of assessment 2003, the tax payable would be:

a) **If it was a resident small & medium company**

	RM
1st RM100,000	20,000
Balance @ 28%	42,000
	62,000

b) **If it was not a resident small & medium company**

RM250,000 @ 28% **RM70,000**

INCOME		Rate (%)	Tax Payable (RM)
On the first	2,500	0	0
On the next	2,500	1	25
On the first	5,000		25
On the next	5,000	3	150
On the first	10,000		175
On the next	10,000	3	300
On the first	20,000		475
On the next	15,000	7	1,050
On the first	35,000		1,525
On the next	15,000	13	1,950
On the first	50,000		3,475
On the next	20,000	19	3,800
On the first	70,000		7,275
On the next	30,000	24	7,200
On the first	100,000		14,475
On the next	50,000	27	13,500
On the first	150,000		27,975
On the next	100,000	27	27,000
On the first	250,000		54,975
Above	250,000	28	

The mechanics of the calculation is to find the "**on the first**" threshold which lies below the chargeable income and ascertain the tax payable on that threshold of income. Having determined this, we should deduct this threshold from the chargeable income and subject the balance to the "**on the next**" tax rate. The total of both the figures will provide the tax payable.

Example 2.

Mr. Macbeth, a resident individual has a chargeable income of RM73,962 for the year of assessment 2003. His tax payable for year of assessment 2003 is computed as follows.

	RM
On the first RM70,000	7,275.00
On the balance of RM3,962 @ 24%	950.88
Total tax payable	8,225.88

Candidates should note that, for chargeable income exceeding RM250,000 the scaled rates, and **not a flat rate of 28%,** is used for computing total tax payable, as is illustrated in the example below:

MIT TAX I DEC 1998 Q3
(abstracted and updated to 2003)

The tax payable on the chargeable income for Mr. Akay of RM311,883 is computed as follows:

	RM
On the first RM250,000	54,975.00
On the balance of RM61,883 @ 28%	17,327.24
Total tax payable	72,302.24

Tax Rebates

After computing the tax payable for a resident individual, a rebate is awarded provided certain conditions are fulfilled. The rebate is given before any set-off under sec.110 or credit is allowed under sec. 132/133. However, any excess cannot be carried forward or be refunded

SECTION 6A(2) - CRITERIA FOR TAX REBATE FOR INDIVIDUAL

Where the chargeable income of the individual does not exceed RM35,000 and the individual qualifies for personal relief under S46(1)(a) i.e. relief for self of RM8,000, a rebate of RM350 is granted to him. In the event the individual qualifies for spouse relief, a further RM350 is granted in respect of the spouse.

Example 3.

Mr. Julius Caesar has a chargeable income of RM15,000. He is married but also pays alimony to his ex-wife.

Scenario 1: His wife also has a chargeable income of RM15,000, which is assessed separately.

The tax rebates available are:

Mr. Julius Caesar	RM350 + RM350 (for the wife relief in respect of the alimony payment)
Mrs. Julius Caesar	RM350
Family :	*RM1,050*

Scenario 2: His wife has no total income but the couple is assessed separately.

The tax rebates available are:

Mr. Julius Caesar	RM350 + RM350 (for the wife relief in respect of the current wife)
Family :	*RM700*

Scenario 3: The couple elect for joint assessment.

The tax rebates available are:

Mr. Julius Caesar	RM350 + RM350 (for the wife relief in respect of the current wife)
Family :	*RM700*

SECTION 6A (3) - RELIGIOUS DUES

A rebate shall be granted for a year of assessment for any payment for zakat, fitrah or any other Islamic dues which is obligatory and paid in the basis year. The payment must be evidenced by a receipt issued by, an appropriate religious authority established under any written law for example, Pusat Pungutan Zakat ("PPZ").

SECTION 6A (3A) - PURCHASE OF PERSONAL COMPUTER

A rebate of RM400 shall be granted for the year of assessment in relation to the purchase of a personal computer in the basis year for that year of assessment. The payment must be evidenced by a receipt.

However, no rebate shall be granted:

- for the four following years of assessment i.e. only once in five years;
- where the personal computer is used for the purpose of the claimant's business; and
- where such rebate has been granted to the spouse.

MIT TAX I DEC 1998 Q3 (abstract)

After computing, the tax payable a rebate of RM400 is awarded to Mr. Akay in respect of his purchase of a personal computer.

