Malaysian Institute Of Taxation

Tax Nasional

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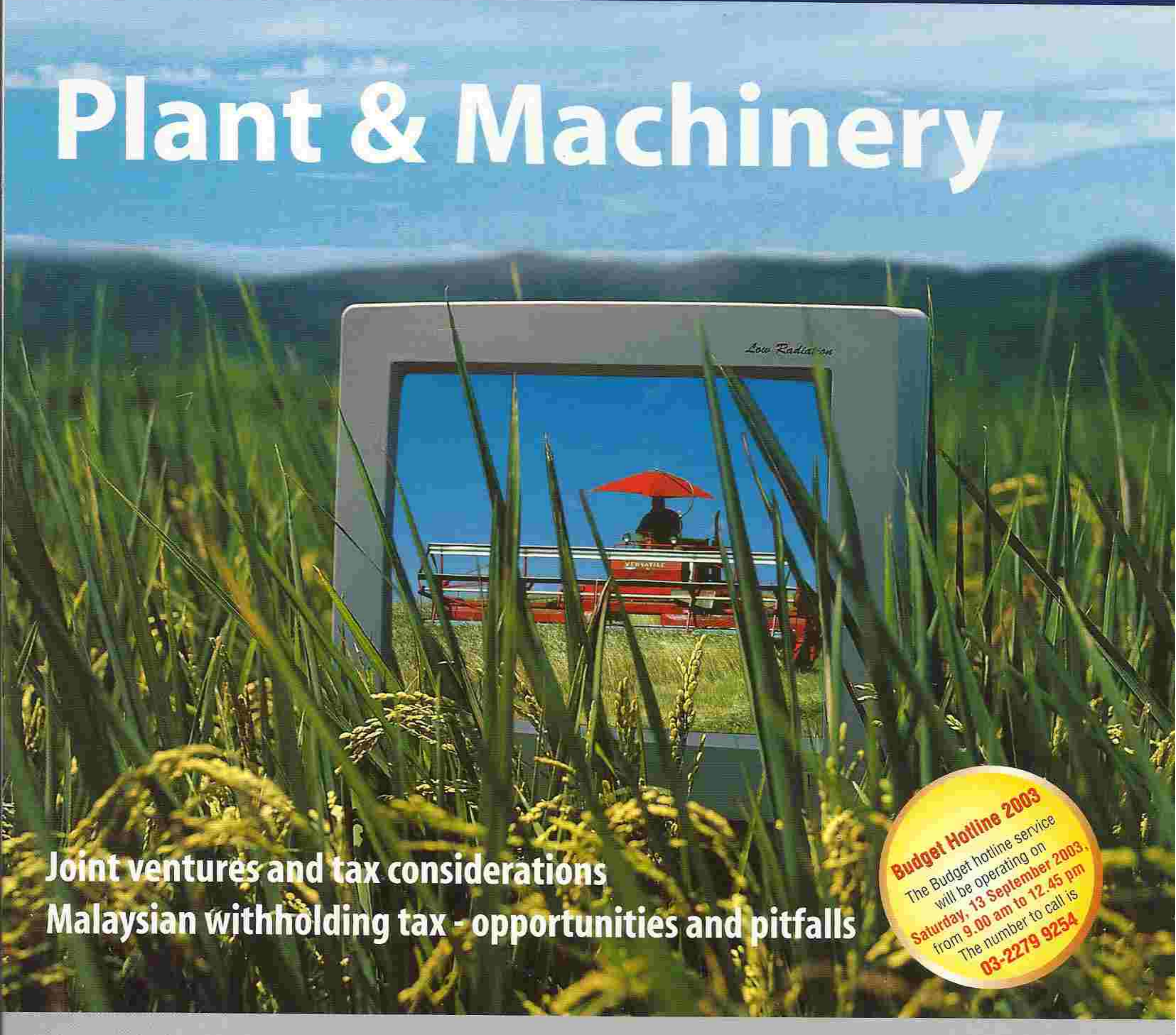
Plant & Machinery



Joint ventures and tax considerations

Malaysian withholding tax - opportunities and pitfalls

Budget Hotline 2003
The Budget hotline service will be operating on **Saturday, 13 September 2003, from 9.00 am to 12.45 pm**
The number to call is **03-2279 9254**

CCH

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How to become a member of the Malaysian Institute of Taxation

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

BENEFITS AND PRIVILEGES MEMBERSHIP

The Principal benefits to be derived from membership are:

- Members enjoy full membership status and may elect representatives to the Council of the Institute.
- The status attaching to membership of a professional body dealing solely with the subject of taxation.
- Obtain of technical articles, current tax notes and news from the Institute.
- Obtain of the Annual Tax Review together with the Finance Act.
- Opportunity to take part in the technical and social activities organised by the Institute.

CLASSES OF MEMBERSHIP

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

Qualification required for Associate Membership

1. Any Registered Student who has passed the examinations prescribed (unless the Council shall have granted exemptions from such examinations or parts thereof) and who has had not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
2. Any person whether in practice or in employment who is an advocate or solicitor of the High Court of Malaya, Sabah and Sarawak and who has had not less than three (3) years practical experience in practice or employment relating to taxation matters approved by the Council.
3. Any person who has passed the Advanced Course examination conducted by the Department of Inland Revenue and who has not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
4. Any person who is registered with MIA as a Chartered Accountant and who holds a Practising Certificate and an audit licence issued pursuant to the Section 8 of the Companies Act, 1965.
5. Any person who is registered with MIA as a Chartered Accountant with Practising Certificate only and has had not less than two (2) years practical experience in practice or employment relating to taxation matters approved by the Council.
6. Any person who is registered with MIA as a Chartered Accountant without Practising Certificate and has had not less than three (3) years practical experience in practice or employment relating to taxation matters approved by the Council.
7. Any person who is registered with MIA as a Licensed Accountant and who has had not less than five (5) years practical experience in practice relating to taxation matters approved by the Council after admission as a licensed accountant of the MIA under the Accountants Act, 1967.
8. Any person who is an approved Tax Agent under Section 153 of the Income Tax Act, 1967.

Fellow Membership

A Fellow may be elected by the Council provided the applicant has been an Associate Member for not less than five (5) years and in the opinion of the Council he is a fit and proper person to be admitted as a Fellow.

APPLICATION FOR MEMBERSHIP

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

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

	Fellow
(a) Upgrading Fee	*RM300*
(b) Annual Subscription	*RM145*

	Associate
(a) Admission Fee	*RM200*
(b) Annual Subscription	*RM120*

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

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

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

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

The Institute's 11th Annual General Meeting (AGM) was held recently in Eastin Hotel. I was glad to see the large turnout at the AGM and to welcome back Tuan Haji Abdul Hamid, Dr. Veerinderjeet Singh, Dr. Jeyapalan and Mr. SM Thannermalai who were re-elected as members of the Council. I would also like to take this opportunity to welcome Mr Lim Heng How who was also elected as a member of Council. Mr Lim brings with him over 30 years of invaluable experience from working with the Inland Revenue Board ("IRB") and I am sure that the Institute will advance further with Mr Lim's contribution as a member of Council.

A number of significant events have taken place in the recent months. Among them is the much-awaited transfer pricing guidelines recently introduced by the IRB. The guidelines will serve to provide practitioners and the commercial world with a framework on transfer pricing practices and reduce the ambiguities of transfer pricing.

In addition, due to the time constraint and volume of tax returns, a number of members had begun to express their worry of not being able to file all their December 2002 year end clients returns by the due date on 30 July 2003. As the date grew closer and more members began raising their concerns, the Institute, on behalf of the members submitted an appeal to the IRB for an extension of the deadline. We are truly grateful to the IRB in considering our request by granting an extension of time to file the tax returns. However, it has to be stressed that members ought to be more diligent in scheduling their work to comply with the filing deadlines stipulated.

As part of the Institute's objective of being more representative of the profession and in endeavouring to propel the Institute onto greater heights, the Institute successfully organised its annual and the first ever two-day National Tax Conference. This conference, the 3rd National Tax conference, was jointly held and organised with the IRB on 5 and 6 August 2003. The profile of the National Tax Conference has been growing from year to year and we hope to see even more members participate in next year's conference.

The Institute was also involved in many other events such as being given the honour of being the first organisation from the private sector to host the Customs-Private Sector Consultative Panel meeting. We also participated in a Technical Dialogue with the Technical Division of the IRB on 18 July 2003. A number of issues were discussed in the Technical Dialogue, and regular dialogues such as this help assist in resolving a number of issues and fosters a closer working relationship with the authorities.

The Institute will continue to improve and expand on the existing programmes and explore new initiatives. I foresee exciting times ahead as the Institute embarks on a journey to achieve even greater recognition.

Ahmad Mustapha Ghazali
PRESIDENT

The Institute will continue to improve and expand on the existing programmes and explore new initiatives.

Heartiest Congratulations

to

Y. Bhg. Datuk Dr. Abdul Samad Haji Alias

PRESIDENT
MALAYSIAN INSTITUTE OF ACCOUNTANTS

on being conferred the

PANGLIMA JASA NEGARA

which carries the title 'Datuk''

on the occasion of

the 60th Birthday On 7 June 2003 of His Majesty

The Yang Di-Pertuan Agong XII
Tuanku Syed Sirajuddin Ibni Al-Marhum Tuanku Syed Putra Jamalullail

D.K.P., D.K., S.S.P.J., D.K.M., D.M.N., D.K.(PERAK), D.K. (KEDAH), D K. (NEGERI SEMBILAN), D. K. (KELANTAN), D. K. M.B. (BRUNEI), D. K. (SELANGOR), D.K.(TERENGGANU), S.P.M.J., S.P.C.M., S.S.M.P., Grand Order of King Tomislav (Croatia), Grand Collier De L'Independence (Grand Medal of Independence) - Cambodia, Grand Croix De L'Ordre (Royal Sash) - Cambodia

from

Malaysian Institute Of Taxation

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

Editor's Note

In an effort to help strengthen the Malaysian economy, the Prime Minister Dato' Seri Dr. Mahathir Mohammad recently announced an economic stimulus package to the tune of RM8.1 billion on 21 May 2003. An overview of the main strategies of the said package together with the possible tax ramifications to the grants handed out by the Government are explored in this issue. More is explained with other articles of interest below:

Plant: Horse or Elephant? Several landmark cases trace the interpretation of the words "Plant and Machinery". The word "machinery" generally posed very little problem. However, various tests have been applied by the courts to determine particularly what amounted to a "plant" and what did not. The list is not exhaustive and with new cases over time, the definition given to plant is expected to "grow". Nakha Ratnam Somasundaram takes us on a historical tour of interpretation of the word "Plant".

Developments in Respect of Malaysian Withholding Tax and Other Related Issues – Opportunities and Pitfalls Tan Hooi Beng and Chow Chee Yen examine the withholding tax scenario in Malaysia. The decision in SGSS has set a paradigm in Malaysian taxation, with regard to the applicability of the business article in tax treaties and the withholding tax provision. Parliament has since amended sec. 15A of the ITA to exclude payments to non-residents for offshore services rendered outside Malaysia in respect of sec. 4A(i) and (ii) from Malaysian withholding tax. Whilst every effort taken by the Revenue to preserve our tax base should be commended, interpretation of local tax legislation must be done on a fair basis and should consider other international aspects of taxation.

Joint Ventures and Tax Considerations Some of the many and varied tax issues that need to be considered when entering into joint venture arrangements are highlighted by Harvindar Singh. The tax issues could encompass the whole scope of Malaysian taxation, depending on the complexity of the JV structure, including those relating to other tax jurisdictions when cross border issues come into play.

Cost of efficiency studies, gratuity and retrenchment benefits and Section 33 of the Income Tax Act 1967 Dr Arjunan Subramaniam brings us up to date on the recent Court of Appeal decision in *International Foods Sdn. Bhd.* where the court had to decide on whether monies paid by a company for an efficiency study in an effort to increase productivity and reduce costs and monies paid to retrenched staff who were made redundant as a result of the said study, was deductible as expenses under sec. 33(1) of the *Income Tax, 1967*.

Grants… Handouts from the government? But the government can take back (some of) what it gives away… Government provides grants for the purpose of assisting organisations or industries that are seen to be in need of special assistance for their growth and has long been employed as a tool of economic development. However, recipients of grants are not automatically exempted from liability to income tax, in the absence of specific provisions exempting grants. PricewaterhouseCoopers looks into the possibility that government may take back some of what it gives through tax.

Sales Tax in Malaysia It is a single stage tax levied on imported goods as well as goods manufactured in Malaysia. Thomas Selva Doss provides us with an overview of the sales tax policies, procedures and practices in Malaysia.

New Strategies - Towards stimulating Malaysia's economic growth Adeline Wong and Karen Tan highlight some of the more important and salient strategies and measures to assist Malaysia in overcoming the present economic situation and the challenges ahead proposed in the Pre-emptive Stimulus Package on 21 May 2003.

Basis of Assessment This is part of a series of articles by Siva Nair on business income. Part 1 in this issue looks at understanding the basis of assessment of business income for the different persons generating income.

HARPAL S. DHILLON
Editor of Tax Nasional

Contents

3rd Quarter 2003

Tax Nasional

Official Journal of the Malaysian Institute of Taxation

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8th Graduation & Prize Giving Luncheon

There were 42 jubilant students who received certificates for completing the respective levels of the MIT Professional Examinations held in December 2002 at the 8th Graduation & Prize Giving Luncheon held on 28 June 2003, at the Eastin Hotel. At the ceremony, the students were privileged with receiving their certificates from the Guest of Honour, En. Mohd Saian bin Hj. Ridzuan, Deputy Director General of the Inland Revenue Board.

Excellent performance awards were bestowed upon 3 students who sat the recent examinations. They are, Ms. Lim Ee Chuo for Best Performance in Taxation I paper, Ms. Ng Lai Lai for Best Performance in Taxation II paper and finally Ms. Emily Liew Keng Mei for Best Overall Performance at the Intermediate Level. PricewaterhouseCoopers and Atarek Kamil Ibrahim & Co sponsored the prizes for excellent performance.

"The professional examination seeks to overcome the present shortage of qualified tax practitioners in the country and to provide opportunities for persons who are in the tax profession to earn a professional qualification which provides scope for advancement in their organisation" said Prof. Dr Jeyapalan Kasipillai, Chairman of the Examinations Committee in his welcoming speech.

Guest of Honour, En. Mohd Saian bin Hj. Ridzuan, Deputy Director General of the IRB addressing students, prize winners and guests at the graduation and prize giving luncheon

"We are of the vision that these students completing the MIT Professional Examinations will be the guardians of the tax profession in the coming years. Hence, MIT is under a duty of care of its members and to the tax profession, to become stewards of the future, by way of guidance and standards" he added.

The Guest of Honour, En. Mohd Saian Hj. Ridzuan said, "Under the self-assessment tax regime, tax practitioners are now seen as 'partners', ensuring that the correct amount of tax is required to be declared and paid to the government. In this regard of safeguarding the nation's tax revenue, it needs competent tax practitioners who are able to provide adequate and sound advice to taxpayers be they individuals or companies."

The ceremony was attended by representatives from the various educational institutions, professional bodies and families of students.

Students and prize winners with En. Mohd Saian bin Hj. Ridzuan (Guest of Honour), En. Ahmad Mustapha Ghazali (President) and Prof. Dr. Jeyapalan Kasipillai (Chairman of Examinations Committee)

En. Mohd Saian presenting the prize to Ms. Liew Keng Mei, a prize winner for Best Overall Performance in the Intermediate Level. Looking on is the President of MIT, En. Ahmad Mustapha Ghazali.

December 2002 Examinations

List of prize winners, graduates & successful students

The following candidates completed the Foundation Level

1 Lim Sai Luan
2 Tee Sock Ching
3 Lee Bee Chin
4 Lim Peng Peng
5 Lim Ee Chuo
6 Tiong Pei Ling
7 Chong Pak Chung
8 Chin Oi Len
9 Chong Siau Yen

The following candidates completed the Final Level

1 Lin Kuw Ming
2 Low Fue Cheu
3 Cheong Yee Ching
4 Au Yoong Phooi Hun
5 Kee May Lee
6 Law Chee Meng
7 Lee Lai Hiang
8 Wong Wee Kee
9 Manvinder Singh Ajeet Singh

The following candidates have graduated in the December 2002 examination session:

1 Wong Wee Kee
2 Lee Lai Hiang
3 Low Fue Cheu
4 Au Yoong Phooi Hun
5 Law Chee Meng
6 Manvinder Singh Ajeet Singh
7 Cheong Yee Ching
8 Kee May Lee
9 Lin Kuw Ming
10 Wong Kok Keng

The following candidates completed the Intermediate Level

1 Nishantha Raja Rathnam
2 Lin Kuw Ming
3 Lau Aik Fang
4 Ong Lily
5 Daljit Kaur Nirmal Singh
6 Manvinder Singh Ajeet Singh
7 Liew Keng Mei
8 Lee Fook Li
9 Lai Kiat Yeen
10 Chan Wai Leong
11 Gan Meng Lee
12 So Fok Tai
13 Soo Hui Hua
14 Tai Chew Ngo
15 Tan Chin Hwa
16 Murugu Tamil Selvan Anbanatham
17 Goh Swee Lan
18 Au Yeong Pui Nee
19 Low Saw Heok
20 Wang Yoke Lian
21 Wong Kok Keng
22 Yii Hieng Hoon
23 Philip Sondon
24 Yap Yien Ling
25 Foo Yun Tien

The following candidate has been issued with Certificate of Graduateship:

1 Low Fue Cheu

Prize Winners

Best Performance in Taxation I
Ms. Lim Ee Chuo
(Prize sponsored by Atarek Kamil Ibrahim & Co)

Best Performance in Taxation II
Ms. Ng Lai Lai
(Prize sponsored by PricewaterhouseCoopers)

Best Overall Performance in Intermediate Level
Ms. Liew Keng Mei
(Prize sponsored by PricewaterhouseCoopers)

National Tax Conference

MIT President, En. Ahmad Mustapha Ghazali recently led a delegation to make a courtesy call on the Director General of the Inland Revenue Board, Tan Sri Dato' Zainol Abidin bin Abdul Rashid. During his visit En. Ahmad Mustapha discussed the salient issues of the past 2nd National Tax Conference as well as the current steps being taken for the then forthcoming 3rd National Tax Conference on 5 and 6 August 2003. Both gentleman expressed their respective interest in maintaining the spirit of collaboration and cooperation for the years to come.

left to right: Tengku Kamarulzaman (Director of National Tax Academy), En. Ahmad Mustapha Ghazali (President of MIT) and Tan Sri Dato' Zainol Abidin bin Abdul Rashid (Director General of the IRB).

Tax expert made professor

A SENIOR tax academic and council member of the Malaysian Institute of Taxation, Dr Jeyapalan Kasipillai (*pic*), has been appointed a professor by Universiti Utara Malaysia (UUM) in Kedah.

Now attached to UUM's School of Accountancy, Prof Jeyapalan was its deputy dean for a year. Prior to that he was the founding director of the university's Institute of Taxation Research.

Upon graduating from Universiti Malaya (UM) in May 1974, Prof Jeyapalan worked as a newspaper journalist for less than a year. He subsequently wrote a column for *The Star*, entitled Tax Matters.

He obtained a Masters degree from Stirling University in Scotland and his doctoral thesis from New England University in Australia.

Prof Jeyapalan served the Inland Revenue Board for 14 years before joining UUM in 1990. He also conducted a taxation course on a part-time basis at Universiti Kebangsaan Malaysia from 1980 to 1985 and taught on advanced taxation at UM from 1986 to 1991.

A fellow member of both the UK Chartered Institute of Secretaries and the Malaysian Institute of Taxation, Prof Jeyapalan is also a member of the Australian National Institute of Accountants.

For two years until September 2000, he served as chief editor of *Analysis*, an academic journal published by UUM. He was consulting editor for the *Malaysian Tax Reporter* and serves in the editorial committees of *Tax Nasional*, *Akauntan Nasional*, *Analysis* and *e-Journal of Tax Research*, a publication of the Australian Taxation Studies Programme at New South Wales University in Sydney.

Prof Jeyapalan has authored six academic books on taxation and published over 50 articles in local and international journals. In 2000, he received the Best Researcher Award and in the following year was presented with an Excellent Service Award by UUM.

MIT Council Member and Chairman of the Examinations Committee, Dr. Jeyapalan Kasipillai has been appointed a Professor by Universiti Utara Malaysia. News on the appointment was recently featured in the STAR newspaper.

The MIT delegation with En. Manap bin Dim at the LHDN Branch in Temerloh

11th Annual General Meeting

The Malaysian Institute of Taxation convened its 11th annual general meeting recently in Eastin Hotel.

The President, En. Ahmad Mustapha Ghazali in addressing the members said, "We must be diligent in attaining greater membership. I subscribe to the principle of strength through numbers. The more people the Institute represents, the greater is our voice. We have achieved recognition as one of the professional qualifications eligible for a tax agent's licence under sec. 153 of the *Income Tax Act, 1967*. That is merely our first step. We will strive for our own Practising Certificate to become a reality and ultimately gain its recognition by the Ministry to be as an equivalent under sec. 153. But that is a vision far away and in order to achieve that, we will need the support in terms of greater membership numbers."

The AGM witnessed the election of Mr. Lim Heng How, Executive Director of Deloitte KassimChan and former Deputy Director General of Inland Revenue Board to the Council. Retiring Council Members, Tuan Haji Abdul Hamid bin Mohd Hassan, Dr. Veerinderjeet Singh, Dr. Jeyapalan Kasipillai and Mr. SM Thannermalai were re-elected to the Council at the AGM.

The President yet again stressed to the members the importance of the Institute emerging as the paramount tax body in the country and urged them to further promote membership to colleagues and friends before declaring the closing of the 11th AGM of the Malaysian Institute of Taxation.

Office bearers at the 11th Annual General Meeting From left: Chow Kee Kan (Honorary Secretary), Ahmad Mustapha Ghazali (President), Quah Poh Keat (Vice President) and Dr. Veerinderjeet Singh (Vice President)

EAST COAST BRANCH

On 19 June 2003, the East Coast Branch led by its' Branch Chairman, Mr. Wong Seng Chong made a courtesy call on the Senior Assistant Director of Inland Revenue, Temerloh Branch, in the State of Pahang. The newly formed Temerloh Branch has a staff strength of 51 under the able leadership of En. Manap bin Dim.

It boasts, a beautifully designed layout equipped with both a conference and function room.

