Malaysian Institute Of Taxation

TAX NASIONAL

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Malaysia's First MAP Team

Page 9
Interpretation of Tax Statutes – New Directions

Page 13
Taxation of Interest Income Under Section 4(a) of the Income Tax Act 1967 – Where are we now?

CCH

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National Tax Conference 2004

24 & 25 August 2004

Sunway Lagoon Resort Hotel, Selangor

Gaining A Competitive Edge

Comments from previous attendees

NTC 2001

"This conference helps me think clearer about the self assessment and good governance!"

"Great opportunity to meet and exchange with leading tax professionals and senior revenue officials!"

"Great conference! Great experience & atmosphere. Thanks!"

NTC 2002

"Thoroughly enjoyed this conference!"

"I really appreciated to be able to listen to the current issues affecting the tax practice, to understand the growing trend of globalisation, and the way the topics support best practices!"

"Overall, well done as the conference has benefited me in understanding better the current tax system!"

NTC 2003

"It's a good conference. The conference topics covered not only the current world events but also new challenges in tax administration."

"I learned a lot about the tax local and international tax issues."

"I enjoyed the presentations and received valuable information!"

The Premier Tax Event of the Year

National Tax Conference 2004

24 & 25 August 2004

Gaining A Competitive Edge

Sunway Lagoon Resort Hotel, Selangor

CONFERENCE HIGHLIGHTS

Following the successes of the three previous National Tax Conferences, the Lembaga Hasil Dalam Negeri Malaysia (LHDNM) and the Malaysian Institute of Taxation (MIT) are proud to bring once again the 4th National Tax Conference 2004 with a theme of **"Gaining A Competitive Edge".**

This two-day Conference will bring together tax practitioners, tax accountants, tax related academicians, accountants, financial planners, directors and government agencies to a platform for a discussion with renowned local and international speakers to keep abreast of current developments in the field of taxation.

GUEST OF HONOUR

The Honourable Prime Minister of Malaysia, Y.A.B Dato' Seri Abdullah bin Haji Ahmad Badawi has been invited to officiate the Conference.

CONFERENCE TOPICS

- Gaining an Edge in Foreign Market
- Managing Tomorrow's Tax Administration
- Islamic Financing – An Alternative to Traditional Financing
- The 2004 Challenges – Self Assessment System for Individuals
- Moving Overseas: Indirect Tax Issues
- Enhancing and Sustaining Competitiveness of SME's
- Taxation of Intellectual Property

SPEAKERS

- Director General of LHDNM
- President of MIT
- Head of Departments of LHDNM
- International Speakers from OECD, ATO, PWC Singapore and Revenue Department of Thailand
- Senior officials from government agencies
- Prominent speakers from the domestic tax profession

NTC 2001

NTC 2002

NTC 2003

NTC 2004

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How to become a member of the Malaysian Institute of Taxation

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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.

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

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   (b) All educational and professional certificates in support of the application
2. Two identity card-size photographs.
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(b) Annual Subscription	*RM200*
	Associate
(a) Admission Fee	*RM200*
(b) Annual Subscription	*RM150*

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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 President's Note

Six months of the year 2004 has passed and the members of the Institute have gathered for a time of fellowship to exchange views on the future direction of the Institute at the recently concluded 12th Annual General Meeting (AGM).

The 12th Annual General Meeting (AGM) was successfully held on 12 June 2004 at the PJ Hilton. I would like to take this opportunity to thank the members for attending the AGM and appreciate the comments and suggestions put forth at the meeting. I am also grateful to all the members of the Institute who have in one way or another contributed time and effort to execute the policies of the Institute.

As President of the Institute, I would like to announce that the 4th National Tax Conference 2004(NTC04), the premier tax event of the year is expected to be held on 24th and 25th August 2004. As in the past, this is a comprehensive two day conference jointly organised between the Institute and the Inland Revenue Board (IRB).

The Finance Minister II, Tan Sri Nor Mohamed Yakcob will be officiating the 4th NTC04 and members are duly recommended to note the date of this event. The theme of the conference entitled "Gaining a Competitive Edge" is hope to bring together tax practitioners, tax accountants, tax related academicians, accountants, financial planners, directors and government agencies to a platform for discussion with renowned local and international speakers to keep abreast of current developments in the field of taxation.