SECTION 6C - TAX REBATE ON FEES

A rebate shall be granted for tne year of assessment in respect of fees paid to the Government in the basis year for that year of assessment for the issue of an Employment Pass, Visit Pass (Temporary Employment) or Work Pass.

Joint and Separate Assessment

The introduction of separate assessment for the spouse in 1975 was in recognition of the contribution of women towards the economic well being of the country. However, not all of her income could be assessed separately. With effect from year of assessment 1991, a wife is automatically assessed separately on her income from all sources without the need to make an election i.e. she is treated as a ***femme sole*** for tax purposes. Therefore, an election is only required where a combined assessment is preferred for that year of assessment.

With effect from year of assessment 2001, the husband can elect for his total income to be aggregated with the total income of his wife and assessed in her name for that year of assessment i.e. the wife becomes the "assessed party" and the husband, the "joining party", subject to the following:

- an election can only be made with one wife; and
- aggregation only applies if there is no election made by his wife or wives to aggregate their income with him.

For joint assessment the election must be made in writing before April 1 in the year of assessment or any subsequent date (as permitted by the DG) that the total income of the joining party shall be aggregated with the total income of assessed party and assessed in his/her name for that year of assessment.

CONDITIONS FOR ELECTING JOINT ASSESSMENT

To be eligible to elect for combined assessment for a year of assessment:

- the husband and wife must have been living together and did not cease to live together in the basis year
  - > living together is not a geographical concept but one of intention i.e. they must not be not be divorced or separated by a court order or deed of separation;
- did not cease to be husband and wife in the basis year; and
- the joining party must be either a Malaysia citizen or Malaysian resident or both.

EXPENDITURE INCURRED BY THE "JOINING PARTY" SHALL BE DEEMED TO BE EXPENDED BY THE "ASSESSED PARTY".

This relates to the following expenditure:

- basic supporting equipment;
- medical expenses for serious diseases;
- expenses for complete medical examination; and
- purchase of reading materials.

Where an election is made for joint assessment, the aggregation of the income is only at the stage of total income. Therefore, the allowable deductions, capital allowances, losses and donations of one party cannot be used to set-off the income of the other party. The only deduction subsequent to aggregation of income is the personal reliefs.

In the last article we have seen how the rules relating to personal reliefs apply in the case of joint and separate assessments. These peculiarities are summarised below:

- Under separate assessment, both parties can claim personal allowance of RM8,000 for self. For joint assessment, the assessed party claims RM8,000 and spouse relief of RM3,000;
- With effect from year of assessment 1996, a wife who is assessed separately on her income may elect in writing to claim the child relief in respect of any or all their children, otherwise the child relief is automatically given to the husband;
- Under separate assessment, each party can claim a maximum of:
  - > RM5,000 for insurance premium or contributions to approved provident funds;
  - > RM3,000 for medical & education policies; and
  - > RM1,000 in respect of EPF annuity schemes.

However, in the case of joint assessment, although the amounts expended by the joining party is deemed incurred by the assessed party, the maximum claim is still RM5,000 for insurance premium or contributions to approved provident funds and RM3,000 for medical & education policies and RM1,000 in respect of EPF annuity schemes.

Example 4:

Mr. Romeo and his wife Ms. Juliet, each purchased a life insurance on their own lives paying RM4,000 premium each and a medical policy each in the names of their children paying RM2,000 premium each.

Under separate assessment:

As a family, the full RM12,000 can be claimed assuming there is sufficient income to absorb the relief for each party.

Under joint assessment:

The assessed party can only claim a maximum of RM8.000 i.e. RM5,000 and RM3,000 in respect of the life and medical insurances.

RECOVERY OF TAX PAYABLE UNDER JOINT ASSESSMENT

Responsibility for the settlement of the tax payable under joint assessment lies with the assessed party. However, if the tax is not settled, the authorities have recourse against the joining party to the extent of the tax attributable to that party's total income that was aggregated. The portion of the "joining party's" tax which can be collected from him / her is calculated as follows:

$$\frac{A}{B} \times C$$

where A is the "joining party's" total income
B is the aggregated total income of both husband & wife
C tax charged for the year of assessment

Currently, a single tax return form is to be completed by a married couple, and the husband continues to be responsible for filing the tax returns. However, with the advent of self-assessment from year of assessment 2004, separate return forms will be issued to the husband and wife.