Ideas were exchanged between senior officers of the Temerloh Branch and members of MIT on ways to make the self-assessment system a success. It was generally agreed that more tax seminars, jointly conducted by the LHDN, MIT and MIA, on self-assessment for individuals and partnership should be carried out in Mandarin.

The delegates and senior staff of the LHDN were later treated to morning tea prepared by staff of the LHDN, followed subsequently by an invitation to lunch hosted by the MIT.

Members from the East Coast Branch with LHDN, Temerloh Branch staff

PERAK BRANCH

In an effort to strengthen ties between MIT and the authorities, the Perak Branch Chairman, Mr. Lam Weng Keat and the Committee members paid a courtesy call on the newly appointed Head of Royal Customs Department Ipoh, Tuan Haji Mohd Sehan on 16 May 2003. The Branch members together with Council Member, Mr. Lee Yat Kong also met the newly appointed Head of Inland Revenue Board Ipoh, En. Mohd Noor Lamsah on 24 June 2003.

Topical Tax Law Issues

The self assessment system has shifted the onus onto taxpayers to accurately assess their own tax liability. Hence, taxpayers and tax professionals as advisors are now required to keep abreast with the latest developments in tax and changes in revenue legislation, in being able to accurately compute their tax liability. In view of this, a conference on Topical Tax Law Issues was organised by the Malaysian Institute of Taxation in collaboration with Commerce Clearing House Sdn Bhd ("CCH") on 19 June 2003 at the Prince Hotel & Residence, Kuala Lumpur, to update participants on the implications of recent legislative changes and cases law decisions affecting tax.

Four leading Counsels addressed the participants on four major tax law issues currently affecting taxpayers, providing technical insight and guidance whilst cutting through the complex legislative and case law issues.

Ms. Goh Ka Im and Mr. Anand Raj, from Shearn Delamore & Co presented during the morning session. Speaking on the recent developments on service tax, special classes of income and DTA relief, respectively. In the afternoon session, Consultant with Azman Davidson & Co, Mr. WSW Davidson talked on regrossing, the meaning of "technical" under Section 109B and application of sec. 91(3). Later, Mr. Y M Leow briefed participants on sec. 34A of the *Real Property Gains Tax Act* and its applicability to property developing companies.

Islamic Financing And Malaysian Tax Principles

In view of the increasing importance of Islamic Financing Instruments and their implication on Malaysian Taxation, the Malaysian Institute of Taxation and the Islamic Banking and Finance Institute Malaysia organised a one-day intensive seminar on "Islamic Financing and Malaysian Tax Principles" on 23 May 2003 at Nikko Hotel, Kuala Lumpur.

A host of speakers with extensive experience on the subject matter were lined up for the seminar to analyse and enlighten participants, on how current tax laws apply to the general principles of Islamic financing.

The seminar was divided into two sessions, the morning session focused on an overview of Islamic Banking and Islamic Financing to enable participants to acquire a basic understanding of the subject matter. The afternoon session focused on how the current tax laws apply to Islamic transactions.

Customs-Private Sector Consultative Panel Meeting

4 June 2003

MIT was given the honour of being the first organisation from the private sector to host the Customs-Private Consultative Panel Meeting. The meeting was held 4 June 2003 at the Petaling Jaya Hilton and was attended by a large number of delegates from a number of organisations from the private sector. The Director General of the Royal Customs Department, Tan Sri Dato' Paduka Abdul Halil and senior officers from the Royal Customs Department were also present in the meeting where a fruitful discussion was held to resolve a number of operational and technical matters.

REGISTRATION FORM / INVOICE

**This registration form serves as the conference invoice.
No further invoice will be issued.
Admittance will not be permitted unless payment
is received by 6 October 2003.**

NATIONAL ACCOUNTANTS CONFERENCE

6 - 7 October 2003

Log on to **www.mia.org.my** for online registration

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Designation ______________________________

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Organisation ______________________________

Address ______________________________

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____

Tel ______________ Fax ______________

Email ______________________________

____

Company Stamp & Signature
(sign & stamp for non-card payment)

REGISTRATION WITH PAYMENT

REGISTRATION FEE (Inclusive of Conference Dinner)	MEMBER	NON-MEMBER	PAYABLE
	per delegate		
EARLY BIRD (with payment on/before 5/9/03)	RM 650	RM 800	
NORMAL	RM 750	RM 900	
Members of ACCA, CIMA, CPA Aust. & MICPA	Please refer to the respective scheduled bodies		
EXTRA DINNER TICKET	RM 250		
DINNER TABLE of 10 persons	RM 2250		
	TOTAL		

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Address: Malaysian Institute of Accountants, Dewan Akauntan, 2, Jalan Tun Sambanthan 3, Brickfields, 50470 Kuala Lumpur.

TERMS & CONDITIONS

CONFERENCE FEES

Group discount for three (3) persons and above from the same organisation is 10% off the applicable registration fee.

The normal rate will be applicable after 5 September 2003 for unpaid early bird registration.

Members of scheduled bodies are to submit their registration forms to their respective bodies to enjoy special rates.

NOTE: Please send cheque/bank draft to:
**Malaysian Institute of Accountants,
Dewan Akauntan, 2, Jalan Tun Sambanthan 3,
Brickfields, 50470 Kuala Lumpur.**

CPE CREDIT HOURS

All participants will be presented with a Certificate of Attendance for use in registering CPE credit hours.

CANCELLATION

Please inform us in writing seven (7) days prior to the Conference date, i.e by 25 Sept 2003, if you intend to cancel your registration. Please substitute a delegate if you wish to avoid cancellation penalty (20% of the registration fee). Cancelled unpaid registrations will also be liable for full payment of the Conference fees.

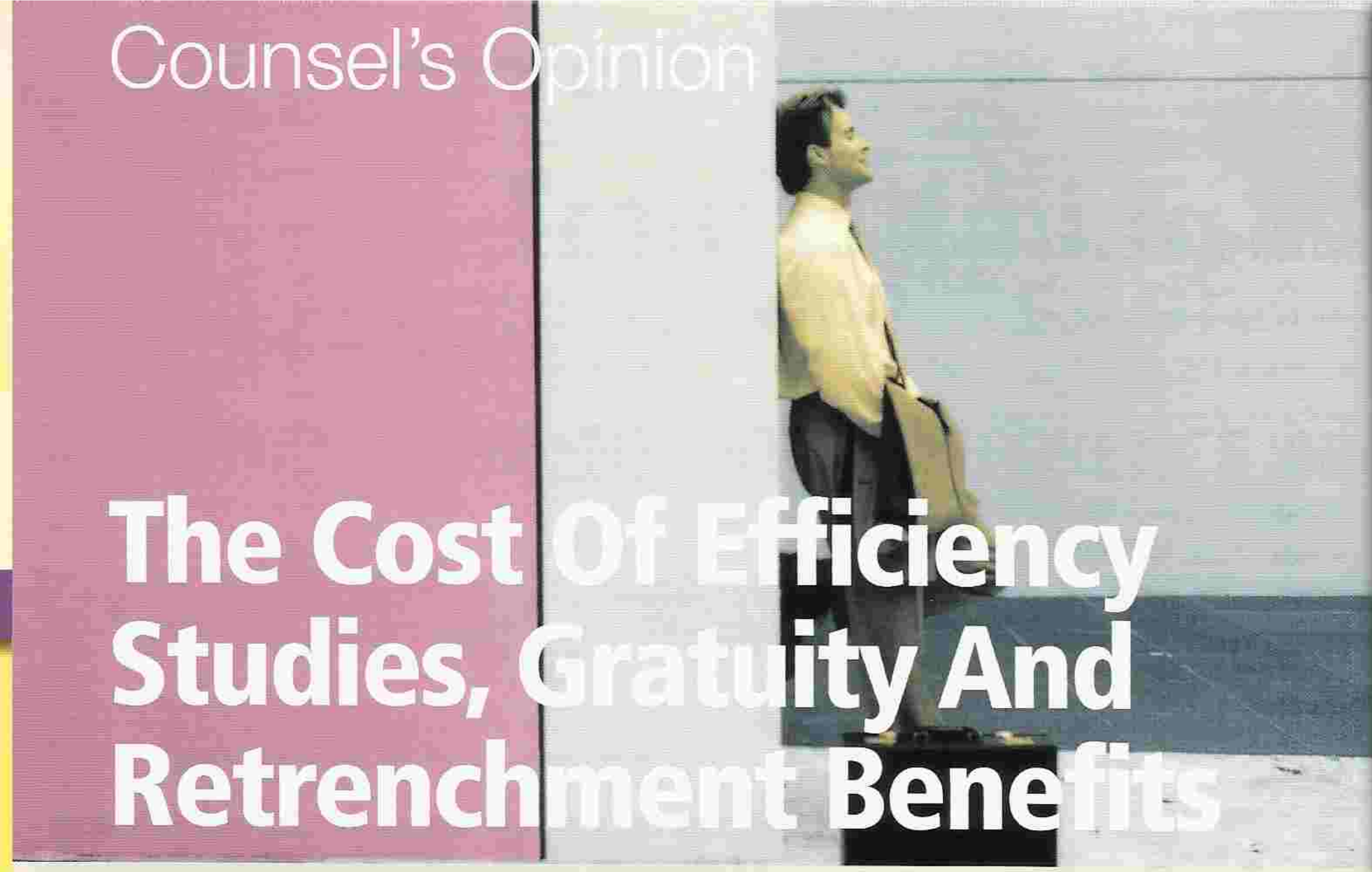
DISCLAIMER

The Conference Organiser reserves the right to change the speakers, date and to cancel the programme should circumstances beyond its control arise. MIA also reserves the right to make alternative arrangements without prior notice should it be necessary to do so.

Upon signing the registration form, you are deemed to have understood and agreed to the above terms and conditions.

HIGHLIGHTS OF PAST CONFERENCES

1. **Sultan Azlan Shah, the then Yang DiPertuan Agong gracing the Conference Dinner.**
2. **Cross section of the 1500 participants at the NAC 2002.**
3. **Siti's presence at the dinner ensured full audience while the mesmerising Kris Dayanti had all eating out of her hands.**



The Cost Of Efficiency Studies, Gratuity And Retrenchment Benefits

Section 33, Income Tax Act 1967 Scope Expounded

by DR ARJUNAN SUBRAMANIAM

International Foods Sdn Bhd, W02-144-1999 was decided by the Court of Appeal on 24 May 2003 in favour of the taxpayer. The issues, facts and arguments presented in the case are summarized here. But note however, that the principles in the case of *Cosmotron* [1997] STC 1134, need not be addressed here since the payments in *International Foods Sdn. Bhd.* were not related (no nexus) to the liquidation of the Appellant company. As such, the principles laid down by the High Court in *Ampat Tin Dredging Ltd* [1982] 2 MLJ 46 continue to be relevant for the present.

THE ISSUES BEFORE THE COURT OF APPEAL

1. Whether the sum of RM590,825.00 incurred and paid in 1985 to Alexander Proudfoot (M) Sdn. Bhd. by the Appellant's in respect of an efficiency study to increase productivity and reduce costs in the Appellant's business is an expense wholly and exclusively incurred in the production of gross income and deductible under sec. 33(1) of the *Income Tax, 1967* ('the Act').

2. Whether the sum of RM393,369.00 incurred and paid in 1985 by the Appellant's to it's redundant employees as gratuity/retrenchment benefits is an expense wholly and exclusively incurred in the production of gross income under sec. 33(1) of the Act.

FACTS

3. The material facts were that –

   In an effort to support and comply with the Malaysian Government's New Economic Policy, the Appellant and Food Specialities (M) Sdn. Bhd. both members of the Nestle Group of Companies were amalgamated and the entire share capital of the Appellant was acquired by Food Specialities (M) Sdn Bhd;

4. The efficiency study carried out by Alexander Proudfoot (M) Sdn Bhd was for the period of June 1985 to 31 December 1985, in respect of the Appellant and continued to February 1986 even though the Appellant's business was transferred to Food Specialities (M) Sdn Bhd;

"**It was also argued** that the learned judge had applied the wrong test for deduction under sec. 33, Income Tax Act 1967 by holding the efficiency study did not benefit the defunct company, whereas the correct test is the **object of the expenditure as opposed to the effect.**"

5. The cost of the study for the period June 1985 to 31 December 1985 was RM590,825.00 and was charged to the Profit and Loss Account of the Appellant for the year ending 31 December 1985;

6. The scope of the efficiency study was directed at increasing productivity and reducing costs of running the Appellant's business. The projected savings for the Appellant was in the region of RM1,210,000.00 per annum;

7. The study also showed the redundancy of employees of various categories;

8. The efficiency study was accepted and implemented and consequent to its implementation, the following results were achieved by September 1985 –

   i) improvement in production – 10% increase in noodle line speed;

   ii) reducing losses in production;

   iii) savings in cost of labour –

      - noodle plant – the staff was reduced by 46 individuals i.e. from 180 to 134 persons; culinary plant – the staff was reduced by 30 individuals from 74 to 44 persons;
      - reduction in non-productive time; and
      - improvement of plant maintenance;

   iv) not all the Appellant's staff were retrenched. The retrenchment exercise was confined only to redundant staff pursuant to the efficiency study conducted;

   v) the retrenchment benefits amounting to RM393,369.00 paid to the redundant staff was calculated based on the length of service of the said staff;

   vi) there was also retrenchment of the staff of Food Specialities (M) Sdn. Bhd. and other subsidiaries of Nestle (M) Sdn. Bhd. arising out of the efficiency study; and

   vii) the retrenchment exercise was carried out on 15 December 1985.

FIRST ISSUE – COST OF EFFICIENCY STUDY - RM590,825.00

Summary of Grounds of Appeal – First Issue

9. It was submitted that the learned trial judge had erred in that His Lordship had wrongly held that the efficiency study lead to the liquidation of the Appellant when the efficiency study had nothing to do with the liquidation, which was the direct result of the need to comply with Malaysian Government's New Economic Policy. It was also argued that the learned judge had applied the wrong test for deduction under sec. 33, *Income Tax Act 1967* by holding the efficiency study did not benefit the defunct company, whereas the correct test is the object of the expenditure as opposed to the effect.

10. Since the learned Special Commissioners had found as a fact that –

   a) the scope of the efficiency study was directed at increasing productivity and reducing costs of running the Appellant's business. The projected savings for the Appellant was RM1,210,000.00 per annum;

   b) the study also showed redundancy of employees in various categories;

   c) the efficiency study was accepted and implemented and consequent to its implementation the positive results as outlined in paragraph 8 (i)-(iii) above, were achieved by September 1985 .

11. It was successfully argued that the making of findings of fact is within the scope and ambit of the learned Special Commissioners powers which the learned Judge could not usurp.

12. Findings of fact are to be made by the learned Special Commissioners and it is an error of law for the learned judge to assail those findings. [*See* the Privy Council decision of *Chua Lip Kong v. Director General of Inland* Revenue [1982] 1 MLJ 235, P.C].

13. The learned judge in his written judgment *inter alia* had questioned – "For whose benefit was this study conducted?" and concluded it is impossible to accept the contention that the **efficiency study was meant for the benefit of the defunct company.**"

It was also shown to the court that that the retrenchment exercise arose out of the recommendations of the efficiency study and had nothing to do with the possible liquidation of the company.

14. It was argued that this conclusion was erroneous factually as the Appellant company was operational during the relevant period and also legally as the cost of the efficiency study is deductible even if it benefited another (*Commissioners of Inland Revenue v. Patrick Thomson Ltd. (In Liquidation)* 37 TC 145)

15. Finally, it was successfully submitted that as the learned Special Commissioners had given reasons for their findings, and there was nothing *ex-facie* bad in law and there was no misdirection on their part and their decision ought not to have been overruled. (*Edwards v. Bairstow & Anor.* [1956] AC 14).

SECOND ISSUE – COST OF GRATUITY AND RETRENCHMENT BENEFIT – RM393,369.00

16. It was also forcibly argued by the Appellant that the learned judge had erred –

    i) In holding that the gratuity and retrenchment benefits due to the possible liquidation of the company as opposed to being the result of the efficiency study;

    ii) In applying the wrong test of "effect" and not the object of the expenditure; and

    in failing to consider that the payments were accrued for past services and incurred within the meaning of sec. 33, *Income Tax Act 1967* upon payment.

17. The argument was based on the fact that the Appellant company, as a matter of record, was in existence at the material date of 31 December 1985. In fact the Appellant exists till today and although the Appellant is on the road to liquidation, the process is not yet complete.

18. It was also shown to the court that the retrenchment exercise arose out of the recommendations of the efficiency study and had nothing to do with the possible liquidation of the company. The retrenchment was confined only to redundant staff pursuant to the efficiency study conducted. Further, the facts proved also showed that the retrenchment benefits were paid in respect of Redundant staff only and calculated on the length of service of each member of staff.

19. The case of *Mallalieu v. Drummond (H.M Inspector of Taxes)* [1983] STC 665, was relied on to show that expenditure could have a private advantage and it did not necessarily follow that it was not deductible for tax purposes. Further, it was also argued that expenditure incurred currently for past services or activities was tax deductible (*The Texas Co. (Australasia) Ltd v. Federal Commissioners of Taxation* [1940] Vol.5 ATD 290 and *Herald & Weekly Times Ltd v. Federal Commissioners of Taxation* [1932] Vol.2 ATD 69). Thus the liability to pay gratuity and retrenchment benefits paid out were in respect of production of income.

CONCLUSIONS

On Issue One

20. The facts were for the learned Special Commissioners. The learned judge had erred by making his own findings of fact that the efficiency study led to the liquidation of the Appellant, when the fact is that the Appellant was actively trading for the period 1 January 1985 to 31 December 1985 to a tune of RM39,759,909.00 and the possibility of liquidation did not stop the Appellant from trading to the last day 31 December 1985. By the same token all expenditure incurred to 31 December 1985 should be allowed.

On Issue Two

21. The expenditure of gratuity and retrenchment was incurred for past services and accrued and payment on 15 December 1985 only crystallized the accrued liabilities. The Court recognized that

    i) the liability was for past services accrued,

    ii) the payment only crystallized the existing liability.

    iii) At any rate, in this particular case the retrenchment was the result of the efficiency study and the possibility of liquidation had nothing to do with it.

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Plant: Horse Or Elephant?

By NAKHA RATNAM SOMASUNDARAM

The Malaysian Income Tax Act does not provide a definition for the term "plant and machinery". This article looks at several landmark case laws to trace the interpretation of the words "Plant and Machinery" over the last century, and the various tests applied by the courts to determine particularly, what is "plant", and what is not "plant". Two recent case laws: a Malaysian case decided in Kuala Lumpur and a Scottish case decided in Edinburgh, will be reviewed in some detail to see how the courts presently interpret the words "Plant and Machinery".

The definition of plant and machinery has come a long way from the days of the horse (*Yarmouth v. France* [(1887) 19 QBD 647] to the present day artificial grass carpet (*Anchor International Ltd. v. CIR* [(2003) SC 3006/02])

If taxation lends itself to a Darwinian study, it would be interesting indeed to see the evolution of the meaning of the words "Plant and Machinery" over the years since Yarmouth (1887) – to the present day Anchor International (2003)

Accountants' recognise that assets, particularly plant and machinery, depreciate over time due to usage, wear and tear. Accordingly a depreciation provision is made in the accounts to reflect the 'true profits' of the business. However accounting depreciation is not recognised as a tax-deductible expenditure by the tax laws simply because it really represent the writing off of a portion of the capital cost of an asset over time. It is not truly an expenditure incurred but merely a provision.

However, having regard to the commercial reality, the taxpayer is granted a tax depreciation or "capital allowances", on qualifying expenditure incurred on plant and machinery, for the purpose of quantifying the taxable income of a business under the *Income Tax Act 1967* (as amended) (hereafter referred to as "the Act")

THE MEANING OF PLANT AND MACHINERY

There is no definition of the words "Plant and Machinery" in the Act. Schedule 3, para. 1 of the Act reads as follows:

> "Subject to this Schedule, qualifying expenditure for the purposes of this Schedule is qualifying plant expenditure or qualifying building expenditure within the meaning of paragraphs 2 to 6".

Turning to para. 2 to 6, one finds there no definition of the word "Plant and Machinery". In the absence of a statutory definition, one therefore has to resort to case laws to find the meaning of "Plant and Machinery".

"Plant and Machinery" is a compound expression; the word 'machinery' generally posed very little problem. No disputes or disagreements arise in establishing what is machinery – the common perception being, it is a mechanical contraption, equipment, apparatus or device that probably has several moving parts and perhaps makes a lot of noise and din when in operation. A steamroller or piling machines are good examples of "machinery".

"Plant" however does not lend itself to such simple identification. The difficulty of doing so when a word or term is not statutorily defined is expressed very well by Lord Denning in *Heather v. P.E. Consulting Group Ltd* [(1972) 48 TC 293]. In that case, his Lordship was concerned with the issue of what is revenue and what is capital expenditure, and commented as follows:

> *"The difficulty arises because of the nature of the question. It assumes that all expenditure can be put into one category of the other, but this is simply not possible. Some cases lie on the border between the two; and this border is not a line clearly marked out; it is a blurred and undefined area in which anyone can get lost... It is like the border between day and night, or between red and orange. Everyone can tell the difference except in the marginal cases; and then everyone is in doubt..."*

Hence, the word "plant" with no universally accepted definition (not yet!) remains a mystery even today. It is as elusive as ever, defying a definition even after nearly 116 years of litigation (the *Yarmouth* case was decided in 1887).

The writer thinks that this is probably so because the original definition of "Plant" started off on the wrong foot (A horse? Plant? And it was not even an income tax case!!).

PLANT - A HISTORICAL PERSPECTIVE

An attempt will be made here to trace the evolution of the word "plant" over the course of more than one century to get a better understanding of the issues involved in its definition for tax purposes. Towards this end, the relevant case laws and the comments by the judges in those cases are deliberated in a chronological order. The first case that deliberated the meaning of "plant", way back in 1887, was *Yarmouth v. France*.

Yarmouth v. France [(1887) 19 QBD 647]

This was not a tax case but a workmen's compensation case under the *Employer's Liability Act* 1880. A worker was injured by a horse and he claimed compensation. The employer disputed the claim, saying that a horse in not plant. However, the court held that a horse was plant for the purposes of the relevant legislation i.e. the *Employer's Liability Act* 1880, giving rise to the celebrated dicta of *Lindley* LJ as follows:

> *"There is no definition of plant in the Act, but in its ordinary sense it includes whatever apparatus is used by a businessman for carrying on his business – not his stock in trade which he buys or makes for sale, but all goods and chattels, fixed or movable, live or dead, which he keeps for permanent employment in his business"*

Daphne v. Shaw (11 TC 256)

Since it was agreed that a horse is indeed plant, the courts wanted something straight from the horse's mouth when it came to the question of books. Apparently they picked the wrong horse and so, in the case of *Daphne v. Shaw* the books used by a solicitor were held to be **not** plant or machinery. The grounds for that decision was that the books were not apparatus or implements used in carrying out the operation of the vocation. *Rowlatt* J decided this case in 1926.