Also, the Institute will again be preparing for numerous technical programmes for the year, such as the annual technical and operational dialogues with the IRB and the Royal Customs Department and the pre-budget dialogues with the Ministry of Finance.

This year will be a year of consolidation for the Institute, as I will be directing the Institute to focus on the improvement of existing members' services and activities. In this respect, I request that the Council look into avenues to streamline and improve the existing services and activities.

In line with the objective of forming a regulatory body, this year will see the Institute engaged in a series of aggressive promotional activities to increase its membership.

To conclude, I foresee exciting times ahead for the Institute and hope the Institute will achieve its membership target.

Ahmad Mustapha Ghazali
PRESIDENT

The Editor's Note

The first four months of the year has seen the Institute bustling with activities. In April 2004, the Institute has the honour of welcoming two representatives from the World Bank to its premises. A successful workshop on personal taxation was jointly organised with The Star, which sees positive response from the public. Also since the beginning of this year, members of our Examinations Committee has been visiting public universities as part of the Institute's promotional activities. More of the Institute's events are covered in the Institute News. With continuous support by members, I am confident that we will have more exciting events coming ahead.

Other articles of interest covered in this issue include:

Interpretation of Tax Statutes – New Directions

An article by Dr. Arjunan Subramaniam brings us up to date on the new directions in the interpretation of tax statutes following the Federal Court's decision and an understanding on the approach adopted and the limitation of the approach.

Taxation of Interest Income Under Section 4(a) of the Income Tax Act 1967 – Where are we now?

The development of *IMSB* case, prompts Vijey M. Krishnan to highlight the current position on taxation of interest income and the significance of the Special Commissioner's decision in this case as well as a brief discussion on the decided cases of *American Leaf Blending* and *Pan Century Edible Oil*.

Gearing Up for the Self-Assessment Tax Regime for Individuals

With the Self-Assessment System (SAS) in place, this timely article by Chow Chee Yen provides readers with a comparison between the Official Assessment and the Self-Assessment System and further examines the mechanism of SAS on individuals.

GST – Is Malaysia ready to introduce this "trendy broad-based consumption tax"?

Goods & Service Tax (GST) which exists in several Asia-Pacific countries has yet to be introduced in Malaysia. As there has been much anticipation about the introduction of this consumption tax, Karen Tan highlights some of the core issues related to GST, the reason behind its growth in the world and the extend of Malaysia's readiness in implementing this new tax regime.

Taxation of Shipping in Malaysia – Towards a Maritime Nation

The taxation of shipping industry has always been a complicated issue as a result of the specialised nature of this industry. As Malaysia steps up in an effort to become one of the important maritime nation, Steve Chia provides an explanation on the taxation of shipping in Malaysia covering the scope of charge for resident and non-resident operators and the incentives available for eligible operators.

Green Tax – Its Potential in Malaysia

Assoc Prof Dr. Siti Normala Sheikh Obid provides an understanding on green tax and its effect on social and economy and a discussion on the environment policy in Malaysia which includes the possibility of introducing green tax in Malaysia.

Horse Tracks ... and Elephant Tracks

The determination of what is plant and what is not plant has never been an easy task as revealed in this article by Nakha Ratnam Somasundaram. This article looks into the interpretation of plant as governed by the legislation and also reviews decision from recent cases both foreign and local.

Learning Curve

For this issue, Siva Nair looks at the understanding of what constitutes the commencement of business based on the guideline issued by the Inland Revenue Board and decided cases and the significance of determining the date of commencement on a business.