Example 5.

A merchant of Venice, Sherlock has been trading in Malaysia for the past year whilst his wife makes some money selling Venetian blinds. For year of assessment 2002, the wife elected for her income to be aggregated with that of her husband. Their respective total incomes were RM30,000 and RM2,000. The tax payable for the year of assessment 2002 was say RM500. Assume, after a heated domestic quarrel Sherlock, disappears and the IRB seeks to recover the tax from his wife. The amount she would be liable for is:

$$\frac{2{,}000}{32{,}000} \times \text{RM500} = \text{RM31.25}$$

SHOULD I ELECT FOR JOINT OR SEPARATE ASSESSMENT?

The answer lies in the computation of the tax payable in both cases and comparing the tax position in either case.

CASE 1:

Mr. Othello is a technician earning RM2,500 per month whilst his wife runs a food business which had an statutory income of RM30,000 for the year ended 31/12/2003. She also has a brought forward loss of RM28,000.

TAX COMPUTATION

MR. OTHELLO	RM	MRS. OTHELLO	RM
Salary	30,000	Statutory income (business)	30,000
		Less: B/f losses	(28,000)
Total income	30,000	Total income	2,000

SEPARATE ASSESSMENT	MR. OTHELLO RM	MRS. OTHELLO RM
Total income	30,000	2,000
Less: Personal relief	(8,000)	(8,000)
EPF	(3,300)	
Chargeable income	18,700	NIL
Tax Payable:		
1st RM5,000	25.00	
Balance @ 3%	411.00	
Total tax payable	436.00	NIL

JOINT ASSESSMENT (wife join husband)	RM
Total income	32,000
Less: Personal relief	(8,000)
Wife relief	(3,000)
EPF	(3,300)
Chargeable income	17,700
Tax Payable:	
1st RM5,000	25.00
Balance @ 3%	381.00
	406.00

Family:	**RM436.00**	**RM406.00**
	TAX SAVING	**RM30.00**

Therefore, if the total income of either spouse is less than RM3,000, then it would be more beneficial to opt for a combined assessment.

CASE 2

Cymberline, a merchant from Venice, came to Malaysia, obtained a job as a construction worker, worked perseveringly and rose to the rank of project supervisor. He became a Malaysian citizen, got married and has six children all under he age of 18.

As fate would have it, poor scaffolding in one project resulted in him having a fatal fall which crushed his left leg, leaving him a dismal jobless handicap. Being a pious person, he took this blow of fate in stride, collected his compensation and registered as a disabled person with the Department of Social Welfare.

Most of the compensation was invested into a company conducting a tailoring business. His wife Helena was a manager in the company drawing a salary of RM52,000 p.a. and contributed RM7,000 to the EPF.

The balance was used to buy some rated convertible loan stock from which Cymberline received interest income of RM14,000. This was utilised to settle his life premiums of RM1,400, premium for an education policy for their first son of RM1,000 and purchase a wheelchair for RM5,600.

Lets compute the tax payable by the family as a whole under different scenarios and determine which one will produce the least amount of tax payable (or the maximum amount of refund!)

SCENARIO A:
NO ELECTIONS ARE MADE I.E. SEPARATE ASSESSMENT WHERE MR. CYMBERLINE CLAIMS CHILD RELIEF

	Cymberline (RM)	Helena (RM)
Total income	14,000	52,000
Less: Personal reliefs		
Self	8,000	8,000
Disabled self	5,000	–
Wheelchair	5,000	–
Child relief – 800 X 6	4,800	–
EPF / Life insurance premiums	1,400	5,000
Education policy premiums	1,000	–
	25,200	13,000
Chargeable income	NIL	39,000
Tax payable:		
On the first 35,000	NIL	1,525.00
On the next 4,000 @ 13%	520.00	2,045.00

SCENARIO B:
SEPARATE ASSESSMENT
- HELENA ELECTS TO CLAIM CHILD RELIEF

	Cymberline (RM)	Helena (RM)
Total income	14,000	52,000
Less: Personal reliefs		
Self	8,000	8,000
Disabled self	5,000	–
Wheelchair	5,000	–
Child relief – 800 X 6	–	4,800
EPF / Life insurance premiums	1,400	5,000
Education policy premiums	1,000	–
	20,400	17,800
Chargeable income	NIL	34,200
Tax payable:		
On the first 20,000	NIL	475.00
On the next 14,200 @ 7%	994.00	1,469.00
Less: Tax rebate	350.00	1,119.00