Munby v. Furlong [(1976) STC 72]

Half a century later, a crucial foxy (pardon the pun) decision was made by Mr. *Justice Fox* who held that books are indeed "plant". In delivering judgment for the taxpayer, Mr. *Justice Fox* went on to say that:

> *"...It seems to me that one thing which is clear from all the cases is that the meaning of "plant" is merely a matter of construction to be determined according to ordinary principles of construction and taking into account all the circumstances of the individual case. The modern cases clearly establish that Lindley LJ's definition as a valuable general guide, and they clarify various other matters. But they do not attempt to lay down a hard and fast meaning or to delineate boundaries with precision. The matter is, as it always was, one of construction. I would take the view that the taxpayer is right and that these books are plant.*
>
> *So applying it ...it seems to me quite plainly to cover books purchased by a barrister for the purpose of his profession. Those books do indeed represent apparatus used by him for carrying on his profession, and that to my mind is the end of the case."*

In this case, a solicitor bought books for his law library soon after he set up practice. He claimed capital allowances on the books, saying that they are chattels of his profession and "plant" within the *Yarmouth v. France* dictum.

Jarrold v. John Good & Sons Ltd [40 TC 681]

Buildings have partitions and these partitions can either be fixed or they can be moveable. In the case of *Jarrold v. John Good & Sons, Ltd.* [40 TC 681], moveable partitions were held to be plant. The partitions were part of the setting but were not part of the premises in which the trade was carried on. The partitions were used to sub divide the floor space. It could be unscrewed and fitted elsewhere with relative ease.

The Commissioners found that as a matter of commercial necessity, the partitions had to possess mobility and flexibility for the day to day running of the business. They were apparatus with which the company carried on its business. The John Good case does not mean that all moveable partitions are plant. The taxpayer will have to satisfy the Director-General of Inland Revenue ("DGIR") that they need to possess "mobility" as a matter of commercial necessity. There must have been instances when the partitions were moved on those grounds.

In that case, the issue was whether movable partition are part of the setting i.e. part of the premises and therefore not plant. *Pennycuik* J noted as follows:

> *"...the short question in this case is whether the partitioning is part of the premises in which the business is carried on or part of the plant with which the business is carried on... ...in this case it is clear that the movable partition were so adapted that the arrangement inside the building should be as flexible as possible to meet the changing demands of the trade...it must be remembered that the loss of an agency might well cause a department to cease altogether, whereas the acquisition of an agency might involve the setting up of a new department; and changes in the business of any of these agencies might reduce or increase the size of the various departments and thereby alter the accommodation required. The trade, which was carried on by the respondent, was that of a shipping agent, and to carry on that business efficiently, a flexible system of building was required. The dividing line between what is "Plant" and what is not is a narrow one, and the facts of this particular case come near to that dividing line. But in my judgment...in the circumstances of this case –and I think each case does depend largely on its own circumstances – the partition should be regarded as something more than a mere setting for the carrying out of the trade; ......I am not at all satisfied that these partitions did perform a merely passive role. It is certainly true that it did not contain any working parts such as a machine contains. Had they done so, it may well be that they would have come within the definition of "Machinery". But "Plant" is a wider term..."*

In the above dicta of Lord *Pennycuik*, concepts such as "setting" and "functions" are mentioned in relation to a plant. This is the beginning of the use of "Functional Test" and the "Setting Test".

The "Functional Test" is based on the concept that to be a plant, an asset must actually perform some function, whether active or passive, for the carrying on of the taxpayer's trade.

In the case *Benson v. The Yard Arm Club Ltd.*, [53 TC 67] Buckley LJ said:

> *"The functional test provides the criterion to be applied. Is the subject matter the apparatus or part of the apparatus employed in carrying on the activities of the business..."*

On the other hand, the "Setting Approach" implies that an asset that is merely a setting from which the business is carried on is not plant. While it is easily stated, it is difficult in practice. The *Jarrold v. John Good* case did bring out this difficulty when *Pennycuik* J noted:

> *"...The setting in which a business is carried on and the apparatus used for carrying on a business are not always mutually exclusive. Certain fixture or chattels in certain trades may well represent the setting in which the business is carried on, from one point of view, and apparatus used for carrying on the business from another point of view..."*

CIT v. Taj Mahal Hotel [82 ITR 44]

In this Indian case, the Supreme Court of India decided that sanitary and pipeline fittings in a hotel were part of "plant" and not merely a setting for the purposes of carrying on its hotel business.

CIR v. Barclay, Curle & Co. Ltd. [45 TC 221]

This is a leading case in its field. A company of shipbuilders and repairers constructed a dry dock on the banks of the river Clyde. The cost comprised of £186,928 for the excavation for the dock, £500,380 for the concrete works and £243,288 for the ancillary equipment and machinery. The dock was designed to receive a ship from the river and hold it in place in the dock where, after the ship is brought in, the water in the dock will be pumped out to expose the lower part of the ship for repairs and maintenance. Upon completion of the repairs, water will be pumped in into the dock to re-float the ship out to sea. The dock therefore had an active function of getting the ship from the river, holding and securing it for repair, and returning the ship back to the river.

Lord *Reid*, in delivering judgment, said:

> "...*it seems to me that every part of this dry dock plays an essential part in getting large vessels into position where work on the outside of the hull can begin and it is wrong to regard either the concrete or any other part of the dock as a mere setting or part of the premises in which this operation takes place. The whole dock, is, I think, the means by which or plant with which, the operations is performed*..."

Commenting on this case, Sir Donald Nicholls V-C in *Carr v. Sayer* [(1992) STC 396] said:

> "...*Equipment does not cease to be plant merely because it also discharges an additional function, such as providing the place in which the business is carried out. For example, when a ship is repaired in a dry dock, the dock also provides the place where the repair work is carried out. That is no more than the consequence of the extensive size of the piece of fixed plant*..."

Cooke v. Beach Station Caravans Ltd. [(1974) 49 TC 514]

In this 1974 case, the question was whether a swimming pool can be a "plant". The amenities of a caravan park operator included swimming pools provided with an elaborate system of filtering, chlorinating and heating. The cost included £3,353 for excavating, concreting and lining the pools as well as the surrounding terrace. The Revenue refused to admit the expenditure as qualifying "plant". On appeal, the Chancellery division held that the whole structure was expenditure on plant and machinery. The decision in *John Good* and *Barclay Curle* was applied.

In this case the "Functional Test" was applied, and in the words of *Megarry* J:

> "...*Nobody could suggest that the principal function of the pool was merely to protect the occupants from the elements...they are part of the apparatus used by the company for carrying on its business as caravan part operators. The pool was part of the means whereby the trade is carried on and not merely the place at which it is carried on*"

The pool was considered not on their own but in relation to the business carried on.

Dixon v. Fitch's Garage Ltd. [(1975) STC 480]

A new test "The Amenity Test" was introduced in this case. The company was operating a petrol filling station. The service area of the filling station was protected by a metal canopy. The company claimed capital allowance on the canopy. The claim was disallowed. Before arriving at the decision, the Courts raised several pertinent issues. For example, does the canopy help to supply petrol or is it merely a part of the setting where petrol is supplied? According to *Brightman*, J., this question admits a negative answer. The petrol pump would deliver petrol to vehicles whether or not there was a canopy overhead. The canopy merely makes the business of supplying petrol more comfortable for motorist and the staff of the petrol station. It does not help to deliver the petrol.

The "Functional Test" expounded in *Barclay, Curle & Co* was explained and applied in this case. In explaining the test, *Brightman* J said:

> "...*The proper test is whether the canopy has a functional purpose to enable the taxpayer company to perform the activity of supplying petrol to motor vehicles. I ask myself, " Does the canopy help to supply petrol", or is it merely a part of the setting where petrol is supplied? In my judgment this question admits only of a negative answer. The petrol pump would deliver petrol to vehicles whether or not there was a canopy overhead. The canopy merely makes the business of supplying petrol more comfortable for motorist and the staff of the petrol station. It does not help to deliver the petrol. It is not part of the means by which it is supplied. It is not like the dock case where the dock was useless without its operating machinery and vice versa or the silo case, where the silo and its contents were totally interdependent. Further, there is a clear thread running through the recent cases...showing that a structure is not plant if its only purpose is to provide shelter and it plays no part in what may be termed the "commercial process". That conclusion is I think an inevitable result of the application of the functional test. In this difficult area of the law, it is, in my view, important to stick to the established test. In his submission to me the taxpayer's Counsel sought to introduce a new test; whether the item in question is commercially desirable or necessary to enable the taxpayer to sell his petrol to the best advantage. That, to my mind, is an amenity test as distinct from a functional test, and is not a permissible test. The right test is the functional test*..."

This "Amenity Test" was not wholly dismissed. It was brought into focus again in another case that is deliberated below.

CIR v. Scottish & Newcastle Breweries Ltd. [(1982) STC 296]

The new concept of "Amenity or Setting" i.e. capital expenditure incurred, considered commercially desirable for the purpose of promoting a trade or business can be, in particular circumstances of the case, comprise "Plant". This was considered by the House of Lords in the Scottish & Newcastle case.

By this time Judges were not entirely happy with the "Functional Test" and considered it rather inadequate and inconclusive. It was however accepted that whatever test applied must have regard to the nature of the business carried on by the taxpayer.

In the leading speech in the House of Lords, Lord *Wilberforce* discussed the distinction between "Plant" and "Setting" and went on to say:

> *"...Another much used test word is "function" – this is useful as expanding the notion of "Apparatus"; it was used by Lord Reid in Barclay Curle...but this too must be considered, in itself, as inconclusive. Functional for what? Does the item serve a functional purpose in providing a setting? Or one for use in the trade?*
>
> *It is easy without excessive imagination, to devise perplexing cases. A false ceiling designed to hide unsightly pipes is not plant though the pipes themselves may be (Hampton v. Fortes Autogrill)...is tapestry hung on an unsightly wall any different from a painted mural. And does it make a difference if there was a damp patch underneath? What limit can be placed on attractions, interior or exterior, designed to make premises more pleasing to the eyes or other senses? There is no universal formula, which can solve these puzzles...in the end each case must be resolved, in my opinion, by considering carefully the nature of the particular trade being carried on, and the relation of the expenditure to the promotion of the trade. It seems to me on the Commissioner's findings, which are clear and emphatic, that the respondent's trade includes, and is intended to be furthered by, the provision of what might be called the 'atmosphere' or 'ambience' which (rightly or wrongly) they think may attract customers. Such intangibles may in a very real sense and concrete sense be part of what a trader sets out, and spends money, to achieve ....a good example might be a private clinic or hospital, where quiet and seclusion are provided, and charged for accordingly. One can well apply the 'Setting Test' to these situations. The amenities and decorations are in such a case as the present are not, by contrast with the Lyons case, the setting in which the trade carries on his business, but the setting which he offers to his customers for them to resort to and enjoy. That it is setting in the latter and not the former sense for which the money was spent is proved beyond doubt by the Commissioner's findings..."*

At the time this case was heard, there was much confusion between "Setting" and "Premises". In fact the two were moving closer to each other and in some instances, it was even overlapping. This was highlighted by Lord *Lowry* when his Lordship gave full judgment in the Newcastle case. His Lordship said:

> *"...My Lord, the appellant's (i.e. the Revenue) primary fallacy, in my opinion was to identify 'setting' inevitably with 'premises' or place, by misapplying to this case the observation of the judges in Jarrold when facing the question whether the articles are part of the premises or setting in which the business is carried on or part of the plant with which it is carried on. This was in a case where the word 'setting' had no theatrical or artistic significance, as it would have in the phrase "appropriate setting" meaning the right atmosphere.*
>
> *And even if one assumes that 'the setting" is the same thing as 'the premises' it is fallacious to say that articles used to adorn the setting thereby ceased to be apparatus used by the taxpayer company for the carrying on of their business...*
>
> *It is in my view equally fallacious to deny that the creation of atmosphere is for the purposes of his trade, an important function of a successful hotelier...now the creation of the right atmosphere is a means to an end in the carrying on of such a trade; it is not a trade itself or a separate part of the trade. ...Everything ...from the ornaments, is used purely to create an atmosphere. The mere fact that some of the ornaments are free standing on the floor or on the shelves or tables and that others are supported or suspended from or affixed to walls or ceilings is quite beside the point. They are all part of the hotelier's plant as defined in Yarmouth v. France. ...One of the trade functions of a hotelier is to make the interior attractive to customers: why then should one deny that the items used for this purpose are plant?"...*

In the *CIR v. The Scottish & Newcastle* case, the facts were as follows: a company spent £104,498 on the provision of electric fittings and wiring, décor and murals in some hotels and public houses it ran in the course of its business, and claimed capital allowances on the amount of capital expenditure on plant. The "décor and murals" included items affixed to the walls, but all were detachable, some more easily than others. The evidence was that the lighting and décor for each premises were carefully designed, having regard to the type of clientele it was desired to attract; different kinds of clientele (e.g. tourists, businessman, etc) want different kinds and standards of facilities. The Special Commissioners took the view that the company's trade included the provision of accommodation in a "situation, which includes *atmosphere* – atmosphere judged in the light of the market" which particular premises were intended to serve, and that the fitting and décor served a functional purpose in the trade. They also served as part of the setting of the trade, but it was the function of the trade to provide a special and attractive setting for its customers. The Commissioners disallowed the wiring expenditure of £2,635 as relating to the fabric of the building but otherwise allowed the claim. The House of Lords upheld the decision of the Special Commissioners.

In another situation, a fast food company tried to claim capital allowance on the basis of creating an atmosphere or ambience, but failed. The case is examined next.

Wimpy International Ltd. v. Warland and Associated Restaurants Ltd. v. Warland [(1988) BTC 591]

Two companies operated in the field of fast food catering, running respectively Wimpy and Pizzaland restaurants. During the 1970s both chains were affected by increasing competition from similar chains. The parent company decided that the premises should be improved and redesigned to reach a wider market. To that end, such items as new lighting, shop fronts, floor and wall tiles, suspended ceilings, wall panels and mirrors, raised floors, balustrading and stairs were installed. The Inspector of Taxes disallowed the claims as expenditure on the provision of plant and machinery for the purposes of the trade.

The Special Commissioners considered the various items and concluded that they were not plant qualifying for capital allowances.

The company appealed to the High Court contending that what was being marketed was the serving of food in a particular ambience, that all the items in dispute were installed to improve the ambience of the restaurant and to attract customers. They were thus used in the business even if some of the fixtures became part of the building.

In giving judgment *Hoffman* J stated as follows:

> "...*Mr. Aaronson (the counsel for the taxpayer) invites us to find that ...décor, food and service make up the product marketed by the company in its trade; by decor he means all the surfaces visible to the customers and the lighting in the restaurant. The décor item do not therefore simply contribute to the setting, but as in the Scottish & Newcastle case, constitute apparatus used in the trade of selling that product...Mr. Aaronson's proposition is, in our opinion, too wide. It is not 'décor' as such, which, in the light of the Scottish & Newcastle decision, is to be regarded in suitable cases as part of the thing sold by a restaurant owner but 'ambience' and 'atmosphere'. We accept that atmosphere was an ingredient in the product, which the company offered to its customers; and it follows from the Scottish & Newcastle that apparatus, which served to create that atmosphere, may be plant even though it played no part in the preparation and service of meals. But we cannot treat 'decor' as a global item. We have to consider each item separately and determine whether its function was to embellish the premises by way of atmosphere or whether it falls on the other side of the dividing line as being part of the place or setting in which the trade was carried on.*"

Here one can see that the Judge is approaching the matter of décor in a so-called **"Piece-Meal Approach"**, which was rejected by the Judges in the case of *Barclay, Curle and Co. Ltd.* In that case the revenue adopted the "Piece-Meal Approach" – i.e. the excavation expenditure should be looked into separately from the other expenditure on machinery and equipment. The majority of the House of Lords rejected that approach, and to quote two of the Lords would be appropriate here:

Lord *Guest* at page 245:

> "...*It is unrealistic, in my view, to consider the concrete works in isolation from the rest of the dry docks. It is the level of the bottom of the basin in conjunction with the river level, which enables the function of dry-docking to be performed by the use of dock gates valves, and pumps. To effect this purpose excavation and concrete work were necessary..*"

Lord *Donovan* at page 249G:

> "...*Furthermore I regard the "piece-meal" approach as unreal. The dry dock ought, I think, for present purposes to be regarded as a whole, with all its appurtenances of operating machinery, power installations, keel blocks, tubular side shores, and so on...*"

This "Piecemeal Approach" was avoided in the subsequent cases of *Schofield v. R & H Hall Limited* [49 TC 538] and *Cooke v. Beach Station Caravans Limited* [49 TC 514]

No matter how one looks at the matter, whether as a whole or by piecemeal, the question of what is "Plant" and what is "Setting" is not the right choice of words for describing these expenditures. Uthwatt J in *J. Lyons & Co. Ltd. v. Attorney – General* [(1944) Ch. 281] used the word "Setting" to refer to things, which were among other things, the premises but also things that were neither part of the premises nor used in carrying on the business.

However the setting in which a business is carried on can, in ordinary language include the plant used to carry it on. Hence the use of the word "Setting" in relation to "Plant" is not a very appropriate or precise tool to apply to the "Business Use Test", especially in its application to the business of restaurant and hotels where an important way in which the business is conducted is the provision of setting that creates an atmosphere. The same can be said for most hospitality business including nursing and medical centers where peace and quiet is a premium.

Sometime the "Setting" would include the premises themselves (as in the case of the fast food restaurant). These are excluded from the concept of plant but not for the same reason as the lamps in *J. Lyons & Co Ltd v. Attorney General* but simply because they are the premise.

According to *Hoffman* J, no matter how "purpose built" the premises may be, they are not plant if they constitute the premises or place upon which the business is conducted.

The "plant and setting" dichotomy conceals an ambiguity that does not lend itself easily to an application especially where the two are very close or in some cases even overlapping. In fact, the expenditure changes character with the type of test used. And therefore one has to be careful to apply the correct test to determine whether a particular expenditure qualifies as plant. In explaining his decision in the case of Wimpy International, *Hoffmann* J said:

> "*...This case is about the application of what I have called the 'premises test' to additions and improvements to restaurants for the purpose of making them more attractive to customers. In that respect, it is unlike the Scottish & Newcastle case, which was mainly about the application of the business test to items, which were plainly not part of the premises. The items in dispute in that case were wall décor, plaques, tapestries, murals...pictures and metal sculptures to decorate hotels. All of these were held to be chattels or trade fixtures and not integral parts of the premises. The Revenues refused them capital allowances as plant on the grounds that they formed the 'Setting' which is in one sense...they certainly did. But the House of Lords held that they nevertheless passed the business use test because they were used to please and attract customers, and therefore for the promotion of trade...*"

The application of the "business use test" apparently must be in conjunction with the "premises test" for otherwise the business use test may prove itself too liberal and any additions by way of refurbishment to a business premises will qualify. *Lord Lowry* made it very clear in the *Scottish & Newcastle* case [(1982) 55 TC 252] that the "premises test' must also be applied in conjunction with the "function test" when his Lordship said at p. 277:

> "*...Moreover, the test accepted in this case by the Commissioners and affirmed by the Inner House draws a line which can be held without trouble: something which becomes part of the premises, instead of merely embellishing them, is not plant, except in the rare case the premises themselves are plant, like the dry dock in Barclay, Curle or the grain silo in Schofield ...*"

Hoffmann therefore concluded the case by arguing that an item would only qualify as plant if it passed all the following three tests:

a) It must not form part of the premises or place in or upon which the business is carried on i.e. the "premises test"
b) It must be used for the carrying on of the business i.e. the "business test"; and
c) It must not form part of the stock-in-trade.

Diagrammatically the various tests and the approaches used can be illustrated as shown below:

Ketua Pengarah Hasil Dalam Negeri v. MSDC [(2003) MSTC 3,973].

The tests used in the Wimpy case were applied in the local case of *Ketua Pengarah Hasil Dalam Negeri v. MSDC Sdn. Bhd* [(2003) MSTC 3,973].

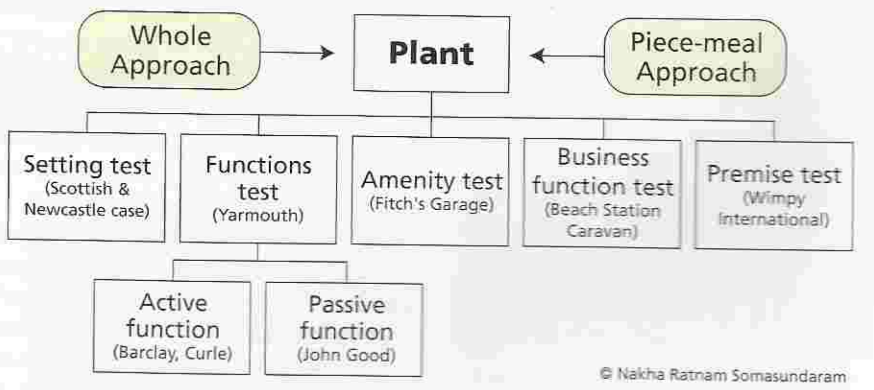
The taxpayer was a private limited company incorporated in 1986. Its principal activity is to carry on the business of driving school for motor cars, motorcycles, lorries, tractors and all other motor vehicles; instructing, teaching, guiding and rendering services of all kinds which the company thought fit. The Minister of Transport licensed the company to operate as a driving institute.

In complying with the conditions of the permit issued for its driving school, the taxpayer had bought two pieces of land in Malacca, situated near the Malaysian Road Transport Department and incurred capital expenditure on the construction of the following on the land:

a) A training ground; and
b) A building.

The training ground is specially constructed to the Road Transport Department's specification. It includes a 5-metre broad tarred road circuit that contains slopes and inclines, undulations, various types of parking lots, dangerous curves, roundabouts, slipways, traffic light junctions, T-junctions and other similar motorway intersections and "obstacles".

Chart 1 Plant: Approaches and Tests Used



Special grounds are constructed for motorcycle training including skid stretch and emergency braking stretch.

The building consisted of an office and classrooms for the teaching of theoretical lessons in motor vehicle driving, driving rules and regulation. Instructors trained and licensed by the Road Transport Department, will teach these subjects.