Harpal S. Dhillon
Editor of Tax Nasional

Malaysian Institute Of Taxation

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

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Contents

2nd Quarter 2004

6 **Institute News**

8 **Malaysia's first Mutual Agreement Procedure (MAP) Team**

Counsel's Opinion

9 **Interpretation of Tax Statutes – New Directions**
By Dr. Arjunan Subramaniam

Direct Taxes

13 **Taxation of Interest Income Under Section 4(a) of the Income Tax Act 1967 – Where are we now?**
By Vijey M. Krishnan

20 **Gearing Up for the Self-Assessment Tax Regime for Individuals**
By Chow Chee Yen

24 **GST – Is Malaysia ready to introduce this "trendy broad-based consumption tax"?**
By Karen Tan

28 **Taxation of Shipping in Malaysia – Towards A Maritime Nation**
By Steve Chia

34 **Green tax – Its Potential in Malaysia**
By Assoc Prof Dr Siti Normala Sheikh Obid

40 **Horse tracks ... and elephant tracks**
By Nakha Ratnam Somasundaram

Learning Curve

46 **Commencement of Business**
By Siva Nair

Indirect Tax

51 **Service Tax in Hotels**
By Thomas Selva Doss

Case Digest

54 **Refund of Stamp Duty Rejected**

55 **Date of land transfer is the date of acquisition of shares**

Note : The views expressed in the articles contained in this journal are the personal views of the authors. Nothing herein contained should be construed as legal advice on the applicability of any provision of law to a given set of facts.

Visit by World Bank Research Team

In April, the Institute had the privilege of welcoming two representatives from the World Bank Institute to its premises. Dr Frank Flatters and Mr Anwar Shah were in Malaysia recently as part of a programme to undertake a study on the tax incentives in Malaysia. Accompanied by Ms Sarojini Devi, an official with the Tax Analysis Division of the Ministry of Finance, the World Bank representatives met Vice President Dr Veerinderjeet Singh, Honorary Secretary Mr Chow Kee Kan, council member Mr Harpal Singh and some members of the Institute and had a short discussion on the effectiveness of the tax incentives in Malaysia.

From left: Mr Anwar Shah, Dr Frank Flatters and Ms Sarojini Devi

Visit to Royal Customs Malaysia

In April, President En Ahmad Mustapha Ghazali led a delegation comprising of Mr Harpal Singh Dhillon and Mr Tony Seah to pay a courtesy call to the Director General of Royal Customs Malaysia, Tan Sri Dato' Paduka Abdul Halil bin Abdul Mutalib in Putrajaya recently.

From left: Alan Chung, Harpal Singh Dhillon, Tan Sri Dato' Paduka Abdul Halil bin Abdul Mutalib, Ahmad Mustapha Ghazali, Tony Seah and Mohamed Hafiz.

Visits to public universities

Vice President, Dr Veerinderjeet Singh with the members of the Economics & Management Faculty of Universiti Putra Malaysia.

As part of its promotional activities to encourage local undergraduates to pursue a career in taxation, members of the Examinations Committee have been visiting the public universities in the country from the beginning of the year.

With the increasing demand for competent tax professionals due to the self-assessment system in Malaysia, there are tremendous opportunities for accounting graduates to specialise in the field of taxation. Furthermore, the MIT Professional Examination is the only professional taxation examination in the country and the principal objective is to produce qualified tax personnel. Hence, the Institute is of the view that it can collaborate with local universities in increasing the number of tax personnel in the country by way of encouraging local accounting undergraduates to pursue the MIT Professional Examinations.

Following the visits, the Institute will be organising a series of career talks in local universities to promote the Institute and the profession to the undergraduates.

Workshop on Personal Taxation

Majority of the taxpayers in Malaysia are not aware of the implementation of the self-assessment system for individuals in 2005. The lack of awareness among the public prompted The Star to organise the "Personal Taxation Simplified" workshop in collaboration with the Institute.

The workshop was recently held in the Eastin Hotel, Petaling Jaya and attracted over 160 participants.

Speaker, Ms Teoh Boon Kee addressing one of the salient points at the workshop.

The MIT members with LHDN officials

East Coast Branch in a Dialogue with LHDN

On 8 March 2004, the East Coast Branch of the Institute jointly with MIA, Pahang Branch held a dialogue with Lembaga Hasil Dalam Negeri(LHDN), Cawangan Raub. The Honorary Secretary of the Institute, Mr K K Chow, was also present.

Various tax issues were brought up for discussion and deliberation. Some of the tax issues were peculiar to LHDN, Cawangan Raub, while others were general in nature.

LHDN briefed members present on the salient changes brought about by the Form B for year of assessment (YA) 2003, the dos and don'ts so as to avoid pitfalls. A draft copy of Form BE and Form B for YA 2004 was circulated.