SCENARIO C:
JOINT ASSESSMENT
- HELENA ELECTS TO JOIN CYMBERLINE

	Cymberline (RM)
Total income	66,000
Less: Personal reliefs	
Self	8,000
Disabled self	5,000
Wheelchair	5,000
Wife relief	3,000
Child relief – 800 X 6	4,800
EPF / Life insurance premiums	5,000
Education policy premiums	1,000
	31,800
Chargeable income	34,200
Tax payable:	
On the first 20,000	475.00
On the next 14,200 @ 7%	994.00
	1,469.00
Less: Tax rebate – self	350.00
– spouse	350.00
	769.00

SCENARIO D:
JOINT ASSESSMENT
- CYMBERLINE ELECTS TO JOIN HELENA

	Helena (RM)
Total income	66,000
Less: Personal reliefs	
Self	8,000
Wheelchair	5,000
Wife spouse	3,000
Disabled self	2,500
Child relief – 800 X 6	4,800
EPF / Life insurance premiums	5,000
Education policy premiums	1,000
	29,300
Chargeable income	36,700
Tax payable:	
On the first 35,000	1,525.00
On the next 1,700 @ 13%	221.00
	1,746.00

Therefore, in this case, it is obvious that the best scenario for the Cymberline family is to opt for joint assessment, whereby Helena elects for her income to be aggregated with that of Cymberline.

Practical Exercise

Mr. Braun, an Australian citizen, is partially retarded and registered as a disabled person with the Department of Social Welfare. However, he has been issued a work permit for which he spent RM250 to be employed as an insurance executive in K.L. He has a monthly salary of RM1,800 from which he contributes 15% to EPF. He has taken 2 life insurance policies, the first on his life and the second on the joint lives of his wife, Brenda and son Bratt paying RM350 quarterly and RM860 half yearly respectively. A medical policy was taken on his name for which he pays RM2,000 p.a.

He under went a complete medical check up in June 2002 incurring RM750 and paid medical expenses for Brenda who was suffering from Parkinson's Disease, amounting to RM3,600 and paid RM5,600 for her father's medical treatment. During the year, he purchased a personal computer costing RM4,800 and donated a painting worth RM7,600 to the National Art Gallery.

Brenda received royalties of RM73,000 for translation of a book on physics to Bahasa Malaysia at the request of Dewan Bahasa dan Pustaka. She took up a medical policy on her name paying RM2,000 p.a. and another educational policy for their son Bruno for which she paid RM1,500 p.a.

Details of children:		
Bratt	22	Studying at University of Malaya on a scholarship for RM4,000 p.a.
Bernice	20	Schooling in Sydney
Bruno	18	Schooling in K.L. and receives RM1,000 p.a. from his grandfather's estate
Brandon	14	Crippled at birth and certified disabled, is now schooling. Received a wheelchair costing RM3,800 from his father in May 2002
Bridgette		Born on 31/12/01 but died of pneumonia the following afternoon

Required:

(a) Compute Mr Braun's and his wife's tax liabilities for the year of assessment 2002, assuming that they make no elections.

(b) Give any advice that you think would be appropriate for rearranging their investments or exercising rights to make tax elections which would improve their tax situation.

(c) Compute their tax liabilities for the year of assessment 2002 assuming that they have acted on your advice as in (b) above.