The taxpayer claimed capital allowances in respect of the building and the training ground as qualifying building expenditure and qualifying plant expenditure under sch. 3 of the *Income Tax Act 1967* (as amended) for the years of assessment 1992, 1994 and 1995. The Director-General of Inland Revenue rejected the claim, taking the position that the training ground and the school buildings were settings and therefore did not qualify for capital allowances.

The taxpayer appealed.

The Special Commissioners had to determine, based on the facts available, whether the capital expenditure incurred in constructing the school building and the training ground, were qualifying expenditure. In considering the taxpayer's claims for capital allowance, the two items i.e. the buildings and the training ground was considered separately. They decided that based on existing law, the buildings were merely part of the setting in which the business was carried on. The buildings had no function to perform other than to shelter the trainees who were given instructions in theory. As such, the buildings were only the structure within which the function of educating the trainees were carried on and therefore did not qualify as a plant. Further the building were not used for an approved service project, since approval had to be obtained from the Minister of Finance and not the Minister of Transport, as alleged by the taxpayer. Consequently, the buildings did not qualify for capital allowances.

As regards the training ground, the taxpayer has satisfied the following conditions considered in the case of Wimpy International Limited mentioned above:

a) The training ground must form part of the premises or place in which the business is carried on - i.e. it must pass the "premises test'
b) The training ground must be used for carrying on the business i.e. it must comply with the "business test"
c) The training ground must not form a part of the stock in trade.

Further the taxpayer's training ground had also fulfilled the following four conditions for capital allowance:

a) The person incurring the capital expenditure must be carrying on a business
b) The capital expenditure must have been incurred on the provision of machinery or plant;
c) The machinery or plant must be used for the purposes of the claimant's business.
d) The person must be the owner of the asset at the end of the basis period

The training ground, which is specially, prepared for carrying out the business of a driving institute is in fact an integral part of the taxpayer's business and is therefore plant for the purposes of capital allowances under sch. 3 of the Act.

The DGIR appealed to the High Court against the Commissioner's decision but this was dismissed. The High Court's decision by Faiza Thamby Chik, J. was quite instructional and is summarised below for that reason:

a) The court's duty in a case stated by the Commissioners could only be allowed if it was shown that the Commissioners' determination was erroneous on point of law.
b) There was no statutory definition of "plant". Although permanence and other test words such as "setting", "apparatus", and "functional" had been considered in various cases, there was no universal formula, which could solve these puzzles. In the end each case must be resolved by considering carefully the nature of the particular trade being carried on, and the relation of the expenditure to the promotion of the trade.
c) The Court agreed with the Commissioners that whether an "apparatus" is plant has to be considered in relation to trading activities as a whole and/or all its constituents parts and appurtenances must be viewed as a whole. The fundamental test is that an apparatus will constitute plant if it fulfils the function of a plant, in that it is the means by which a trading operation is carried on.
d) It was quite obvious that without the training ground, the taxpayer would not be able to carry on their business of a driving institute.

The "whole approach" and the functional test were clearly dominant in the determination of this case.

Anchor International Limited v. Commissioners of Inland Revenue [2003 SC 3006/02]

This case was decided in Edinburgh on 15-16 January 2003. The appellant company is involved in the provision of leisure facilities in various sites throughout the United Kingdom. The leisure facility included pitches specifically designed for a five-a-side football matches. There was also a clubhouse building on each site providing a combination of indoor facilities, including shower and changing rooms, snooker and pool tables, coin-operated gaming machines, function rooms and bars. These facilities are available to persons using the pitch. About 70% of the gross income of the appellant is derived from the pitch and another 20% coming from the provision of food and drinks. The balance is made up sundry income from locker rent and amusement machine.

At the appeal, it was agreed that the clubhouse building and the cost of the land underlying the pitch would not qualify for plant allowance. The provision of goal post, rebound boards and dedicated flood lights are accepted as eligible for capital allowances.

The question was whether the pitch qualifies as plant?

The artificial pitch is popular because games can be played everyday (as compared to one game per evening in summer and one game per week in winter, on a natural turf). It is also possible to play other games on the pitch besides the five-a-side football.

Expenditure on the construction of the artificial pitch involves the undertaking of a ground investigation followed by a topographical study. If found suitable, the ground is prepared by excavating and stripping the topsoil to prepare an underground drainage system, including a cut and fill operations where necessary. The ground is then trimmed and proof rolled. A layer of terram geotextile is laid to prevent contamination and to facilitate clean drainage. A stone base complying with tight legal regulations is laid, on which another layer of terram geotextile is placed. A synthetic grass carpet with sand in-fill is laid onto the terram layer in strips. The sand in-fill helps to anchor the artificial grass carpet and also keeps the pile upright giving the carpet its durability and playing characteristics. About 25-30 kg of sand is used per square meter, the whole pitch requiring about 22 tons.

The pitch has a life expectancy of between five years (intensive use) and nine years (average use). Worn out and damaged strips (normally occurring in the centre of the pitch) can be repaired or replaced. The company claimed a sum of £297,863 that included a sum of £195,456 on excavation, infilling, drainage, terram geotextile and carpet.

The Revenue argued that the expenditure should be looked as a whole, that it is a structure (under the UK legislation) and is therefore excluded as plant. The taxpayer argued that the carpet retained its separate identity and is separate from the land works i.e. the foundation. It was argued that the distinction is between an item which plays a specific part in the generation of profits of the trader (which is plant whether or not it constitutes premises) and an item which, although used by the taxpayer for trade purposes, in not, itself exploited to earn profits but performs a general housing function (which is not plant). If something is plant, then it does not matter if it also performs a different function.

The Special Commissioners decided that one could regard the pitch (if the "Whole Approach" is adopted) or the carpet (if the "Piecemeal Approach" is adopted) as both the setting and the means with which the business is carried on. The dual nature is no different from *Barclay Curle* or the *Beach Station Caravan* cases. In this case the trade is the provision of synthetic football pitches, which generate about 70% of the turnover of the business. So in one sense, the trade is the provision of the setting, and in another sense, the pitch and the carpet are the plant with which the trade is carried on. It is not possible to make the distinction, as the Revenue claims, between football being played *on*, rather than *with*, the carpet.

According to Dr. J. F. Avery Jones, the Special Commissioner, '*...the fact that there are cases where plant serves both purposes shows, that once the plant is used in the trade it does not matter that it is also the setting...*'

CONCLUSION

Since there is no definition of "plant and machinery", several tax principles have been developed to identify what items could be classified as "plant and machinery". The list is not exhaustive and with new court cases, it is expected to grow over the years to come.

To quote Lord Lowry in Scottish & Newcastle:

> *"...The word 'Plant' has frequently been used in fiscal and other legislation. It is one of a fairly large category of words as to which no statutory definition is provided ...so that it is left to the court to interpret them. It naturally happens that as case follows case, and one extension leads to another, the meaning of the word gradually diverges from its natural or dictionary meaning. This is certainly true of 'plant'. No ordinary man, literate or semi-literate, would think that a horse, a swimming pool, movable partitions, or even a dry dock was plant – yet each of these had been held to be so; so why not such equally improbable items as murals or tapestries or chandeliers? ...And ... if after enduring nearly a century of Yarmouth v. France, Parliament decides that 'plant' must receive a statutory definition, something can no doubt be done to curb the 'excesses' of the Special Commissioners and the judiciary ..."*

In fact, Lloyd LJ in *Wimpy* summed it up nicely, when he said:

> "... 'Plant' is like an elephant, easy enough to recognise *when one sees it...*" *[Emphasis added]*

The catch is: "**when one sees it!**"

What if you don't see it?

Then it could be like the proverbial four blind men (read: taxpayer, tax agent, Revenue and the Courts) trying to "feel" the elephant! The writer feels at that stage it does not matter whether it is an African elephant or Indian elephant – and what colour it is – whether white or grey!!

For income tax purposes, plant, horses and elephants will remain as grey as ever – for another century, perhaps.

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Annual Post-Budget Luncheon Talk on the 2004 Budget

By: Dato' Kamariah binti Hussain

Head of the Tax Analysis Division, Ministry of Finance

Date : **16 September 2003, Tuesday**

Venue : **Nikko Hotel, Kuala Lumpur**

Time : **10:30 am - 2:30 pm**

Significant Coverage

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11:10 am	**The 2004 Budget Tax Proposals** **Speaker: Dato' Kamariah binti Hussain** Head of the Tax Analysis Division, Ministry of Finance
12:00 pm	Open Forum – Panelists • A Representative from the Inland Revenue Board, Malaysia • A Representative from the Royal Customs Department, Malaysia • A Representative from the Malaysian Institute *of* Taxation
12:20 pm	Q & A Session
1:00 pm	Lunch
2:30 pm	End of programme

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Joint Ventures And Tax Considerations

By HARVINDAR SINGH

Joint ventures ("JV") are a common feature in the business world. As such, it is imperative to be aware of the tax issues typically associated with a JV. This article attempts to highlight some of the salient points that need to be considered when entering into JV arrangements.

Overview

When two or more parties form a JV, the following issues need to be considered from a tax perspective:

- Choice of JV entity – legal structure
- Profit distribution and repatriation
- Financing a JV
- Transfer pricing issues
- Cross border investments

What is a JV

There are various forms of JVs. One description of a JV is ... "a series of contractual understandings between two or more entities in corporate or partnership format which combine market, technology and / or production advantages of each for an agreed upon sharing of capital, management, operating responsibilities and profit".

Legal structure of the JV

A JV would normally take the form of an incorporated JV company, an unincorporated business venture akin to a partnership or be carried out by way of contractual / collaboration agreements.

A JV company is the most common form of structure. It offers stability and limited liability. A JV company is a taxable entity for income tax purposes and it is distinct from its shareholders.

An unincorporated JV is governed by the *Partnerships Act, 1961*. As with all partnerships, it is not subject to income tax. There is a separate assessment for the JV partners who will be liable for income tax on their share of the taxable profits. An unincorporated JV is however subject to *Real Property Gains Tax* ("RPGT") under the RPGT Act, 1976 if the JV disposes of real property of Real Property Company shares.

Tax issues to consider when setting up a JV

In the course of setting up a JV, the parties involved might pool their resources such as transferring assets to the JV entity. Tax-wise, the issues that arise from the transfer of capital assets would incorporate income tax, RPGT and stamp duty.

The transfer of assets is normally not subject to income tax, except where capital allowances / industrial building allowances have been claimed in the past by the transferor. In such situations, it would be necessary to calculate balancing allowances / balancing charges. A balancing charge arises when the disposal proceeds are greater than the tax written down value of an asset. Conversely, a balancing allowance would be the result of the disposal proceeds being lower than the tax written down value.

A pertinent point to consider would be the applicability of "controlled transfer provisions" where the transfer will be deemed to have taken place at a value equal to the tax written down value and a balancing allowance / balancing charge computation would not be applicable.

A sale is deemed to be a "controlled sale" where a person disposes of an asset in relation to which an initial or annual allowance has been claimed in the past, the asset has been used in the business and the transferor / transferee are "controlled" entities. In other words, it is a situation where the transferor has control over the transferee or vice versa; or some other person has control over the transferor and transferee of the asset (para. 38 of sch. 3, *Income Tax Act, 1967*).

RPGT is applicable where chargeable assets i.e. real property or shares in a real property company ("RPC") are disposed. The rate of tax ranges depending on the duration for which the chargeable asset is held and whether it is held by companies or individuals. The following table shows the rates applicable to the various categories of taxpayers:

For companies and individuals
(who are citizens or permanent residents)

Acquisition period	Companies (%)	Individuals and other persons (%)
Disposal within 2 years	30	30
Disposal in 3rd year	20	20
Disposal in 4th year	15	15
Disposal in 5th year	5	5
Disposal in 6th and subsequent years	5	Nil

Individuals that are not citizens or permanent residents

Assets disposed by an individual who is not a citizen or permanent resident is subject to tax at the following rates:

	Rate
Disposal within 5 years	30%
Disposal in 6th and subsequent years	5%

Needless to say, when the owner of the chargeable assets is considering transferring them to the JV entity, he has to be mindful of the length of ownership of such assets.

A RPC is a controlled company owning property and or shares in a RPC, the defined value of which is at least 75% of its total tangible assets (including shares in another RPC). The disposal of RPC shares is a disposal of a chargeable asset that is subject to RPGT. It is therefore important to structure the JV entity carefully to avoid a JV company from being considered a RPC, especially where the JV entity is to be set up for a short period of time such as in the case where a particular project's duration is short. If the JV company is an RPC and the JV parties sell their shares within 2 years, the applicable RPGT rate on the chargeable gain is 30%.

Special exemption from RPGT

The *Real Property Gains Tax (Exemption) (No. 2) Order 2003* has been gazetted and has effect from 1 June 2003.

The Order exempts any person from the payment of RPGT in respect of chargeable gains accruing on the disposal of any chargeable asset from 1 June 2003 to 31 May 2004.

Both the acquirer and disposer will still be required to file the relevant RPGT returns notwithstanding the fact that the gains are not taxable.

As far as stamp duty implications are concerned, it is a duty that is imposed on documents and not on transactions. For the transfer of assets, stamp duty at the rate of 1% to 3% will be levied on the transfer document. In the case where the transaction is entered into overseas, Malaysian stamp duties will apply if the transfer document is brought into the country. The transfer document has to be stamped within 30 days of being brought into Malaysia.

For certain assets that are transferred such as debts, the transfer may be affected by way of a Board of Directors resolution. Where there is no instrument of transfer, stamp duty would not be applicable. However, in case of disputes and where legal action is being taken against the debtors, the absence of the instrument of transfer will jeopardize any attempt to take the matter to the courts. In the case where there is an instrument of transfer but it is not stamped, such an instrument will not be permissible as evidence in the courts.

Exemption from stamp duty is available under sec. 15 and 15A of the *Stamp Act, 1949*. Section 15A is wider and applies in the case of transfer of assets between related companies which are at least 90% associated. Section 15 is narrower and applies in the case of a disposal of an undertaking under a scheme of reconstruction or amalgamation. For an exemption under sec. 15, the consideration must consist of at least 90% in shares and certain conditions need to be met in order for the transfer to be eligible for exemption.

Profit extraction

Dividends

For an incorporated JV, the repatriation of profits available for distribution is normally by way of dividends. Income tax paid by a Malaysian resident company on its profits is imputed to the dividends paid to its shareholders. Shareholders are assessed on the dividends received but a credit is given for the tax already suffered at source i.e. paid on behalf of the shareholders by the company.

Management, technical assistance and license fees

The JV parties may be providing specific services to the JV company and as such, should be charging fees to the JV entity. For income tax purposes, the above expenses should be deductible provided the "wholly and exclusively incurred" test under sec. 33 of the *Income Tax Act, 1967* is satisfied. By extracting such payments, the taxable profits in the JV entity are reduced. It would be imperative to avoid transfer pricing issues especially if it involves shifting the profits from one tax jurisdiction to another. The pricing policy must be appropriate and commercially justifiable to reflect arm's length transactions.

Withholding tax

The payment of technical fees, management fees, interest or royalties by the JV entity to a non-resident JV partner is subject to withholding tax. The rate of withholding tax is reduced under certain double tax agreements that Malaysia has entered into. Therefore, the Malaysian JV should explore the possibility of doing business with entities in countries which offer the lowest withholding tax exposure.

Where payments are made by Malaysian residents to non-residents for technical or advisory services which are performed in Malaysia, withholding tax generally at the rate of 10% is applicable. This tax is applied on the gross amount of the payments.

With effect from 21 September 2002, services rendered abroad (outside Malaysia) by non-resident service providers will not be subject to Malaysian taxation. In the case where there are services rendered overseas as well as in Malaysia, it is imperative that the JV entity keeps supporting documentation, agreements etc. in place to show clearly the type and value of the services rendered in Malaysia or outside Malaysia for this purpose, to prove to the tax authorities the portion of fees that are payable for services rendered in Malaysia which are subject to withholding tax.

If properly structured, the nominal value and premium payable upon the redemption of the RPS would be a return of capital and not subject to income tax.

Financing a JV

The principal methods of financing a JV would be by way of share capital and/or loan capital (including the issuance of bonds, notes, debentures etc).

Equity financing would typically involve a cash injection. Where the JV parties are unsure of their long term plans in respect of a joint venture project and do not intend locking themselves up equity-wise, they may consider to partly finance the JV via loan financing.

Loan financing provides the flexibility in that if the JV parties wish to convert the amounts loaned to equity, the loan documents can be tailored as such.

There are no official thin capitalisation rules in Malaysia, and whilst there are no hard and fast rules as to whether a taxpayer is thinly capitalised, a debt to equity ratio not exceeding 3:1 is often used as a guide.

Interest paid is fully relievable subject to the general tests of deductibility (i.e. related to the earning of income). However, attention must be given to specific provisions, which seek to impair relief where borrowings can be associated directly or indirectly with non-income producing investments or loans.

It is also essential to ensure that the interest being charged is reasonable.

Where a loan is to be obtained from overseas, BNM approval is required if the amount borrowed is RM5 million or more. For cases where the amount borrowed exceeds RM1 million, it would suffice to inform BNM.

Loan financing might not necessarily be a tax efficient way to fund a Malaysian JV company as interest payable to non-residents will be subject to withholding tax. Whilst it is possible to get around this problem by obtaining interest free loans, there could be deeming provisions in foreign tax jurisdictions that impute a tax charge on deemed interest. A case in point is the New Zealand tax authority's practice to impose a tax charge in New Zealand on the New Zealand loan provider. This would hardly be the desired situation for a New Zealand multinational company which provides loans to its JV company in Malaysia.

The use of Redeemable Preference Shares ("RPSs") is perhaps more tax efficient (note that BNM approval is required for exchange control purposes as RPSs are regarded as credit facilities).

If properly structured, the nominal value and premium payable upon the redemption of the RPS would be a return of capital and not subject to income tax. Where the redemption of RPS is at the value of total paid up capital, it would appear that there should be no tax issues. The redemption of RPS can also be carried out more expeditiously than a capital reduction exercise in the case of ordinary shares.

In the case where the redemption is at a premium, it is also possible to argue that it should not constitute a distribution of income *(CIR v. Universal Grinding Wheel Co., Ltd)*. However, it is necessary to consider the facts of each case to assess the risk of the redemption being regarded as a deemed distribution.

In *CIR v. Universal Grinding Wheel Co., Ltd*, the respondent company redeemed its issued GBP1.00 RPSs at their nominal value plus a premium of 7s. per share. The company made a fresh issue of preference shares for the purpose of the redemption; the premium was paid out of the Company's profits which would otherwise have been available for dividend.

In the assessment to Profits Tax on the company, the premiums of 7s. per share were treated as part of the gross relevant distributions to proprietors. The Company appealed and contended that it had purchased its preference shares for 27s. per share, that the full redemption price was a sum applied in reducing its share capital and accordingly, no part of it should be treated as a distribution.

The Special Commissioners held that the redemption of the RPSs was simply a way of reducing the share capital of the Company. In order to reduce the share capital in that way, the Company had to, and did apply, 27s. in payment for each share. The case went up the House of Lords, and the decision of the Special Commissioners was upheld.

An alternative route of raising funds is through the issuance of bonds. A JV company could issue bonds which will be redeemed at a future date. The tax treatment of discounts and premiums is not specifically addressed in the *Income Tax Act* nor in Malaysian case law and this is a rather gray area. There are two schools of thought with regard to the taxability/deductibility of discounts. On the one hand, it is opined that the discount is not interest and therefore there is no issue of withholding tax being applicable on payments made to non-residents and the discount expense is of thought that contends that the discount is akin to interest and therefore withholding tax is applicable and the discount is deductible in the hands of the bond issuer *(Davies v. Premier Investment Co Ltd; Lomax v. Peter Dixon)*.

In determining the tax treatment of discounts and premiums, it is important to consider factors such as the capital risk undertaken, the presence of a commercial rate of interest in computing the discount etc.

The use of Labuan

BNM does, in certain circumstances, permit borrowings from or through Labuan. Where a loan is granted to a Malaysian JV company by a Labuan Offshore Bank, which is licensed to conduct banking business under the *Offshore Banking Act 1990*, interest paid or credited to such a bank is not subject to withholding tax where such interest is attributable to a business carried on by the bank in Malaysia.

It is therefore possible to mitigate withholding tax on borrowings from overseas if the funds are routed through a Labuan Offshore Bank and channeled to the Malaysia JV company. When the Malaysian JV pays interest to the Labuan bank, there is no need to withhold tax.

Exit strategies

Exit strategies in the context of this article refers to how an outbound or inbound investment should be structured for tax efficiency.

Inbound investments

Where an investment is made in a Malaysian JV company by a foreign party, it is important to consider the tax implications that will arise when the foreign party decides to divest its investment.

Upon divestment of shares in a JV company, there is no capital gains tax in Malaysia. However, for the disposal of RPC shares, *Real Property Gains Tax* may apply. Where a foreign JV party repatriates funds arising from the divestment of their shareholding back to the home country, it will be necessary to consider the home country tax rules on capital gains.

Outbound investments

For a Malaysian JV party venturing abroad, needless to say, it would be necessary to understand the tax rules of the foreign country. In addition, it is also important to consider the likely tax effects of divesting the shareholding in the foreign country and repatriating the funds to Malaysia.

An illustration, there could be capital gains tax in the foreign country (Country A for example) upon the disposal of shares in an incorporated entity in Country A if the shares are held directly by a Malaysian resident.

It is perhaps possible to make use of favourable provisions in the tax treaty that Country A has with Country B (for example) where the treaty could perhaps stipulate that if the investment in County A is held by residents of Country B, there would be no capital gains tax imposed on the residents of Country B on the disposal of the investment in Country A.

Thus a Malaysian investor could route its investment in the overseas JV through the setting up of a subsidiary in Country B which will then hold the investments in Country A. It is important that the setting up of a company in a low tax jurisdiction has a commercial basis and it should not be seen to have been set up merely for tax mitigation purposes.

When the shares in the JV company in Country A are disposed by the residents of Country B, there would be no capital gains tax arising in Country A. The gains could then be routed back from Country B to the Malaysian holding company by way of dividends. As this would be considered as being foreign sourced income, it would be tax exempt in Malaysia and is available for distribution as tax exempt dividends (two tier).

Conclusion

The tax issues to be considered are many and varied when forming a JV entity. It is not an exaggeration to say that when entering into a JV arrangement, the tax issues could encompass the whole scope of Malaysian taxation, depending on the complexity of the JV structure. Further, tax issues relating to other tax jurisdictions would also come into the equation in cross border transactions.