Members were informed that LHDN, Cawangan Raub, had recently set up a Task Force. Its objectives include door-to-door visits, serving Section 104 notices, final notices, Section 92 notices etc. So far, this mode of operation proved to be very effective. Tax agents and taxpayers are requested to give their full co-operation on such visits. The local co-ordinator Dr Yap Kim Fay and Mr T H Tan were requested by LHDN, Cawangan Raub, to help LHDN organise talks on the self-assessment system in Raub and Jerantut respectively.

The interesting, fruitful and well co-ordinated dialogue ended with a high tea, hosted by the staff of LHDN, Cawangan Raub.

Southern Branch Dialogue

The Southern Branch of the Institute held a dialogue on the 20 February 2004 at the Hyatt Regency, Johor Bahru.

This tea event was attended by more than 70 members. Besides our members, representatives from the Inland Revenue Board (IRB), Malaysian Institute of Accountants, Malaysian Association of Tax Accountants and the Royal Customs Department were present to grace the event.

MIT Council member, Mr Harpal Singh Dhillon was in attendance at the function.

For the benefit of members, guest speaker En. Saadon Bin Samadi, Director of Malaysian Industrial Development Authority (MIDA) in Johor gave a presentation on "Investment Incentives in the Manufacturing Sector".

Whilst the exchange of ideas was warm, several issues were raised by members about the role of MIDA including the reason why Johor Bahru was lagging behind in attracting investment.

Special Guest speaker En. Saadon Bin Samadi, Director of MIDA Johor with Mr. Harpal Singh Dhillon and Dr. S. Sivamoorthy

The aim of this gathering cum dialogue was to share and interact to raise issues of operational and technical matters when dealing in tax matters with the IRB.

After a sumptuous high-tea, a lively dialogue session was moderated by Mr Tony Seah. Mr Harpal Singh Dhillon responded to the queries from members relating to the activities of the MIT.

Some of the issues raised and discussed, included:

- Translation of the Form B into English.
- Clarification that return forms can be acknowledged at the branch offices on behalf of the Central Processing Centre.
- Query on whether the issue of breaking up the submissions of the Form B and P into two accounting periods for filing should be proposed to IRB for consideration.
- Query on whether a tax credit can be used to offset the instalment payment.

The following matters were also raised and discussed on Field Audits and Investigations :-

- During a field audit, IRB officers cannot take away any records.
- Complaints that IRB officers in Tax Audit and Investigation Units were encouraging taxpayers so that they are not represented by tax consultants.
- Issues on whether expenses incurred by foreign consultants are subject to withholding tax.

Malaysia's First Mutual Agreement Procedure (MAP) Team

Under the Malaysian Double Tax Agreement, there is a provision for solving overseas tax problems faced by the Malaysian taxpayers. Recently, a Malaysian taxpayer invoked the Malaysian – Japanese double tax treaty in seeking the Malaysian government's assistance in solving their Japanese tax problem.

Dinner gathering hosted by the client

MAP Team with the Japanese officials

MAP Team
From left: Che Omar bin A. Rahaman (Director of Audit Department, IRB)
Lee Swee Yin (Senior Assistant Director, Audit Department, IRB)
Dato Mohd Zaid bin Ismail (Head of International Tax Division, IRB)
Dato Kamariah Hussain (Secretary, Tax Analysis Division, Treasury)
Khazali bin Ahmad (International Tax Division, Treasury)

Interpretation of Tax Statutes
New Directions

By DR ARJUNAN SUBRAMANIAM

1. In ***National Land Finance Co-operative Society v. Director General of Inland Revenue [1994] 1 MLJ 99***, Gunn Chit Tuan CJ held, following previous cases on the subject, that a tax statute should be strictly interpreted, thus:

   "..we should remind ourselves of the principle of strict interpretation as stated by Rowlatt, J in ***Cape Brandy Syndicate v Inland Revenue Commissioners****..."*

2. In the Federal Court, (Civil Appeal No: 02-5-2002 (W)) Steve Shim Lip Kiong CJSS reviewed the rule of strict interpretation of a tax statute. His Lordship set out the following propositions:

   (a) a strict interpretation as set out by Rowlatt, J could not be regarded as the locus classicus on the issue,

   (b) in 1899, Lord Russell took a different view:

   "I see no reason why special canons of construction should be applied to any Act of Parliament and I know of no authority for saying that a taxing Act is to be constructed differently from any other Act. The duty of a court is, in my opinion, in all cases the same; whether the Act to be constructed relates to taxation or any other subject, viz to give effect to the intention of the legislature..."