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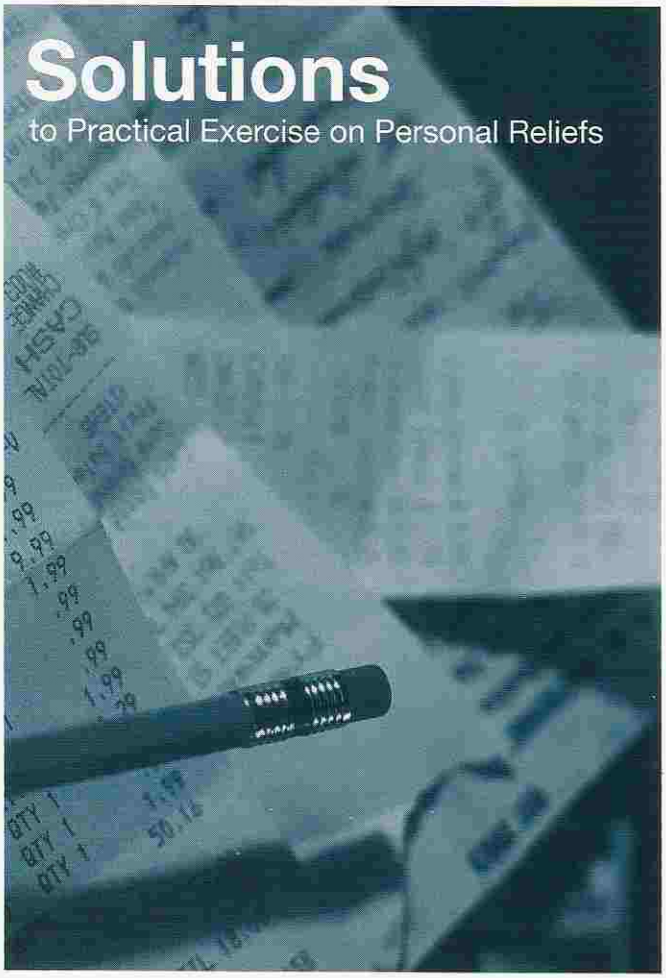
Income regarded as child's total income	Income NOT regarded as child's total income
• Employment income	• Scholarship, bursaries or other educational endowments
• Maintenance payments from a separated parent to which the child is legally entitled to	• Income from property settled on a child but for tax purposes it is deemed to be that of the parent
• Income from a trust or estate	• Payments received are returns of a premium paid for articles or apprenticeship



Solutions

to Practical Exercise on Personal Reliefs

The Author

Siva Nair

holds an 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, AIA and also tutoring undergraduates undertaking Accountancy Degree programmes in both local and foreign universities.

Personal reliefs for Encik Zamani and Puan Zakiah are as follows:

En. Zamani
Personal allowances

Self	8,000
Disabled self	5,000
Study relief (350 X 12)	4,200
Medical expenses for serious diseases (in respect of Zaiton – renal failure)	5,000
Spouse Relief	
Alimony payment (Since Zakiah has total income and has not elected to aggregate her income with that of Zamani)	2,500
Child relief	
Zaiton (he must have commenced education in 1996)	1,600
Zaiman (his income does not **EXCEED** RM3,200)	3,200
Zaiful (RM1,600 but restricted to actual expenditure incurred)	1,200
Zairul (married)	NIL
Zaki (disabled child and total income does not EXCEED child relief)	5,000
Zaili (although at university but still under 18)	800
Others (4 X 800)	3,200
EPF (RM2,500 X 12 months X 11%)	3,300

Puan Zakiah
Personal allowances

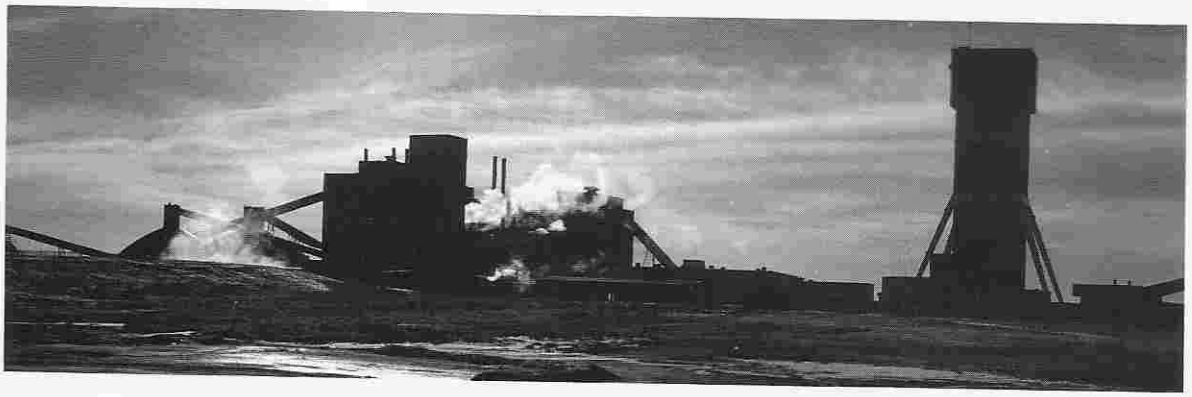
Self	8,000
Disabled self	5,000
EPF	2,050