The Author

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Developments In Respect Of Malaysian Withholding Tax And Other Related Issues – Opportunities And Pitfalls

By TAN HOOI BENG & CHOW CHEE YEN

Withholding tax in Malaysia has evolved in recent years. To begin with, a paradigm has been set in the case of *SGSS (S) Pte Ltd v. Director General of Inland Revenue*[1]. This was followed by the amendment to sec. 15A of the *Malaysian Income Tax Act, 1967* ("MITA"). Moving further, the issues of regrossing and technical as opposed to non-technical services were addressed in *EPM Inc v. Director General of Inland Revenue*[2]. Finally, there was an affirmation of the Revenue's[3] views on income arising from the offshore services attributable to a permanent establishment[4] in Malaysia in the latest dialogue held between the Revenue and various professional bodies on 30 September 2002.

Section 109B vs Section 107A

Before proceeding further, it is vital to have an understanding on two of the most widely applied withholding tax provisions, viz sec. 109B and sec. 107A of the MITA.

Section 109B of the MITA imposes a withholding tax of 10% on certain types of income prescribed under sec. 4A[5] which are deemed derived from Malaysia under sec. 15A. Section 15A provides that the payments falling under sec. 4A shall be deemed to be derived from Malaysia:

- If the responsibility for payment lies with the Government of Malaysia or State Government; or
- If the responsibility for payment lies with a person who is a resident for that basis year; or
- If the payment is charged as an outgoing or expense in the accounts of a business carried on in Malaysia

It is interesting to note that for the deeming provision under sec. 15A to operate, the services under sec. 4A need not be performed in Malaysia.[6] Generally speaking, withholding tax under sec. 109B is a final tax and the non-resident recipient need not file a Malaysian tax return. This is in contrast to sec. 107A as will be explained below.

Under sec. 107A of the MITA, a non-resident contractor who performs or renders any work or professional services in connection with or in relation to any contract projects in Malaysia is subject to 15% + 5%[7] withholding tax on the payments made to him for the services under that contract[8].

A key point to note here is that for sec. 107A to apply, the services must be performed within Malaysia, i.e. the provision of sec. 107A generally contemplates a business presence in Malaysia whereas this not a requirement under sec. 4A.

Section 107A withholding tax is not a final tax in Malaysia. It is merely an upfront interim tax collection. The non-resident contractor is required to lodge a net business tax return to the Revenue on it's Malaysian source income, upon which it would be assessed at the prevailing corporate tax rate of 28%. Upon the assessment of the Malaysian source income, any excess of the sec. 107A withholding tax, over the final tax liability would be refunded to the non-resident. Correspondingly, any shortfall would be payable to the Inland Revenue. Note, that if no income tax return on the Malaysian source is filed, the sec. 107A withholding tax would become the final tax in Malaysia.

More often than not, sec. 107A tends to overlap with sec. 109B. For example, if a non-resident contractor renders technical services in relation to a project carried out within Malaysia, the payment could

1 [2000] 7 MLJ 229
2 [2001] MSTC 3,306
3 Malaysian Inland Revenue Board ("MIRB")
4 Permanent Establishment is a concept used in a tax treaty. Where no treaty is concluded, the concept of business presence is to be considered.
5 Section 4A charges special classes of income (includes amount 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) to tax if they are deemed to be derived from Malaysia.
6 Prior to 21 September 2002.
7 From 21 September 2002 onwards, the rates have been reduced to 10% + 3%. 15% / 10% is on the service portion of the contract payments on account of tax which is or may be payable by the non-resident contractor **whilst** the 5% / 3% is on the service portion of the contract payments on account of tax which is or may be payable by employees of that non-resident contractor.
8 "Services under a contract" is defined to include any work or professional services performed or rendered in Malaysia. The term "professional service" as used in sec. 107A is wide and includes any consultancy, advisory, technical, industrial, scientific or commercial services.

arguably be sec. 107A or sec. 4A payment. In such case, the Revenue would take a practical approach by looking at the physical presence of the non-resident service provider in Malaysia (i.e. the existence of a permanent establishment or business presence). Section 107A would prevail over sec. 109B in cases where the non-resident has a permanent establishment or business presence in Malaysia.

SGSS and amendment to Section 15A

In SGSS, it has been ruled that a Singaporean enterprise could regard technical services rendered to a Malaysian company from offshore (i.e. not performed in Malaysia) as a business profit, hence, not attracting any Malaysian tax (including Malaysian withholding tax) provided the foreign enterprise does not carry on business through a permanent establishment in Malaysia. The principle laid down in this case has had an immense impact and provides avenues for some planning provided that the facts of a case are pari-materia to SGSS. Traditionally, the Revenue has been adamant in arguing that sec. 4A of the MITA overrides business income under sec. 4(a). Consequently, foreign enterprises receiving technical fees without a permanent establishment in Malaysia, may not be able to rely on the business article in the double tax agreement entered into with the Malaysian Government, thus rendering it still subject to Malaysian withholding tax. As such, the decision made in SGSS has set a paradigm in Malaysian taxation, particularly with regards to the applicability of the business article in tax treaties and the withholding tax provisions.

On 21 September 2002, the Malaysian Parliament amended sec. 15A of the MITA whereby payment made to non-residents for offshore services rendered outside Malaysia in respect of sec. 4A(i) and (ii) would no longer be subject to Malaysian withholding tax and this amendment is in line with the decision made in SGSS. The change of legislation is welcomed but is long overdue as the "operational test" (i.e. to tax a person only if he is trading in Malaysia and **not** trading with Malaysia) should have applied long time ago.

Relying on the amended sec. 15A together with the principles laid down in SGSS, there is an opportunity to minimise withholding tax payments. Where possible, preliminary work such as designing, drawing, research & development etc should be undertaken offshore. In this situation, it is vital to specifically define the offshore and offshore work portion and their corresponding fees.

In the recent dialogue held between the professional bodies and the Malaysian tax authorities, the Revenue has confirmed that where part of services are performed in Malaysia and part of it outside Malaysia, the amount attributable to the services performed in Malaysia would be based on the value of services rendered in Malaysia. In this regard, taxpayers are advised to specifically indicate in the contract the following:

- Value of services rendered in Malaysia; and
- Value of services rendered outside Malaysia

The Revenue further indicated that if the above is not possible, the apportionment of the value should be done on a fair and reasonable basis. The Revenue's willingness to accept the fair allocation is indicative of reforms in Malaysia to expedite the transfer of foreign technical know-how into the country.

With proper tax planning, the offshore element should not be subject to any Malaysian withholding tax whilst the onshore portion would be subject to the sec. 109B withholding tax of 10%, on the basis that the non-resident does not have any permanent establishment or business presence in Malaysia.

Additionally, the cost of equipment and materials should be clearly indicated as withholding tax is only imposed on services. It is important to note that in cases where there is an offshore supply of equipment and materials, due care must be taken to ensure that the supply is not related or connected to any permanent establishment or business presence in Malaysia otherwise, the Revenue could tax the profits arising from this supply.

Where possible and viable, German resident contractors may be engaged as Art. 21 of the Malaysia-Germany double tax agreement ("DTA") provides that items of income of a resident which are not expressly mentioned in the Articles of the tax treaty shall be taxable only in Germany. Since the special classes of income under sec. 4A(i) and (ii) are not mentioned in the tax treaty, it follows that they are not subject to Malaysian withholding tax. In practice, this avenue could be beneficial from the tax angle provided that the conditions that it's commercially viable and the presence of the German resident contractor would not create a PE in Malaysia are met. In other words, this planning would succeed for short-term contracts. Having said this, it must be borne in mind that the German tax authority is reckoned as one of the strictest and it's tax system is very onerous.

Alternatively, the Malaysian taxpayer could also seek refuge under the new treaty protection such as the Malaysia- UK DTA whereby the withholding tax rate in respect of technical fees is only 8%. An even better option would be the tax treaty concluded with Namibia in 1999 which accords 5% as withholding tax on technical fees. Also, whenever possible, Australian consultants should be considered to provide consultancy services as the Malaysia – Australia Tax Treaty 1st Protocol[9] (para. 4(c), Art. 5) provides that Malaysian tax will not be applicable with regards to payment for services (including consultancy services) provided by an Australian enterprise **unless** such services are rendered in Malaysia for a period or periods aggregating more than 3 months within any 12 months period, thereby creating a permanent establishment in Malaysia.By the virtue of this protocol, the Malaysian government has accepted the income from consultancy services as business income, hence the business article[10] can be relied on. It is interesting to note that the wording of para. 2(a) of Art. 5 of the Malaysia/Indonesia DTA is similar to para. 4(c), Art. 5 of the Malaysia/Australia DTA,

9 Gazetted on 21 October 1999 and came into force on 27 June 2000.

10 In most business articles of the DTAs, business profits cannot be taxed in a country unless a permanent base is established there.

Developments In Respect Of Malaysian Withholding Tax And Other Related Issues – Opportunities And Pitfalls

whereby consultancy services are accepted as business profits. Having said this, the summary of the withholding tax rates prepared by the tax authority in its official website still shows that technical fees paid to Indonesian resident is subject to 10% withholding as opposed to the 0% rate for payment made to an Australian resident.

Withholding tax planning: Is it necessary?

With regards to withholding tax planning, one may ask whether it is necessary given the fact that withholding tax is a tax on the non-resident. Additionally, in most instances, the non-resident will be able to obtain full tax relief in the non-resident's home country on the Malaysian withholding tax suffered. As such, at the end of the day, the non-resident would pay the same amount of tax, i.e. the net tax payable in the home country (after tax relief on Malaysian withholding tax suffered) plus the Malaysian withholding tax suffered.

Withholding tax planning may prove to be advantageous in the following cases:

- The payee is a related company. Hence, reduction in withholding tax would save the overall group transaction costs, particularly in terms of cash flow timing due to the time frame in which a tax credit is invoked;
- More often than not, Malaysian taxpayers have to pick up the withholding tax themselves since the non-residents insist on their payment being made net of withholding tax;
- The reduction of withholding tax could foreseeably result in a better bargaining position for the Malaysian payer; and
- The non-resident would factor the quantum of withholding suffered by him in arriving at the gross fee.

EPM

Moving further, in the case of *EPM Inc v. DGIR*, the Malaysian High Court upheld that withholding tax borne (through a re-grossing method) by a Malaysian tax resident on behalf of a non-resident, is not deductible for Malaysian tax purposes on the basis that withholding tax is the tax of a non-resident and not a fee for services. In view of this, before a contract is concluded, it is important for the amount of withholding tax to be reviewed with the objective of stipulating the gross amount in the respective agreement to ensure that the Malaysian tax resident obtains a maximum tax deduction whilst not affecting the position of the non-resident in terms of the non-resident's taxability.

The decision in *EPM* has far reaching consequences since most non-residents would prefer to receive payments net of withholding tax. In a nutshell, they would prefer not to create any taxable presence or be associated with any Malaysian tax administration. In the writers' view, the decision made in EPM has more of an impact on Malaysian payers as opposed to the non-resident. The Malaysian payer is not able to claim a tax deduction on the withholding tax borne by him and may attempt to include the withholding tax as part of the gross fee stipulated in the contract. If this is the case, then the expenditure shown in the Malaysian payer's accounts would be the gross contract fee, which is already inclusive of the withholding tax. As such, the Malaysian payer would obtain a full tax deduction on the basis that the actual amount invoiced to the non-resident is the same as per the concluded contract. In *EPM*, the contract entered into with non-resident related party stipulates that the non-resident's 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 *EPM*, the total amount by which *EPM* was invoiced shall be increased by the non-resident to take into account those taxes so that the net amount shall be equivalent to what the non-resident would have invoiced had there been no withholding tax liability. The way the *EPM* contract was structured and the whole arrangement was regarded by the High Court judge as a method "devised" by EPM and its non-resident related party. Moving forward, a key point to note here is that the terms of the contract must be carefully worded so as not to explicitly require the Malaysian payer to bear the withholding tax but instead to factor the tax into the contract price.

Having discussed the above possibility, it is unlikely that a non-resident (particularly if the non-resident is a third party) would agree to this arrangement since he would be subject to higher rate of tax in his home country as a result of the increase in the contract value. Thus, the decision in *EPM* would, at the end of the day, result in the Malaysian tax payers being at the losing end. Hence, with the greatest respect to the High Court, the authors hope that the Court of Appeal would be able to reconsider the decision made at the 1st instance in EPM on the deductibility of the withholding tax borne by the Malaysian payer as a sec. 33[11] deduction. On further analysis, one would find that the withholding tax is part of the business cost and falls squarely within the ambit of sec. 33[12]. Also, one has to distinguish between income taxes by paid by a Malaysian taxpayer and the withholding tax borne by him. The former is incurred after the production of the gross income whilst the later is paid in the course of producing income.

More seriously, quite apart from the issue of regrossing, the High Court has also confirmed the view that **both technical and non-technical** assistance or services in connection with any scientific, industrial or commercial undertaking, venture, project or scheme are regarded as special class of income under sec. 4A. Thus, withholding tax of 10% under sec. 109B would be applicable. Traditionally, the Malaysian tax practitioners have been of the view that non-technical payments are not subject to withholding tax. Having

11 Section 33 of the MITA reads as follows –"Subject to this Act, the adjusted income of a person from a source for the basis period for a year if assessment shall be the amount ascertained by deducting gross income if that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source, including..."

12 On the basis that the technical fees paid to non-resident is in the nature of revenue and is wholly and exclusively incurred for the production of gross income.

said this however, the scope of sec. 4A appears extremely wide and the Revenue has indicated that not only would technical services include any kind of specialised services but also that the subsection would extend to any non-technical services. Hence, the days where tax practitioners regard payments made for day-to-day management are free of withholding tax may be numbered! Nevertheless, the Revenue has also indicated that it is prepared to exclude from sec. 4A any payments made for ordinary day-to-day administration or management services of a routine nature especially those paid to the head office or parent company. Strictly speaking, in the case of *EPM*, the taxpayer had indeed segregated the portion of technical and non-technical services but yet the Revenue has adamantly subjected the entire amount to withholding tax. As such, it is fair to conclude that uncertainty is looming over taxpayers and tax advisers on when the Revenue would apply its concession and when it would not do so. Furthermore, a type of service may be routine to a person but may be "specialised" to others. For example, accounting services is bread and butter to an accountant whilst it is technical to a layman. In *EPM*, the taxpayer has appealed further to the Court of Appeal and the saga continues. Until the day the Court of Appeal delivers its judgment, the following questions remain:

- What is the meaning of "technical"?
- Does the word "technical" qualify not only "advice" but also "assistance" and services?
- Does the word "technical" qualify not only "management" but also "administration"?

As an interim solution whilst waiting for the matter to be decided by the Court of Appeal, a taxpayer may obtain an advance ruling from the Revenue with regards to the applicability of withholding tax on the non-technical portion since, the traditional method of tax planning of splitting the contact value into technical and non-technical portions may no longer hold water following the decision in *EPM*.

Offshore services: Does the Revenue have the taxing right?

In the recent dialogue between the professional bodies and the Inland Revenue, the latter has clarified that the amendment to sec. 15A of the MITA (i.e. sec. 109B withholding tax would not apply to offshore services) shall not affect the determination of the profit attributable to a permanent establishment. The normal approach would continue to apply, i.e. all income attributable to a permanent establishment is taxable whether the services are rendered onshore or offshore.

In light of the above, the point that arises is whether the **Revenue's view can be challenged**? Taxpayers may want to do so as once a permanent establishment or business presence is established in Malaysia, the opportunity to structure offshore services to legitimately avoid sec. 109B withholding tax may no longer be applicable.

As mentioned earlier, once a permanent establishment is established by a non-resident in Malaysia, then sec. 107A withholding tax of 10% + 3% would be imposed on service portion of contract payments as an interim tax. The income attributable to the permanent establishment would be regarded as business income and would be taxed at the prevailing corporate tax rate of 28% upon submission of the non-resident's tax return.

Since we are discussing the scope of taxation within Malaysia, sec. 3[13] of the MITA ought to be referred to. This charging section is unambiguously territorial and remittance based in scope. Only income accruing in or derived from Malaysia or received in Malaysia from outside Malaysia is subject to tax. However, income arising from sources outside Malaysia which is received in Malaysia by a non-resident is exempt from tax.[14]

Also, since the contract income is a business income for a non-resident contractor who has established a permanent establishment or business presence in Malaysia, then one also has to refer to sec. 12(1)(a)[15] of the MITA to ascertain whether the income is derived or deemed derived from Malaysia, and therefore subject to Malaysian income tax. Broadly speaking, sec. 12(1)(a) is a residual section of general application and it refers to the "operations" test whereby if the business income is not attributable to operations carried on outside Malaysia, then it shall be deemed to be derived from Malaysia. So as to say "what is not yours, is mine". Given this, the crucial factor is to ascertain the meaning of "operations of the business carried on outside Malaysia" since if the operations are outside Malaysia, the profits attributable to those operations are not derived from Malaysia and would not be taxable in Malaysia.

In determining whether an activity constitutes the carrying on of a business in Malaysia, it is essential that reference be made to the various acts of persons within Malaysia. Thus, the essential test is not whether the profits concerned arose or were derived from a business carried on in Malaysia but whether the operations from which the profits arose or accrued took place in Malaysia.[16]

Relying on sec. 3 and sec. 12(1)(a) and various decided cases, the question that arises is whether the Revenue has a right to tax income arising from offshore services performed by a permanent establishment? The Malaysian agreements clearly state that, in intention anyway, that the business profits of a foreign enterprise shall not be taxed in Malaysia unless the enterprise is engaged in a trade or business in Malaysia through a permanent establishment here. If it is so

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13 Section 3 of the MITA reads as follows –"Subject and in accordance with this Act, a tax to be known as income tax shall be charged for each year if assessment upon the income of any person **accruing in or derived from Malaysia** or received in Malaysia from outside Malaysia"

14 Paragraph 28, sch. 6 of the MITA

15 Section 12(1)(a) of the MITA reads as follows – "Where for the purpose of this Act it is necessary to ascertain any gross income of a person derived from Malaysia from a business of his, then subject to subsec. (2), so much of gross income from his business as is **not attributable to operations of the business carried on outside Malaysia** shall be deemed to be derived from Malaysia"

16 *See Chunilal B. Metha v. Commissioner of Income Tax, Bombay* (10 ITC 395), *Commissioner of Income Tax, Bombay v. Govindram Seksaria* (10 ITC 406 and (1938) 6 ITR 584) and *X Company Ltd [(1963) 1 MLJ iv]*

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engaged in a trade or business in Malaysia, Malaysian tax would be imposed only on those profits which are **attributable** to the permanent establishment.

In this regard, if the non-resident can prove that the offshore services are attributable to other operations outside Malaysia and is from a foreign source, then the Malaysian Inland Revenue does not have the right to tax the income arising from the offshore services although the Revenue may contend that the offshore work is part and parcel of the main contract and is also attributable/ connected to the permanent establishment in Malaysia. A point to be borne in mind is that if the offshore services could be related to another business presence in a foreign country, then the case against the Malaysian Revenue would definitely be stronger.

There are no provisions in the MITA governing the determination of a source of income. The question of whether the income arising from a particular transaction arose in or is derived from one place or another is a question of fact depending on the nature of the transaction. Based on decided cases[17], the source of a relevant income can be determined in the following manner:

i) Ascertain the nature of income and decide which class of income it belongs to under sec. 4 of the MITA

ii) Ascertain the originating cause of such income, that is, **what** the taxpayer has done to earn the income

iii) Ascertain the geographical location of that originating cause, that is **where** the taxpayer has earned it

The broad guiding principles in determining the source of income laid down in the case of *CIR v. Hang Seng Bank Ltd*[18] is as follows:

> "*...one looked to see what the taxpayer had done to earn the profits in question. If he had rendered a service or engaged in an activity such as the manufacture of goods, the profits would have arisen or* ***derived from the place where the service had been rendered or the profit making activity had been carried on****. But if the profits had been earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities, the profits would have arisen in or derived from the place where the property had been let, the money had been lent or the contracts of purchase and sale had been effected...*"

Against the above discussions, the profit arising from the offshore services performed by a permanent establishment in Malaysia may well be argued as a foreign source income. In this regard, a proper segregation of income and expenditure is of the essence. As such, neither sec. 107A withholding tax nor sec. 109B withholding tax can be imposed on the payment for the offshore services. If necessary, two different contracts can be concluded to segregate the onshore and offshore portions accordingly. Further, the non-resident's related company may be used as a vehicle to provide offshore services whilst the permanent establishment in Malaysia would only undertake the onshore work. With proper planning and documentation, it is going to be an uphill task for the Revenue to argue that the offshore services are attributable to business operations in Malaysia.

Conclusion

As globalisation of the economy takes place, Malaysia must ensure that it continues to attract foreign direct investment as well as encouraging the transfer of technology/know-how. In so doing, Malaysian tax environment must remain conducive. Whilst every effort taken by the Revenue to preserve our tax base should be commended, the interpretation of local tax legislation must be done on a fair basis considering other international aspects of taxation, particularly the treaties entered into with other governments over the globe. Perhaps, the relevance of the various deeming provisions in the Malaysian tax legislation should be re-examined, particularly in this modern times.

The authors are tax consultants at one of the leading tax consultancy firms in Malaysia. The views expressed above are their own.

17 *CIR v. Lever Brothers & Unilever Ltd (1946)* 14 SATC 1, *FC of T v. United Aircraft Corporation (1943)* 7ATD 31
18 1990 STC 733

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

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But the government can take back (some of) what it gives away...

The adverse effects on the Malaysian economy from the SARS epidemic, the Iraq War and the general worldwide economic slowdown led to the announcement of the RM8.1 billion Economic Stimulus Package by the government on 21 May.

This brought cheer to certain sectors of the economy in the form of the many "pro-growth" measures proposed under the said Package. Particularly for small and medium scale enterprises ("SME"), the government's adoption of the Strategy of developing new sources of growth, focusing on developing SMEs as the catalyst of growth, has also made available many opportunities to modernise their business operations and improve their competitiveness.

Grants for business development

One of the methods adopted by the government to render assistance to SMEs is through the provision of grants for specific purposes. The following are some of the grants which will be made available to industries that qualify for such aid:

1. Grants to meet training costs of projects in selected sectors, both domestic and overseas;
2. Grants for companies in selected sectors to undertake R&D activities in Malaysia;
3. Grants for commercialisation of research findings and innovations in selected growth sectors;
4. Grants from the proposed Fund for Development and Promotion of Malaysian Brand Names for Malaysian companies.

These are by no means the only grants being made available to SMEs, as many other grants are currently available for the advancement and development of their businesses. (*See Panel 1 for a list of some grants currently available*)

The government gives... but it can take back some

The use of grants for the purpose of assisting organizations or industries that are seen to be in need of special assistance for their growth, has long been employed as a tool of economic development by the government. Economists may debate on the efficacy of a policy of handing out grants as a measure to achieve certain economic objectives, but from the perspective of the recipient, it may seem that grants offer only benefits without any disadvantages. However, this perception may not be entirely correct, since grants may not necessarily be the pure handouts that they appear to be. For until recently, there was no legislation to exempt the recipient of a grant from the payment of income tax on receipts from the grant. Thus a vital issue that has to be considered on the receipt of a grant is whether that receipt is taxable as income of the business of the recipient. In the absence of specific provisions for the exemption of grants, general rules of taxation do not automatically exempt a recipient from the liability to income tax. Hence it is possible that the government may take back some of what it gave away, in the form of income tax payable on the receipts from a grant!

Taxable or not taxable

In the absence of statutory provisions covering the taxation of grants, the general rule in considering whether a grant is taxable or otherwise, is to apply the test of determining what is the main purpose of the grant. If it is intended to assist the trader to enable him to perform his trading operations more profitably, it will be regarded as a trading receipt[1], which is subject to tax. This principle was established in several cases which went to the Courts in the UK, in which companies receiving subsidies or grants were held to be taxable on the receipts as they represented trading receipts. Among the types of receipts that were held to be taxable receipts of the business, were subsidies paid to a railway company to enable it to meet income charges[2] and a subsidy paid to millers for the purpose of making good a shortfall in profits[3].

[1] Whiteman and Wheatcroft on Income Tax by Peter G. Whiteman and David G. Milne
[2] *Pretoria-Petersburg Railway Co. v. Elwood*(1908) 6 TC.508
[3] *Charles Brown & Co. v. IRC (1930)* 12 TC.1256

PANEL 1

The following is a list of Grants (not exhaustive) available mainly for SMEs.

Grant	Purpose
RosettaNet Grant	The government has allocated RM5m as a grant for local Electrical and Electronic (E&E) companies to implement RosettaNet.
E-Commerce Grant for SMEs	The Scheme is intended to assist SMEs to quickly integrate themselves into the mainstream of the Information and Communication Technology (ICT) in order to ensure their survival in a changing globalised market place. *(Discontinued with effect from 27 June 2002 as it has reached the allocated budget and there is no additional fund)*
Engineering Design Grant	The Scheme provides assistance for SMEs to enhance their engineering design capabilities. This would enable SMEs to carry out their own design in-house.
Market Development Grant	To assist Small and Medium Enterprises in undertaking activities for the development of export markets.
Commercialisation of Research and Development Fund (CRDF)	The Scheme provides partial grants to qualified R&D projects to be commercialised up to a maximum of 50% to 70% or RM2 million, whichever is lower.
Technology Acquisition Fund (TAF)	The Scheme provides partial grant to further promote efforts by the private sector to enhance their technology level and production processes.
Grant for Business Planning and Development (ITAF 1)	The Scheme provides grants to SMEs Business planning studies, Domestic and export market strategy studies, Market feasibility studies, Technology feasibility studies.
Grant for Product & Process Improvement (ITAF 2)	The Scheme provides grants to SMEs for improvement and upgrading of existing processes, products and designs.
Grant to Upgrade Production/Engineering and Design Capabilities	The Scheme provides grants to SMEs to upgrade their production/ engineering and design capabilities.
Grant for Productivity and Quality Improvement and Certification (ITAF 3)	The Scheme provides grants to SMEs for: - Productivity and Quality improvement - Productivity and Quality improvement based on customer's requirements - Documentation of productivity and quality improvement - Productivity and Quality system certification - Total Quality Management Scheme - Quality development systems, Production and Planning Control, Quality Control Circles, Total Preventive Maintenance - Occupational and safety measures - Quality Series: ISO 9000, ISO 14000, ISO 18000 - HACCP, Halal and other product quality certifications
Grant for ICT Application (expanded E-Commerce Grant Scheme)	The Scheme provides grants to assist SMEs' participation in E-commerce and E-manufacturing activities.
Grant for Skills Upgrading	The Scheme provides grant for training programmes to upgrade critical skills, efficiency and productivity of SMEs.
Factory Auditing Scheme	The Scheme provides grants for SMEs to employ technical experts to undertake diagnostic audits on SMEs' manufacturing operations. The audited reports will enable SMEs to seek appropriate assistance to enhance their capability as suppliers of parts and components as well as services to large companies/Multi National Corporations.
For more details on the above grants, please visit the following websites:	**MITI - http://www.miti.gov.my/** **SMIDEC - http://www.smidec.gov.my/** **MATRADE - http://www.matrade.gov.my/**

On the other hand, if a grant or payment is made for the purpose of replacing a capital asset, or upon premature termination of the income-producing capability of an asset[4], then it is treated as capital in the recipient's hands and is not taxable on him. Put in another way, if a grant is determined not to be part of annual profits or gains of a business, it is not taxable upon the recipient. This treatment is based on the decision in the case of *Seaham Harbour Dock Co. v. Crook* (1931) 12 TC. In later cases however, the Courts seem to have embarked on the principle that where the payment on a grant is undifferentiated as between capital or revenue, and where there is none or insufficient evidence to show that it may be for a capital purpose, the grant may be treated as a revenue receipt which is taxable.[5]

Non-taxable grant

The Malaysian Inland Revenue's attempts to tax the receipts from a grant was almost successful in the case of *Dewan Perniagaan Bumiputra Sabah v. KPHDN* (1996) MSTC 3569. In this case the taxpayer was a registered society whose stated objects included developing, promoting and safeguarding the trading, commercial and industrial interests of Bumiputras in Sabah. The taxpayer received money arising from a levy imposed by the State Government on timber exporters. The receipts were treated as a grant from the government and utilized in various ways, including investment in properties, for administrative expenses and provision of loans. The Dewan was assessed to tax on the grant. The taxpayer's initial appeal to the Special Commissioners of Income Tax ("SC") was decided in favour of the Revenue. However, the SC's conclusion that the grant was revenue of a business carried on by the taxpayer was overruled by the High Court. It was held that the grant was given primarily for the non-trading and non-business purpose of protecting the economic interest of Bumiputras and assisting the Government achieve the objectives of the New Economic Policy. Activities to achieve these objectives cannot be treated as being a business or trade carried on by the Dewan. Hence, the grant could not be taxed as revenue of a business carried on by the taxpayer.

[4] "Sterilization of asset" principle established in *Glenboig Union Fireclay Co. Ltd. v. IRC* (1922) 12 TC.427
[5] *Ryan v. Crabtree Denim Ltd* (1987) STC 402; *Paulter v. Gayjen Processes Ltd* (1985) 58TC 350

Grants... Handouts From The Government?
But the government can take back (some of) what it gives away

Some good news...

The good news is that a law was gazetted on 30 January 2003, with the objective of granting relief from tax to recipients of government grants and subsidies. It is called the '*Income Tax (Exemption) (No 4) Order 2003*' ("the Order").

The "not-so-good news" is that although the objective of the Order is to grant relief from tax for recipients of government grants, it is not clear what exactly is exempted under the Order.

The Order

Paragraph 2(1) of the Order grants the following exemption:

2. (1) The Minister exempts –

(a) any person from the payment of income tax in respect of his or its statutory income in relation to the sources of income derived from the allocations given by the Federal and State Government in the form of a grant or a subsidy:

(b) a statutory authority from the payment of income tax in respect of its statutory income in relation to the sources of income derived from-

(i) the income received in respect of an amount chargeable and collectible from any person in accordance with the provisions of the Act regulating the statutory authority; or

(ii) any donation or contribution received.

Before delving into what is unclear in the Order, the following is a summary of what the Order does state clearly:

- The Order takes effect retrospectively from the year of assessment 2002.
- "Persons" who qualify for exemption under para. 2(1)(a) include individuals, companies, bodies of persons and corporations sole, as defined under the ITA. Statutory authorities are exempted under para. 2(1)(b).
- Income that is exempted is "statutory income", namely gross income less allowable expenses and capital allowances ("CA"). Therefore CA has to be deducted from income after allowing deductible expenses ("adjusted income") in the computation of income to be exempted, and would not be available for carry forward to the following year of assessment, unless there is insufficient adjusted income for CA to be fully deducted in the current year.
- Those granted exemption under the Order would still be required to submit an annual Return of Income to the Director General of Inland Revenue.

What is exempted?

Looking at the language of para. 2(1)(a) of the Order, tax practitioners who are familiar with the language of taxing statutes may find that there are least three possible answers to the question "What is exempted under the Order?":

1. One answer which seems to be obvious is "allocations given ....in the form of a grant or subsidy." In other words, the grant itself is exempted. However, the use of the words "sources of income *derived* from the allocations given....in the form of a grant or subsidy" seems to suggest that the grant itself may not be the subject of exemption.

   The specification that "statutory income" is exempted means that a portion of operating expenses and CA would have to be deducted from the gross receipts from the grant to arrive at the amount to be exempted.

2. The second possibility is that income that is exempted is income from a *source* that is derived from utilization of money from a grant, e.g. where the grant is used for operational expenses of a business carried on by the recipient, the income from the business (the "*source*" of income) is exempted. However, the question then arises as to whether receipts on account of the grant itself would also be exempted, for it is generally agreed that a grant would not be regarded as a "source of income" apart from the business in which it is employed.

3. The third possibility would be to regard both the grant and income arising from utilization of the grant as "sources of income derived from...a grant or subsidy" and to compute statutory income based on the total revenue from these "sources". For example, if a grant of RM100,000 is received by a company to be utilized for operational expenses of its business which earned gross operating revenue for the year amounting to RM1 million, the amount which is to be included in gross income for purpose of arriving at the amount of income to be exempted is RM1,100,000.

Informal enquiries made to the relevant authorities seem to point to possibility (1) as the intended position. This has been confirmed by the Revenue at a recent dialogue with various professional bodies. Since there can only be one 'correct' position which is determined in accordance with government policy, it would seem that there is a need for the authorities to convey that clearly so that no 'misinterpretation' can arise.

Conclusion

Notwithstanding these uncertainties, the Order is proof that the government has taken cognisance of the dilemma faced by those in receipt of government grants or subsidies. The many grants made available to SMEs and other enterprises are meant to promote the advancement of these businesses, to assist in their survival and/or continued development. The Order seeks to ensure that those who qualify to receive them should be able to utilize these grants to their full advantage in furtherance of the government's objectives. Nevertheless, it would still be prudent for prospective beneficiaries to seek advice on the tax implications so as not to suffer unexpected adverse tax consequences.

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New Strategies Towards Stimulating Malaysia's Economic Growth

By ADELINE WONG AND KAREN TAN

The much-anticipated Pre-emptive Stimulus Package ("Package") was finally announced by the Prime Minister, Datuk Seri Dr. Mahathir Mohamad ("Dr. Mahathir") on 21 May 2003. The Package unveiled a four-pronged strategy worth approximately RM8.1 billion (USD2 billion) to combat global uncertainty amidst the adverse effects of the war in Iraq and recent outbreak of the Severe Acute Respiratory Syndrome ("SARS").

The 4 main strategies underlying the tax incentives and policies in the comprehensive Package are: promoting investments into Malaysia, strengthening the nation's competitiveness, developing new sources of growth and enhancing the efficacy of the delivery system.

Whilst Malaysia recognises the importance of Foreign Direct Investment ("FDI") into Malaysia, Dr. Mahathir acknowledged that there has been a decline in international capital flows to Malaysia, amidst the global economic uncertainties coupled with increasing competition for FDI, particularly from China. He had also emphasised the importance in stimulating domestic growth within the private sector to create a more attractive and conducive environment for private sector initiatives to thrive in the country.

Below are the highlights of the more important and salient strategies and measures to assist Malaysia in overcoming the present economic situation and challenges ahead:

KEY STRATEGIES FROM THE PACKAGE

First Strategy:
Promoting investments into Malaysia

1. Relaxation of Foreign Investment Committee ("FIC") Guidelines
   In enhancing Malaysia's competitiveness and providing greater flexibility on foreign equity participation in local companies, the Package introduced the following new measures:

   (a) In respect of acquisitions by Malaysian and foreign interests, the only equity condition imposed is maintenance of at least 30% Bumiputra equity.

   (b) The 30% Bumiputra equity requirement will be applied across all ministries except where specific exemptions have already been granted by the Malaysian Government.

   (c) FIC approval only needs to be sought for acquisitions by foreign and Malaysian interests in excess of RM10 million (USD2.6 million) instead of RM5 million (USD1.3 million) previously. However, the percentage of share acquisition and voting rights of Malaysian and foreign interests remain unchanged.

   (d) For acquisitions exceeding RM100 million (USD26 million), companies can apply for an exemption from the FIC Guidelines subject to the approval of the Minister of Finance, on a case-to-case basis, for applications received before 31 May 2004.

2. Other measures
   The foreign equity conditions will also be liberalised to attract more foreign companies to be listed on the Kuala Lumpur Stock Exchange in line with the Capital Market Masterplan.

   The Government had also introduced various tax incentives to encourage the growth of small and medium enterprises ("SMEs") in the country. To complement its efforts, financial institutions have been urged to provide support for the development of SMEs. Amongst other incentives introduced by the Government include, providing SMEs with easier accessibility to funding sources and reducing financing costs so as to enable SMEs become catalysts in generating domestic investment.

Second Strategy :
Enhancing the nation's competitiveness

1. Pre-packaged schemes
   In enhancing the nation's competitiveness, the Cabinet Committee on National Competitiveness, chaired by the Deputy Prime Minister, has recommended various improvements to the existing tax incentives offered to potential investors, on a case-to-case basis.

Under the pre-packaged incentive scheme, Pioneer Status with 100% tax exemption for 10 years or 100% *Investment Tax Allowance* ("ITA") for 5 years has been granted. The incentives will now be further improved by:

(a) extending the maximum period for Pioneer Status from 10 to 15 years (commencing from the first year the company registers profits); and

(b) extending the period for ITA from 5 to 10 years.

2. **Regional Distribution Centres ("RDC") and International Procurement Centres ("IPC")**
With a view to encouraging the establishment of more RDCs and IPCs in Malaysia, the following salient measures were initiated in the Package:

(a) Refunds will be allowed for duties paid by RDCs / IPCs on components and spare parts which are unsold for 1 year, provided that the goods are re-exported; and

(b) RDCs / IPCs are now allowed to source goods from outside Malaysia for shipment to overseas destinations via drop shipment for up to 30% of its annual sales turnover.

3. **One-year exemption from Real Property Gains Tax ("RPGT")**
One of the more prominent measures in the Package is the RPGT exemption for 1 year, effective 1 June 2003 till 31 May 2004. This exemption from RPGT on chargeable gains accruing on the disposal of real property assets for a period of 1 year, was gazetted by issue of the *Real Property Gains Tax* (Exemption) (No.2) Order 2003 on 1 June 2003.

This measure attempts to encourage activities in the secondary property market. The RPGT exemption will certainly be welcomed by the property sector and it is likely that many will seize this opportunity to dispose off their property or real property ("RPC") shares.

4. **Tax incentives for small companies**
The Package further relaxed the requisite conditions in order for small companies to enjoy Pioneer Status or ITA. With the relaxation, small companies with shareholders' fund of at least RM500,000 with 60% of its equity held by a Malaysian can apply for pioneer status or ITA if the company achieves 15% value added or the activities of the company contribute to the socio-economic development of the rural population in Malaysia. Tax exemption of 100% (previously 70%) would be granted for 5 years under Pioneer Status.

5. **Other measures and initiatives**
Amongst the other measures to attract FDI into Malaysia includes the grant of the same tax incentives, which are offered to new OHQs, to existing OHQs, hence entitling them to also enjoy 100% income tax exemption for the remaining exemption period. Research and development ("R&D") companies are also entitled to a second round of Pioneer Status for another 5 years or ITA for a further 10 years. Various grants have also been provided in selected sectors for R&D costs undertaken by industry and research institutions.

Pioneer Status companies which have incurred R&D expenses in Malaysia are now allowed to accumulate and carry forward and be given *another* deduction of the R&D expenses against post Pioneer-Status income. Expenditure on R&D activities undertaken overseas will also be considered for double deductions, on a case-to-case basis.

Stamp duty and tax exemptions are also granted for the purchase of certain categories of property in line with the Home Ownership for the People ("HOPE") schemes. Various training funds have been provided with additional funding to enable retraining and reskilling in selected fields such as Information and Communications Technology ("ICT") and accountancy. Greater flexibility will also be given in hiring expatriates and automatic approvals will be granted for the recruitment of highly skilled workers where local expertise is not available.

**Third Strategy:
Developing new sources of growth**

1. **Boost to the Tourism sector**
Various measures have also been introduced in the Package to assist the tourism sector in combating the adverse economic consequences as a result of the SARS outbreak. The measures include suspending income tax installment payments for travel agents and exempting travel agents and hoteliers from the Human Resource Development Fund levy, with effect from 1 June 2003 until 31 December 2003 respectively.

In addition, hotels and restaurants have also been exempted from service tax from 1 June 2003 to 31 December 2003. The specific exemption under *Service Tax Act 1975* ("STA") was issued on 30 May 2003 pursuant to sec. 6 of the STA.

In an attempt to encourage domestic tourism, employers will also be given double deductions for such expenses incurred for 1 year, commencing 1 June 2003. Apart from seeking to assist the SARS-affected sectors, this measure is believed to have a multiplier effect on the economy with increased private sector consumption. The Tourism Infrastructure Fund has received an additional funding of RM500 million.

2. **Encouraging the growth of biotechnology in Malaysia**
In view of Malaysia's keen interest to promote the development of biotechnology, certain designated sites in the Bio-Valley have been delineated for R&D activities and production of vaccines. Previously, group relief i.e. enabling a company to offset its losses against the profits of another within the same group was only available to those in the food production industry. Group relief is now extended to, amongst others, biotechnology and nanotechnology companies.

3. **Other measures**
   The Government had also provided RM100 million to the Malaysian Venture Capital Berhad ("MAVCAP") to spearhead investment, nurture entrepreneurial development and generate new ICT opportunities. In promoting the agricultural sector as the third engine of economic growth, measures will continually be undertaken to increase investments in large-scale agricultural and commercial activities.

   The customs duty and sales tax on tele and video conferencing equipment (which are not produced locally) to facilitate communication, especially amongst SARS-affected countries are specifically exempted under the *Customs Duties (Exemption) Amendment (No.4) Order 2003 and the Sales Tax (Exemption) (Amendment) No.3 Order 2003.*

Fourth Strategy:
Enhancing the effectiveness of the delivery system

Measures undertaken

As part of the proactive efforts to facilitate investment in the manufacturing sector, the Malaysian Industrial Development Authority ("MIDA") will be appointing special project officers to hand-hold and assist investors in obtaining the necessary approvals for projects until they are fully operational. In an attempt to improve the country's delivery system, various steps will also be implemented to ensure expeditious processing of applications and approvals in the respective government departments.

For instance, processing of proposals and applications by manufacturing companies will be centralised at the Ministry of International Trade & Industry ("MITI") and of corporate proposals at the Securities Commission ("SC"). The proposals will no longer require FIC's consideration.

Specific steps have also been undertaken to expedite the process and approvals required for Building Plans and the issuance of the Certificate of Fitness for Occupation. A fast-track system will also be established to facilitate land alienation and land use conversion applications.

The Package had also acknowledge the need to undertake measures to improve the efficiency of the revenue collecting agencies. Some additional measures such as providing on-line submissions, validation and payments of excise duty, sales tax and service tax and reducing the processing time for stamping of documents through e-stamping are in the process of being implemented.

A new Customer Golden Programme will also be implemented to accord green-lane privileges at entry and exit points to traders who have contributed substantially to the tax revenue and have maintained a good track record of tax payments.

INITIAL REACTION TO THE PACKAGE

Many felt that the Package was a key step in assisting Malaysia overcome the challenges that have resulted from global events and SARS. Whilst some consider the Package as an attempt to address short-term weaknesses in the economy as well as medium-term structural issues, others have expressed their optimism that this Package will support and sustain the growth in various sectors of the economy in the long-term.

EFFECT OF THE PACKAGE

Although the Package was partially aimed at mitigating the effects of SARS and to combat the adverse effects of the Iraq war, the Package had also introduced a whole range of extensive measures to bolster the Malaysian economy. Various aggressive measures have been already put in place in the Package to, amongst others, attract greater volume of FDI into Malaysia and to strengthen the growth of various domestic sectors.

The Malaysian economy is said to be responding well to the Package since the announcement and subsequent implementation of the measures in late May 2003. With the much-added boost from the Package, the economy is expected to perform better in the second half of this year, paving the way for Malaysia to achieve 4 - 5% growth target for 2003.

Bank Negara has maintained optimistically its 4.5% Gross Domestic Product ("GDP") growth forecast for the country whilst the Malaysian Institute of Economic Research had revised its forecast upwards, from 3.7% previously to 4.3%.

The Deputy Finance Minister remarked recently that the positive effects of Package are being felt by the real economy and schemes such as micro-credit launched by Bank Pertanian and Bank Simpanan Nasional had received very encouraging public response. The financial sector also is responding well to the Package and various sectors have also shown gradual improvement, although the tourism sector may take a while longer for tourists to slowly their regain confidence to travel into the region and Malaysia respectively.

Civil servants have also been reminded of their importance in implementing the Package. The successful implementation and achievement of the Package's objectives is, to a large extent, reliant on the efficiency and effectiveness of the delivery system. In order to enhance the delivery system, every level of the Government plays a critical part, from the federal to state, local authorities and district councils respectively.

As Budget 2004 will be announced shortly, it is hoped that the Government will continue to monitor and evaluate the feedback from the Package and supplement any additional measures in the upcoming Budget to ensure that Malaysia will continue to remain resilient and competitive in the prevailing economic climate.

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All participants will be presented with a Certificate of Attendance upon successful completion of the workshop for use in registering CPD hours.