TIME TABLE FOR THE MIT PROFESSIONAL EXAMINATIONS

15 – 19 DECEMBER 2003

TIME	15.12.2003	16.12.2003	17.12.2003	18.12.2003	19.12.2003
* 9.00 am to 12.10 pm	Taxation I	Business & Financial Management	Financial Accounting II	Economics & Business Statistics	Financial Accounting I
* 2.00 pm to 5.10 pm	Company & Business Law	Taxation II	Taxation III	Taxation IV	Taxation V

* Includes 10 minutes of reading time



Regrossing not allowable

The taxpayer a "chargeable person" within sec. 2 of the *Petroleum (Income Tax) Act 1967* ("PITA"), was a wholly-owned subsidiary of Esso Eastern Inc., a North American registered corporation, which was in turn a wholly-owned subsidiary of Exxon Corporation ("Exxon"). Exxon was also the ultimate holding company of all Exxon and Esso affiliates. In 1986, Exxon consolidated its six regional head offices outside of North America into a single division of Exxon and allocated the Head Office Restructuring Costs and other service costs to the taxpayer.

The terms of these payment required that the invoices be paid in full. To achieve that, the taxpayer agreed with its service providers that the latter should gross up their bills so that after deduction of any withholding tax, the service providers would still receive the full amount. The amount of withholding tax was then claimed as deductions. In 1993, the Respondent conducted an investigation and on December 1997 and December 1998, the taxpayer was served with notices of additional/ reduced assessments. The Appellant objected to these notices of additional assessments.

The taxpayer appealed against the Deciding Order of the Special Commissioner of Income Tax, raising the following issues: (1) whether the Revenue was correct in disallowing the deduction of an amount being withholding tax deducted and bringing this amount to charge as additional income; (2) whether the Revenue was correct in treating all service charges paid to the taxpayer by its affiliates as falling within sec. 4A of the *Income Tax Act 1967* ("the Act"); (3) whether the head office restructuring costs were deductible in the computation of the taxpayer's income pursuant to sec. 15(1) of PITA; and (4) whether the Special Commissioners were debarred from raising the assessment for the years of assessment 1984 and 1985 by reason of sec. 39 of PITA.

The court dismissed the taxpayers appeal as:

1. to be eligible for deduction business expense, must be "wholly and exclusively incurred in the production of income". By regrossing the tax amount, the taxpayer was able to reduce their tax liability when it was not wholly and exclusively incurred by the taxpayer.
2. It is common knowledge that the use of the word "or" and "," (comma) in any provision of the law should be read disjunctively. Section 4A(ii) of the Act should therefore be read as technical advice or assistance or services – rendered in connection with technical management or administration – of any scientific, industrial or commercial undertaking or venture or project or scheme. Section 4A of the Act and sec. 109B of PITA mirror each other and provided enough to cover the taxpayer's activities in Malaysia.
3. The deduction to be allowed under sec. 15(1) of PITA must be "wholly and exclusively incurred during that period in the production of the gross income". Here, it was the Head Office which decided to consolidate. So, the costs to the taxpayer's office were "related to the production of income but not exclusively in the production of income". The costs were incurred by the Head Office and not by the taxpayer. The expenditure was therefore remote and the "wholly" test not fulfilled.
4. The taxpayer was only a conduit for the payments to be made by the payer. However, the law held the taxpayer liable in the event of non-payment by them. Any tax planning that had to be done must be within the perimeter of the law. In this case, the taxpayer had not made the payment he should have made and had failed in their duty to make a correct return. The taxpayer had indeed deliberately committed some form of fraud or wilful default or negligence as envisaged by sec. 39(3) of the PITA. The Special Commissioners were therefore not debarred from raising the assessment for the years of assessment 1984 and 1985.

Esso Production Malaysia Inc v. Ketua Pengarah Hasil Dalam Negeri
In the High Court of Malaya (Appellate & Special Powers Division)
Rayuan Sivil No. R1-14-10 of 2000.
Judgment delivered on 20 March 2003.

W.S.W. Davidson, Francis Tan & Lucy Chang Ngee Weng (of Azman Davidson & Co.) for the appellant
Ahmad Khairuddin b. Abdullah & Zaleha bt. Adam
(Legal Officers Inland Revenue Board) for the respondant

[Editorial Note: The taxpayer has appealed to the Court of Appeal. This case will be reported in the forthcoming issue of Malaysian & Singapore Tax Cases]

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