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Please tick ☑ the workshop(s) you wish to register

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☐ **Workshop 2** — *01 November 2003, Saturday*
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☐ **Workshop 3** — *08 November 2003, Saturday*
Tax Incentives and Double Deductions for the Manufacturing Sector

☐ **Workshop 4** — *15 November 2003, Saturday*
Double Tax Treaties and Withholding Taxes

☐ **Workshop 5** — *13 December 2003, Saturday*
Preparation of Tax Computations for Companies

☐ **Workshop 6** — *20 December 2003, Saturday*
Corporate Tax Planning

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- Company Directors
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- Business Owners
- Professionals and Executives
- Company Secretaries
- Advocates & Solicitors
- Accountants
- Tax Executives
- Tax Managers
- Finance Managers

Workshop Highlights

Workshop 1 — 18 October 2003, Saturday

Self Assessment for Individuals

- Business income vs employment income
- Business expenses vs non-business expenses
- Personal relief
- Computation of chargeable income
- Tax planning for individuals
- Self assessment system for individuals

Workshop 2 — 01 November 2003, Saturday

Tax Planning and Strategies for Cross Border Transactions

- Types of holding structure for foreign investments
- Advantages and disadvantages of various holding structures
- Comparison of tax havens
- Repatriation of profits
- Double tax relief

Workshop 3 — 08 November 2003, Saturday

Tax Incentives and Double Deductions for the Manufacturing Sector

- Pioneer status
- Investment tax allowance
- Reinvestment allowance
- Double deductions
- Application procedures and guidelines

Workshop 4 — 15 November 2003, Saturday

Double Tax Treaties and Withholding Taxes

- Withholding taxes
- Objectives of double tax treaties
- Structure of Malaysian double tax treaties
- Double tax relief and tax sparing relief
- Double tax treaties with Singapore and Netherlands
- Case law developments

Workshop 5 — 13 December 2003, Saturday

Preparation of Tax Computations for Companies

- Computation of chargeable income
- Deductible and non-deductible expenses
- Double deductions
- Common tax adjustments
- Steps in preparing a tax computation
- Form C and Form R under the self assessment system

Workshop 6 — 20 December 2003, Saturday

Corporate Tax Planning

- Objectives of corporate tax planning
- Tax planning principles
- Tax planning methodology
- Corporate restructuring
- Case law developments

8 CPD Hours

by:
Chow Chee Yen

Chee Yen is a Fellow Member of the Chartered Association of Certified Accountants (FCCA), an Associate Member of the Malaysian Institute of Taxation (ATII) and a Chartered Accountant of the Malaysian Institute of Accountants (CA).

He is also a graduate of the Malaysian Institute of Certified Public Accountants (MICPA) Examinations and successfully completed the Certified Financial Planner (CFP) conversion programme.

He is currently an Associate Director with an international firm in Kuala Lumpur, specialising in corporate taxation. He has more than 11 years of tax experience and was involved in tax engagements concerning cross border transactions, tax due diligence review, restructuring schemes, corporate tax planning, group tax review and inbound investments.

He is also involved in tax workshops and seminars organised by MIA and MIT on a regular basis. In addition, he has been lecturing extensively in various colleges and university in the Klang Valley for the past 8 years, specialising in taxation papers for professional examinations namely ACCA, MICPA, ICSA and MIT. He was also the Chief Examiner for a taxation paper of a professional examination body.

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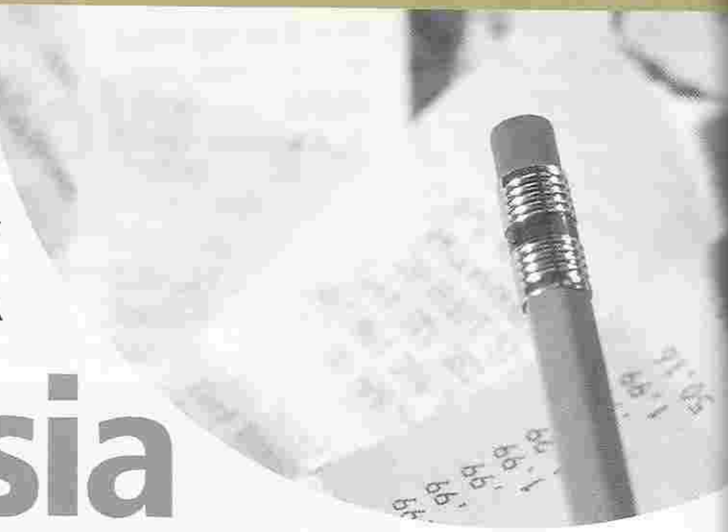

Sales Tax In Malaysia

By Thomas Selva Doss

1. Sales tax came into existence in 1972 as a result of the *Sales Tax Act 1972* ("STA"). It is a single stage tax levied on imported goods as well as goods manufactured in Malaysia. For imported goods, it is levied at the time the goods are cleared from customs control together with any import duty, using import declaration form Customs No.1, which is submitted to the senior officer of customs at the place of import. The amount of tax levied will depend on the rate of import duty and sales tax on the value of the goods declared to customs. Care has to be taken to ensure that the value declared is the transaction value[1] according to the WTO Valuation system.

2. For locally manufactured goods, two further elements must be present before the goods can be subject to sales tax. Firstly, a person has to be a "manufacturer" and secondly, the goods manufactured must be "taxable goods". Both of these terms are defined by sec. 2 of the *STA* although the Act defines the term "manufacturer" widely, to encompass almost every processing activity to be manufacturing and conceptually as such, requires all goods produced to be subject to the sales tax unless specifically exempt. Therefore, by design the STA is inclusive in concept, requiring all goods to be subject to the sales tax, except those which are specifically exempted in Schedule A of the *Sales Tax (Exemption) Order 1980*.

3. Once you are certain that you are a manufacturer of taxable goods, your first obligation would be to apply to the Customs for a sales tax licence, using Form JKED1. The Customs will then issue a sales tax licence via Form ST No.2 for the life of the business/ company which Regulation 6 requires every licenced manufacturer to display in a conspicuous place.

4. Once manufacturing and sales of taxable goods have begun to take place the licenced manufacturer is required to issue an invoice, with the sales tax amount stated separately, in the National Language or English. The sales tax becomes due and payable once an invoice is issued to the purchaser. Subsequently, within a period of twenty-eight (28) days after the end of each taxable period (i.e. a two calendar month period), the manufacturer is required to submit a return in the prescribed Form ST3 stating the aggregate amount of the sales value of all taxable goods sold during the period and the amount of sales tax payable on those goods. The sales tax due can be paid by cash, bank draft, money order, postal order or cheque. However, for payment made by cheque, the senior officer of customs will require the licenced manufacturer to furnish a bank guarantee. The Form ST3 return furnished is accepted by the proper officer of customs as sufficient proof of the matters contained in the return. The last day for furnishing of the returns is the twenty eighth (28th) day of the month following the taxable period. For any sales tax which remains unpaid after the last day on which it was payable, a penalty of ten (10) per cent will be levied on the amount unpaid, and if the sales tax remains unpaid for more than thirty (30) days after the last day on which it was payable, the rate of penalty shall increase by ten (10) percent for every succeeding thirty (30) days to a maximum of fifty (50) per cent of the unpaid amount.

MATERIALS FOR MANUFACTURERS TO BE TAX FREE

5. Sales tax is a single stage tax imposed at the manufacturers level. Therefore, in adherence to the single stage concept, purchases (i.e. of imported or locally produced raw material, components and packaging materials) between manufacturers are exempted from tax under sec. 9 of the STA Sales tax in effect crystallizes upon a sale between a manufacturer and a non-manufacturer (e.g. a trader) or an unlicensed manufacturer.

6. To obtain an exemption from sales tax, the licensed manufacturer has to ensure that the raw materials, components or packaging materials purchased, are used directly in the manufacture of finished goods, which means that they have to be physically

1 In general, the transaction value is the price actually paid or payable for the goods when sold for export to Malaysia. It is the primary basis in customs valuation for the levy of import duty and sales tax. The transaction value is however subject to adjustments for certain mandatory items not included in the price and provided no restrictions/ conditions exist on the buyer.

incorporated into the finished goods. Raw materials and components which are not physically incorporated into the finished goods eg. fuel, sanding discs, spare parts and accessories are not eligible for the sales tax exemption.

7. This sales tax exemption is not automatic. The licensed manufacturer has to apply to the senior officer of sales tax for this facility on Form S.T. No. 5. The S.T. 5 is a facility and not a right. If this facility is abused, the senior officer of sales tax may refuse to grant this facility. One of the main conditions of S.T. 5 is that the importation or local purchase of the raw materials, components or packaging materials is to be done in the name of a licensed manufacturer. If the supplier is a trading company importing or purchasing from a local manufacturer in bulk and supplying to the licensed manufacturer then another facility is available to the licensed manufacturer (and the supplier) known as the S.T. 5A. The S.T.5A is an application to import or acquire on behalf of and for delivery to a licensed manufacturer materials and components free of sales tax for use in the manufacture of goods. The licensed manufacturer must first of all be in possession of a S.T.5 after which he authorises the supplier to apply for the S.T.5A. The S.T.5A will be based on the S.T.5 of the licensed manufacturer. The supplier holding the S.T.5A has to import or purchase locally (from another licensed manufacturer) the goods approved for non-payment of sales tax and deliver them to the licenced manufacturer before the expiry of the S.T.5.

8. Upon importation or after purchasing from a local manufacturer the raw materials, components or packaging materials, the licenced manufacturer has to use them to manufacture his finished goods at his premises. There are instances where the licenced manufacturer has to send the raw materials, components or packaging materials to another licenced manufacturer (a sub-contractor) to complete the manufacture and re-acquire such goods free of sales tax. Sub-contracting is allowed under the STA, provided the licenced manufacturer applies for the facility ST 5B. One has to ensure that the other manufacturer (sub-contractor) has a licence under the STA. After acquiring the finished goods free of sales tax from the second licenced manufacturer (sub-contractor) the first mentioned licenced manufacturer will levy the sales tax on the invoice when the goods are sold to a trader or unlicensed manufacturer.

TIME OF LEVYING SALES TAX

9. Sales tax is levied at the time the goods are sold or disposed of otherwise than by sale. The word "sale" includes barter, goods on hire, hire purchase and goods on consignment. Disposal otherwise than by sale could take various forms – goods given away free of charge, goods applied for own use, goods destroyed etc. Goods exported are not subject to sales tax. The word "export" includes goods sold to Labuan, Langkawi, Tioman, licenced warehouses, licenced manufacturing warehouses, free zones and the Joint Development Area. As proof of export, the licenced manufacturer has to furnish the export declaration form Customs No. 2.

10. Sometimes it is necessary to export goods through a third party. Here, the licensed manufacturer has to request the third party (purchaser) to apply for sales tax exemption under Item 91 sch. B of the *Sales Tax (Exemption) Order 1980* to purchase goods free of sales tax from the licensed manufacturer and subsequently export them. The purchaser has to apply for this exemption which is subject to a number of conditions.

DETERMINATION OF SALE VALUE

11. The sale value of goods is determined as follows:

    i. For goods imported into Malaysia the sale value is the import price plus the amount of customs duty payable,

    ii. For locally manufactured goods the sale value is:

        - in the case of goods sold by a taxable person to a person independent of him, the price for which the goods are actually sold,
        - in the case of goods sold otherwise by a taxable person, the price at which such goods would have been sold if they had been sold in the ordinary course of business to a person independent of the taxable person.

12. In the first instance, for locally manufactured goods sold to an independent purchaser, the price at which goods are sold is accepted as a basis for levying the sales tax. In the second instance, the sale is considered a non-independent sale so the price offered is not accepted as a basis for levying the sales tax. The acceptable price has to be the 'transaction value' according to the World Trade Organisation's ("WTO") valuation system. This new system of valuation for locally manufactured goods came into force on 1st January 2003.

EXEMPTION FROM LICENCING - [SALES TAX (EXEMPTION FROM LICENCING) ORDER 1997] SCHEDULE A

13. The objective of the STA is to obtain revenue from manufactured goods sold, but care is taken not to tax the small local manufacturers who may be burdened by the sales tax. Schedule A of the *Sales Tax (Exemption from Licencing) Order 1997* exempts the following manufacturers from applying for a Sales Tax licence:

    1. A manufacturer of taxable goods, not being a "contractor" as defined in para. 2 below, who satisfies the senior officer of sales tax that the sale value of taxable goods manufactured by him, and which he has sold or otherwise disposed of during the

preceding twelve months did not exceed RM100,000 and that the sale value of goods likely to be manufactured and sold or otherwise disposed of by him during the next twelve months is not expected to exceed that sum; OR

2. A manufacturer of taxable goods, being a "contractor" i.e. a person who performs work on taxable materials wholly supplied by another person, who satisfies the senior officer of sales tax that the total amount charged for such work done by him during the preceding twelve (12) months did not exceed RM20,000 and that the total charges for work to be done by him in manufacturing taxable goods wholly from taxable materials supplied by other persons during the ensuring twelve months is not likely to exceed that sum.

14. In para. 13.1 above, a manufacturer of taxable goods whose taxable sales in the preceding twelve months did not exceed RM100,000 and is not likely to exceed that amount in the next twelve months is not required to apply for a sales tax licence.

15. In para. 13.2 above, a manufacturer of taxable goods being a "contractor" i.e. a person who performs work on taxable materials wholly supplied by another person whose charges for the work done on those materials for the preceeding twelve months did not exceed RM20,000 and the total charges for work to be done by him the next twelve months is not likely to exceed that sum is also not required to apply for a sales tax licence.

16. In both these instances, they are required to apply for a Certificate of Exemption from Licencing. The application is to be made using Form S.T. No.6 and the certificate will be issued via Form S.T. No.7 which has to be renewed every year. Once the manufacturer exceeds the threshold of RM100,000 or RM20,000 as the case may be, he is required to cancel the certificate and apply for a sales tax licence.

EXEMPTION FROM LICENSING - [SALES TAX (EXEMPTION FROM LICENCING) ORDER 1997] SCHEDULE B

17. The definition of manufacture under the STA encompasses a wide range of activities, and as such practically everyone who does some work on materials to change the size, shape or nature of the materials would fall under the category of manufacturers. It is therefore necessary to exempt certain people from applying for a sales tax licence. As such the *Sales Tax (Exemption from Licencing) Order 1997* exempts certain operations which would be classified as manufacture, for example:

    i. The developing and printing of photographs and the production of film slides,

    ii. The engraving of articles with the name of the recipient, his sports record or other circumstances under which the article was donated or awarded,

    iii. The incorporation of goods into building,

    iv. The manufacture of ready mixed concrete,

    v. The preparation of meals etc.

18. Although these operations come within the definition of manufacture under sec. 2 of the STA, anyone performing these operations are exempted from sales tax and will not be required to apply for a sales tax licence.

Bibliography:
1 Sales Tax Act 1972
2 Sales Tax Regulations 1972
3 Sales Tax (Exemption) Order 1980
Schedule A
Schedule B
Schedule C
4 Sales Tax (Exemption From Licensing) Order 1997
5 Sales Tax (Rules of Valuation) Regulations 2002

KEEPING PROPER RECORDS

19. Section 18(1) of the STA requires every taxable person to keep full and true up to date written records of all transactions which affect or may affect his liability to sales tax. These records are to be kept for a period of six years from the latest date to which such records relate. This is necessary because under the Sales Tax Standing Orders an audit known as "inspection of accounts" is to be carried out on all manufacturers licenced under the STA from time to time to ensure that sales tax has been levied correctly, collected and paid to the Sales Tax Division. Non-compliance under this section will render a person guilty of an offence under the STA and be liable to a fine and/or imprisonment. Fortunately, non-compliance is prescribed to be a compoundable offence and in most cases, the senior officer of sales tax will offer a compound to a maximum of five thousand ringgit to the offender.

20. Anyone seeking information on sales tax has to get in touch with the sales tax office nearest to his company or business. Although sales tax was introduced in 1972, it is a relatively unknown tax. Many manufacturers are in the dark, as information regarding sales tax is not readily available or forthcoming, as most of the sales tax procedures are considered classified information for use by the customs officers only.

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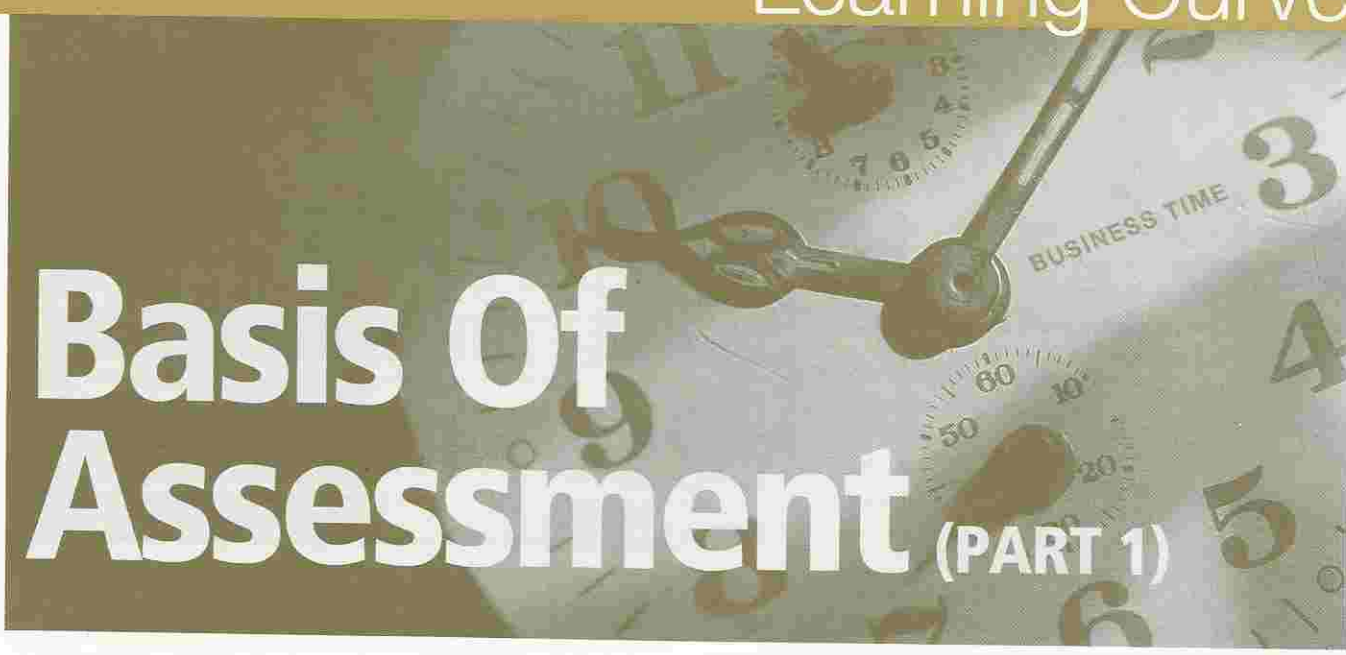


Basis Of Assessment (PART 1)

By SIVA NAIR

In dealing with, personal taxation we looked, firstly, at the assessment of employment income, as it is the main (and some cases, the only) source of income for many individuals. However, many individuals also conduct businesses, either as sole-proprietorships or together with others in the form of a partnership. Going down memory lane, in an earlier article on employment income, we distinguished between an employment and a profession, as income from the exercise of a profession was business income. However, the conduct of a business is not restricted to individuals only, but applicable to companies, cooperatives, associations etc.

We commence our study of business income by firstly understanding the basis of assessment of business income for the different persons generating it.

DEFINITIONS

Year of Assessment

Section 2 of the *Income Tax Act 1967* (as amended) (hereinafter referred to as "the Act") defines a year of assessment as the calendar year.

Basis Year

Section 20 of the Act states that the calendar year coinciding with a year of assessment shall constitute the basis year for that year of assessment. The definition was amended in 2000 to accommodate the shift from preceding year basis of assessment to the current year basis of assessment. Therefore, currently both the year of assessment and the basis year are the same.

Basis Period

The advent of this century saw major changes to sec. 21 of the Act, which deals with the determination of basis periods. Basically, the change was to cater for the change from the preceding year basis of assessment to the current year basis of assessment from year of assessment 2000. This was followed by further amendments to facilitate the introduction of self-assessment for companies in 2001 and for others from 2004.

Section 21(1) of the Act states that the basis year for a year of assessment shall constitute in relation to a source of a person other than a company, the basis period for that year of assessment. Section 21A(1) states that the basis year for a year of assessment shall constitute in relation to a source of a company, the basis period for that year of assessment.

However, sec. 21(2) states that for persons other than a company, the financial or accounting year (full 12 months) can constitute the basis period for a year of assessment for business income whereas sec. 21A(2) states that for a company, the financial or accounting year (full 12 months) can constitute the basis period for a year of assessment for all sources of income.

The *Income Tax (Amendment) Act 2002* has removed the whole of sec. 21 (including all sub-sections) and substituted it with the following new sec. 21 which reads

"The basis year for a year of assessment shall constitute in relation to a source of a person other than a company, trust body or co-operative society the basis period for that year of assessment."

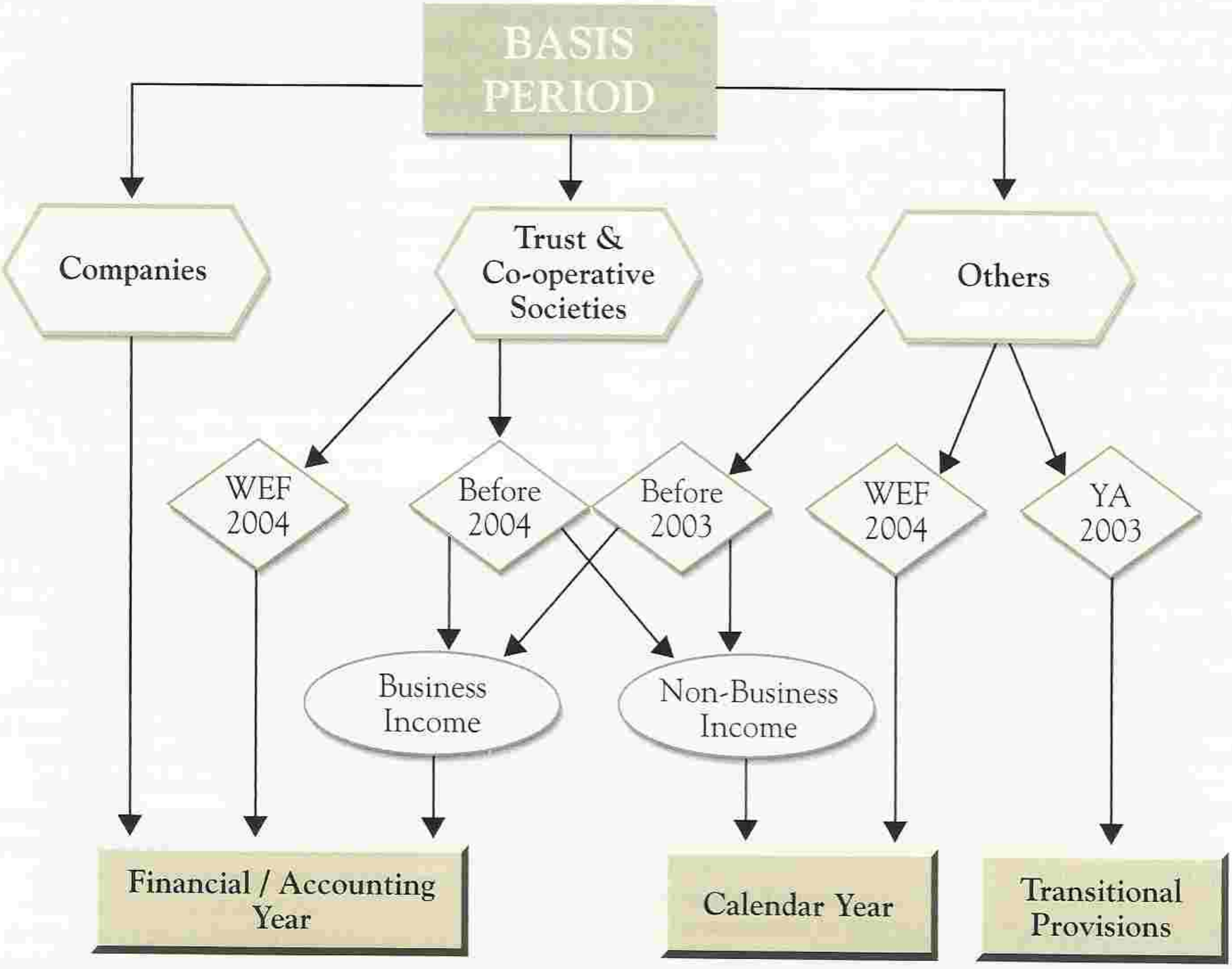
Similarly, sec. 21A was amended to include trust body and co-operative societies in addition to companies. However, although the *Income Tax (Amendment) Act 2002* has already been gazetted, it shall have effect only from year of assessment 2004. Therefore, for year of assessment 2003, trust body and co-operative societies are still governed by the old sec. 21, but for persons other than companies, trust body and co-operative societies, new transitional provisions have been enacted and these are discussed later in the article.

Example 1

Assume a person operates a business in Malaysia preparing accounts to 31st May each year and also receives rental income. Lets determine the relevant basis periods for the years of assessment 2002 to 2004 for each of the sources of income if the person is a sole-proprietor, a company or a trust body / company-operative society.

Basis Periods		Company	Trust Body/ Co-operative society	Sole Proprietor
YA 2002	Business income	1.06.01 – 31.05.02	1.06.01 – 31.05.02	1.06.01 – 31.05.02
	Rental income	1.06.01 – 31.05.02	1.01.02 – 31.12.02	1.01.02 – 31.12.02
YA 2003	Business income	1.06.02 – 31.05.03	1.06.02 – 31.05.03	1.06.02 – 31.12.03
	Rental income	1.06.02 – 31.05.03	1.01.02 – 31.12.02	1.01.03 – 31.12.03
YA 2004	Business income	1.06.03 – 31.05.04	1.06.03 – 31.05.04	1.01.03 – 31.12.04
	Rental income	1.06.03 – 31.05.04	1.06.03 – 31.05.04	1.01.03 – 31.12.04

A summary of what constitutes a basis period is appended below for easy reference.



The topic of basis of assessment involves two major issues:

- Commencement rules — principles relating to the determination of basis periods upon commencement of a business
- Change in accounting date — principles relating to the determination of basis periods when the year-end of a business source is changed i.e. there is a failure to make 12 months accounts.

COMMENCEMENT RULES

Section 21(4) states that where a person commences a business on a day in a basis year and makes up the accounts of his business for a period of twelve months ending on a day other than 31st December, then, there shall be no basis period in relation to the business for the first year. Of course, this sub-section will be deleted with effect from year of assessment 2004 based on the *Income Tax (Amendment) Act 2002*. Section 21A(4) states the same thing for companies (and with effect from year of assessment 2004, trust and co-operative societies) but in relation to any of its sources of income.

However, if they are not for 12 months than sec. 21(4) [or sec. 21A(4)] would not be operative and therefore, the general rule that the basis period is the basis year will apply.

Therefore, in determining the first basis period for the relevant year of assessment, the question you should ask is

Is the first set of accounts for 12 months?

An answer in the affirmative would mean that, that set accounts represents the first basis period for the relevant year of assessment. Otherwise, the basis period would be the period from the date of commencement of business to 31st December of that year.

Example 2
Hanoi Sdn Bhd, commences business on 1.2.2001. Determine his first basis period if he decides to prepare his first set of accounts to:

a) 31st January 2002
b) 31st July 2001
c) 31st March 2002

Solution:

a) *Since the first of accounts are* **for 12 months** *(1.2.01 – 31.1.02), it will be accepted as the first basis period for the relevant year of assessment which in this case will be YA 2002.* ***There is no basis period for year of assessment 2001.***

b) *Since the first of accounts are* **not for 12 months** *(1.2.01 – 31.7.01), the general rule will apply i.e. the first basis period will be to 31st December i.e. 1.2.01 – 31.12.01, for year of assessment 2001*

c) *Again, since the first of accounts are* **not for 12 months** *(1.2.01 – 31.3.02), the general rule will apply i.e. the first basis period will be to 31st December i.e. 1.2.01 – 31.12.01, for year of assessment 2001*

For subsequent years, the question to ask would be

Do you have 12 months accounts ending in the basis year for the relevant year of assessment?

Again, if the answer is in the affirmative, it means that, that set of accounts represents the basis period for the relevant year of assessment. Otherwise, the basis period would be the basis year i.e. 1st January to 31st December.

Example 3
Yangoon Sdn Bhd commenced business on 1.5.01 preparing its first set of accounts to 30th April 2002 and subsequently prepares accounts for a 12-month period. Determine the basis period for the years of assessment 2001 to 2003.

Solution:

Year of assessment	*Basis period*
2001	*No basis period – Section 21A(4) will apply*
2002	*1.5.01 – 30.4.02*
2003	*1.5.02 – 30.4.03*

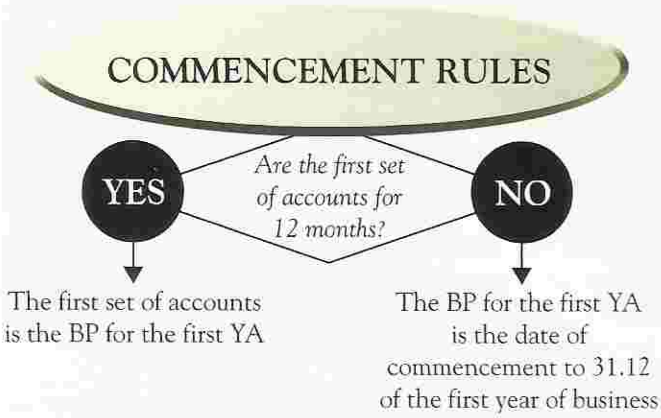
Example 4
Bangkok Sdn Bhd commenced business on 1.10.02 preparing its first set of accounts to 30th November 2002 and subsequently prepares accounts for a 12-month period. Determine the basis period for the years of assessment 2002 and 2003.

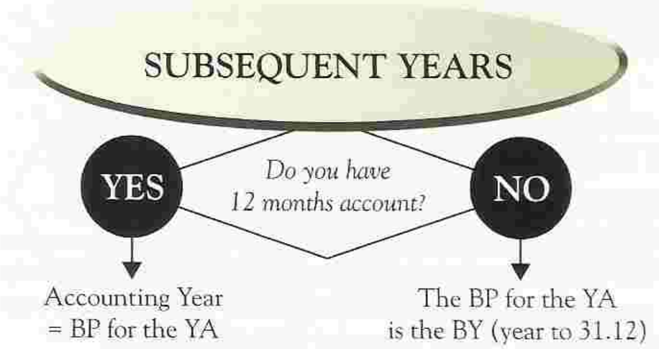
b) Year of assessment	*Basis period*
2002	*1.10.02 – 31.12.02 (since the 1st set of accounts is NOT for 12 months)*
2003	*1.12.02 – 30.11.03 (since there is a 12-month account ending in 2003)*

Example 5
Saigon Sdn Bhd commenced business on 1.9.01 preparing its first set of accounts to 28th February 2002 and subsequently prepares accounts for a 12-month period. Determine the basis period for the years of assessment 2001 to 2003.

Year of assessment	*Basis period*
2001	*1.9.01 – 31.12.01 (since there is* NO *12 month account ending in 2001)*
2002	*1.1.01 – 31.12.02 (since there is* NO *12 month account ending in 2002)*
2003	1.3.02 – 28.2.03 *(since there is a 12-month account ending in 2003)*

Commencement rules relating to the determination of basis periods can be summarised as follows:





MIT TAX II DEC 1995 Q4 (abstracted and updated to 2003)

M-Mart Sdn Bhd commenced business on 1 July 2000 and prepared its first accounts to 31 March 2001, then to 31 March each year subsequently.

Required:
State the basis period for M-Mart Sdn Bhd for the years of assessment 2000, 2001, 2002 and 2003.

Solution:

Year of assessment	*Basis period*
2000	*1.7.00 – 31.12.00 (since there is* **NO** *12 month account ending in 2000)*
2001	*1.1.01 – 31.12.01 (since there is* **NO** *12 month account ending in 2001)*
2002	*1.4.01 – 31.3.02 (since there is 12 month account ending in 2002)*
2003	*1.4.02 – 31.3.03 (since there is a 12-month account ending in 2003)*

SPECIAL CIRCUMSTANCES (prior to year of assessment 2004)

The are specific circumstances detailed in sec. 21(5) and sec. 21A(5), whereby the general rules governing the ascertainment of the basis periods are abandoned and the accounts are accepted as the basis period for the relevant years of assessment. These situations are as follows:

a) Where a company commences operations and is required under any law of the place of incorporation to makeup its accounts ending on a specified day

b) Where a company being a company within a group of companies makes up its accounts ending on the same day as that of all other companies in the group

the period which begins from the day the company commences the business until the end of the accounting period of the business shall constitute the basis period.

Example 6
Jakarta Holding Bhd. which has a 31st March year-end, incorporated a 100% subsidiary Medan Sdn Bhd on the 12.12.02. Medan Sdn Bhd prepares its accounts as follows:

12.12.02 – 31.03.03

01.04.03 – 31.03.04

The basis period for the relevant years of assessment for Medan Sdn Bhd is:

Year of assessment	*Basis period*
2002	*NIL*
2003	*12.12.02 – 31.03.03*
2004	*01.04.03 – 31.03.04*

The absence of a 12-month first set of account, does not disqualify the company from using its accounts as the basis period.

c) Where a person becomes a partner in an existing partnership and the accounts of the business of the existing partnership have been made up for its normal accounting period, the period which begins from the day the person becomes a partner until the end of the accounting period of the business shall constitute the basis period.

Example 7
On 1.9.01, Mr. Praya joins the partnership of Menam and Chao which has always maintained a 28th February year-end, to form the partnership of Menam Chao Praya. The new partnership also prepares its accounts to 28th February.

The basis period for the relevant years of assessment for Mr. Praya is:

Year of assessment	*Basis period*
2001	*NIL*
2002	*01.09.01 – 28.02.02*
2003	*01.03.02 – 28.02.03*

d) Where a person becomes a partner of a person who is carrying on business as a sole proprietor in a basis year and the accounts of the business of the sole-proprietor have been made up for its normal accounting period, the period which begins from the day the person becomes a partner until the end of the accounting period of the business shall constitute the basis period.

Example 8
On 1.5.01, Mr. Singha joins the sole proprietor business of Mr. Poh to form the partnership of SinghaPoh. Since Mr. Poh was preparing accounts to 30th June, the new partnership also prepares its accounts to 30th June.

The basis period for the relevant years of assessment for Mr. Singha is:

Year of assessment	*Basis period*
2001	*01.05.01 – 30.06.01*
2002	*01.07.01 – 30.06.02*
2003	*01.07.02 – 30.06.03*

Section 21A(6) states that where a company commences to a new operation and is already carrying on one or more operations, the basis period of the existing operation will be the basis period of the new operation.

This is further elaborated in sec. 21A(7) which explains that where a company is already carrying on two or more businesses, whichever of those businesses the company carried on shall be taken to be the old business. However, if all were commenced simultaneously then Director-General will direct which is to be taken as the old business.

The meaning of the word "operations" is defined in sec. 21A(8) as any activity which consists of :

- carrying on of a business
- the making of investments
- carrying on of a business and the making of investments
- the making of investments prior to the commencement or after the cessation, of a business

Example 9
Ho Chi Min Bhd. which carries on the business of manufacturing, has a 31st August year-end. On 1.11.03, it commenced a new business of providing management services and prepared its first set of accounts for the new business from 1st of November 2003 to 31st August 2004. This will be accepted as the first basis period for the new business for the year of assessment 2004. The is no basis period year of assessment 2003 in respect of the new business.

However, an individual who operates two or more different businesses can have different accounting dates and therefore a different basis period for each business.

In the next article we shall look at the intricacies arising where a business changes its accounting date.

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Assessment Necessary Only Where There Is Chargeable Income

This was an appeal by the taxpayer from the High Court's refusal of an order for mandamus to direct the Director-General of Inland Revenue ("DGIR") to issue and serve on the taxpayer company notices of assessment for the years of assessment 1982, 1983 and 1984.

In the returns the taxpayer furnished for the years of assessment 1982 to 1984, the taxpayer made a claim for annual allowances. However, the taxpayer did not elect under rule 2 of the *Income Tax (Qualifying Plant Annual Allowances) Rules, 1982* for allowances to be equal to the rates prescribed in the 1968 version of the same. As such, the rates formulated in rule 2 of the 1982 version of the Rules applied. Subsequently, the taxpayer, through tax agents, commenced efforts to have the 1968 rates applied for the relevant years of assessment. However, the DGIR refused. The taxpayer therefore decided to appeal to the Special Commissioner. Such an appeal, however, would require a notice of assessment and this was not issued to the taxpayer, as they had no chargeable income for the relevant years. On request to the DGIR, only the tax computations for those years were produced.

At the appeal in the lower court, it was the taxpayer's case that assessments had been made for those years, and the DGIR was therefore bound by sec. 96(1) of the Act to cause notices of assessment to be served on them and not that the assessments were not made and should be made. The taxpayer's premise for stating that the assessments were made was because the DGIR was able to state that the taxpayer had no chargeable income and to provide the tax computations stating the same. The issue before the Court was therefore, whether the taxpayer was right in contending that the DGIR had made assessments. If they were, then the DGIR was bound by sec. 96(1) to cause notices of assessment to be served on the taxpayer.

The Court dismissed the appeal.

1. It is a matter of construction whether sec. 90(1) makes it mandatory for an assessment to be made in the case of a return delivered under sec. 77. The court regarded sec. 90(1) as emphasising the requirement for the DGIR in every case to determine whether a taxpayer has a chargeable income and what is its amount, and then to make an assessment of the tax payable. The implication of this being that an assessment has to be made only if there is chargeable income to levy tax upon.

2. **On the issue of whether the DGIR had made assessments for the relevant years of assessment, according to sec. 93 of the Act, there is formality, ritual and deliberateness in making an assessment. The prescribed form and date, which would presume when the assessment was made, must be specified in the appropriate space in the form. Any work, inquiry or calculation done before that would not be the making of the assessment but an effort made towards the making of the assessment, which is the completion of the form coupled with the dating of it, and the assessment that is made comprises the matters indicated in the form as stated in paragraph (b) of the section.**

3. In view of the fact that there was no question that assessment forms had been completed for the relevant years of assessment, no assessments had been made in respect of those years and therefore the DGIR was under no duty to have notices of assessment served on the taxpayers.

Ketua Pengarah Jabatan Hasil Dalam Negeri
v. Enesty Sdn Bhd
Court of Appeal, Kuala Lumpur.
Civil Appeal No. W-01-270-1996
Judgment delivered on 12 May 2003.

K I Goh (of Shearn Delamore & Co) for the taxpayer.
Raja Kamarulzaman bin Raja Musa (together with Cik Zaleha binti Adam) for the DGIR.

Director-General's Exercise Of Discretion Was Proper And Reasonable

On 6 April 1998, the taxpayer was acquired by another company and was obliged to change its financial year to coincide with its holding company's. It then wrote to the Director-General of Income Tax ("DGIR") to inform the same. On 23 October 1998, the Minister of Finance announced a change in the tax system from tax on a precedent year basis to a current year basis, beginning from the year 2000. To facilitate this change, tax was to be waived on income derived in the year 1999. Due to the change in its taxpayer's financial year end, the taxpayer did not make up its account for the period from 1 May 1998 to 30 April 1999 but accounts were made for the period from 1 May 1998 to 31 December 1999 instead. It then claimed a waiver of tax for the latter period of 20 months.

The Director-General, however, disagreed and was of the view that it should be determined as follows:

Year of Assessment	Basis Period
2000 (preceding year basis)	1 May 1998 to 30 April 1999
2000 (current year basis)	1 May 1999 to 31 December 2000
2001	1 January 2001 to 31 December 2001

The taxpayer therefore sought a declaration that, inter alia, the DGIR was wrong in his determination of the taxpayer's basis period. This matter therefore came before the Court on the sole issue of whether the DGIR has properly and correctly exercised his discretion under sec. 21(3) of the *Income Tax Act, 1967* ("the Act").

The Court dismissed the appeal on grounds that the DGIR had exercised his discretion properly and reasonably under sec. 21(3) of the Act.

Case authorities showed that there are relevant factors to be taken into account in determining whether These factors are:

(a) that the exercise of discretion must be within the ambit of the statute;

(b) that the DGIR must have regard to the policy and object of the statute;

(c) that the DGIR must have regard to those matters which are expressly or by necessary implication stated in the statute that conferred the discretion; and

(d) that in exercising his discretion, the DGIR must be fair to the general body of taxpayers at large.

The DGIR's discretion did not contravene the express provision of the Act — in particular sec. 21(3) thereof. The DGIR's direction for a period of 12 months for the following year of assessment and 20 months for the next following year of assessment was well within the ambit of the provision of the law. If the DGIR were to accede to the taxpayer's suggestion and issue the direction along the lines as suggested by the taxpayer, there would be unfairness. The basis period of the taxpayer will be more than 12 months while the other taxpayers would be restricted to 12 months only. This could not be a proper and correct exercise of discretion by the DGIR. Every taxpayer must be treated alike. The DGIR owes a legal duty of fairness to the general body of taxpayers.

Prudential Assurance Malaysia Bhd v. Kerajaan Malaysia
High Court of Malaya, Kuala Lumpur.
Originating Summons No. S1(S7) 21-34-2001
Judgment delivered on 10 Jan 2003.

Dato' M Anad Krishnan (of Messrs Anad & Noraini) for the taxpayer.
Abu Tariq Jamaluddin (Legal Officer; Inland Revenue Board) for the Director General of Inland Revenue.

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

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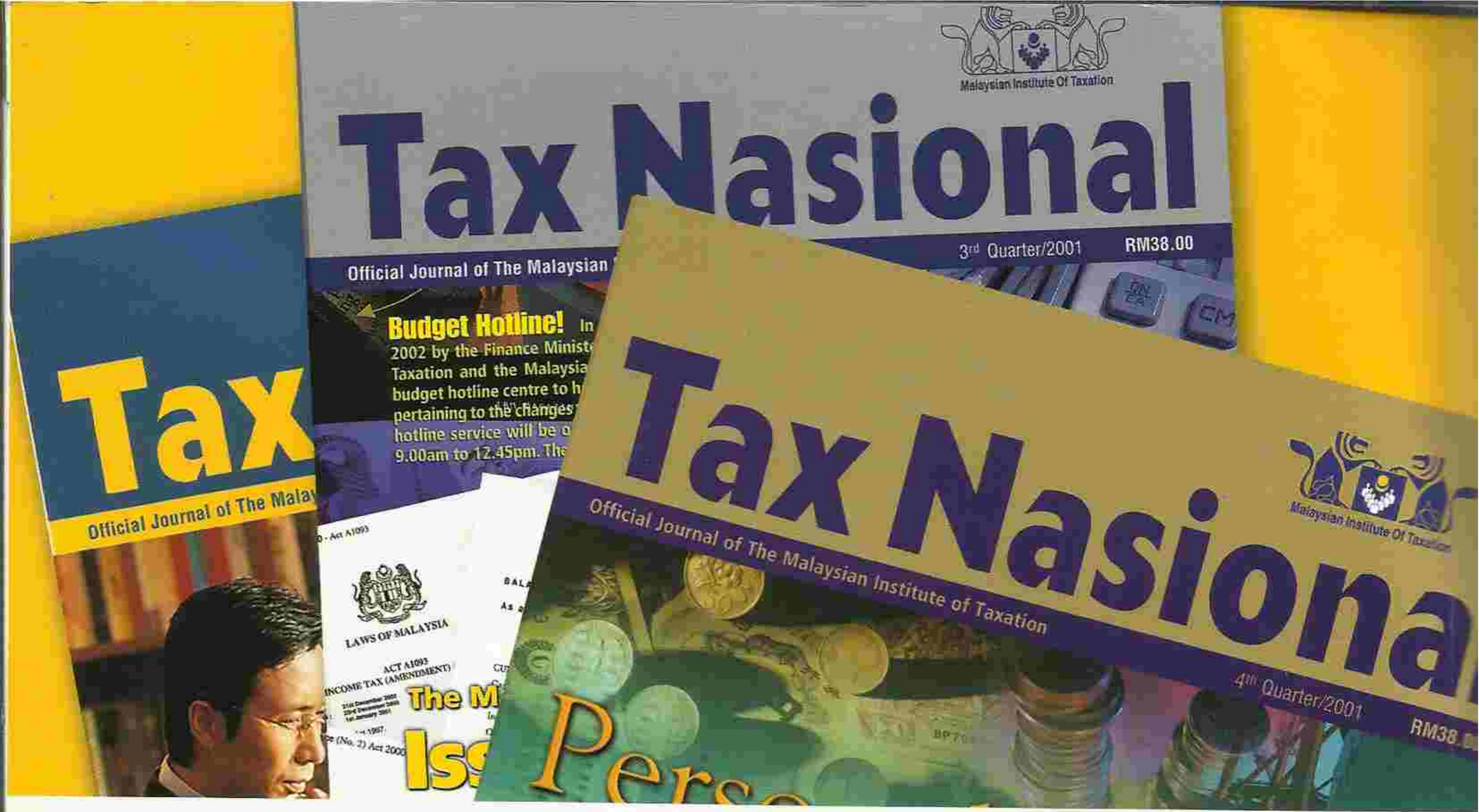

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