   (c) the purpose of the Act can be looked into viz: Lord Wilberforce:

   "A subject is only to be taxed on clear words, not on 'intendment' or on the 'equity' of an Act... What are 'clear words' is to be ascertained on normal principles; these do not confine the courts to literal interpretation. They may, indeed should, be considered in the context and scheme of the relevant Act as a whole, and its purpose may, indeed should be regarded..."

   (d) Clear words are needed before tax can be imposed. But what those words are would be interpreted in line with the purposive approach.

   (e) The purposive approach is entrenched in the U.K (***Pepper v Hart [1993] AC 593***).

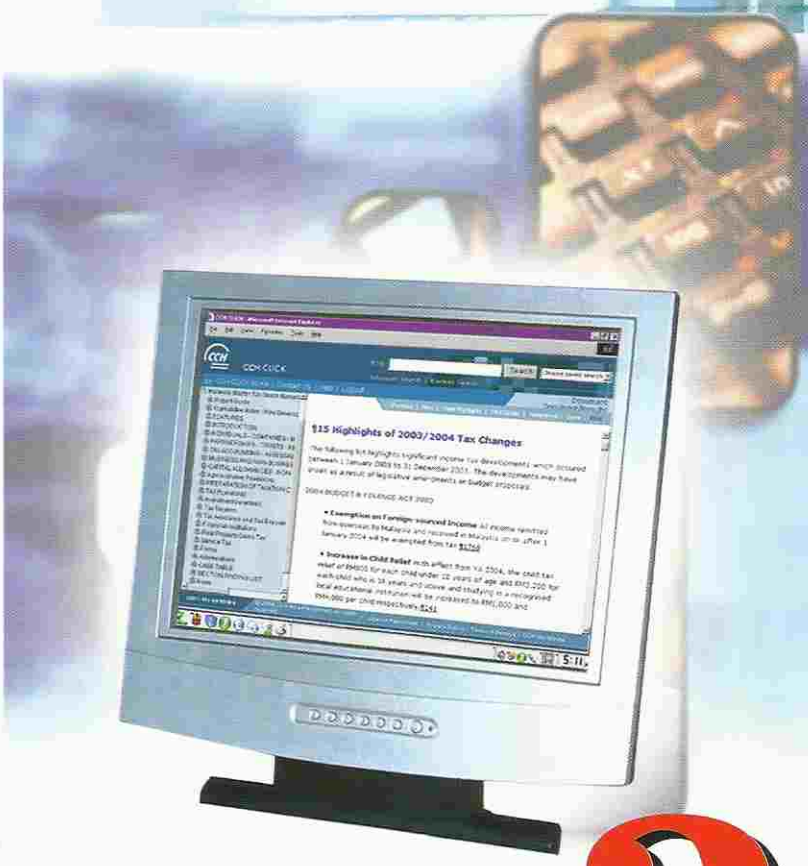
   (f) In Malaysia, Section 17A of the Interpretation Acts 1948 and 1967, effective from 25 July 1997, allows the purposive approach to statutory interpretation, including taxing statutes viz:

   "In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object..."

3. In Malaysia, with the Federal Court's decision, **the strict interpretation of taxing statutes is no longer the law.** The purposive approach is allowed but what are the limits of the purposive approach? These may be summarised as follows:

   (a) Clear words must still be used for imposing a tax. Steve Shim, CJSS set out this as follows:

   "In my view, the distinction between the seed and the kernel has to be expressed in clear terms for the purpose of imposing cess on CPKO. In the absence of such clear words, it would be unfair and inappropriate to construe the relevant provisions as having the effect of imposing cess on CPKO. In the circumstances, I find sufficient merit in respondent counsel's contention that levying cess on CPKO is, by itself, ultra vires the 1979 Act. And I may add, it is also ultra vires the 1979 Order."



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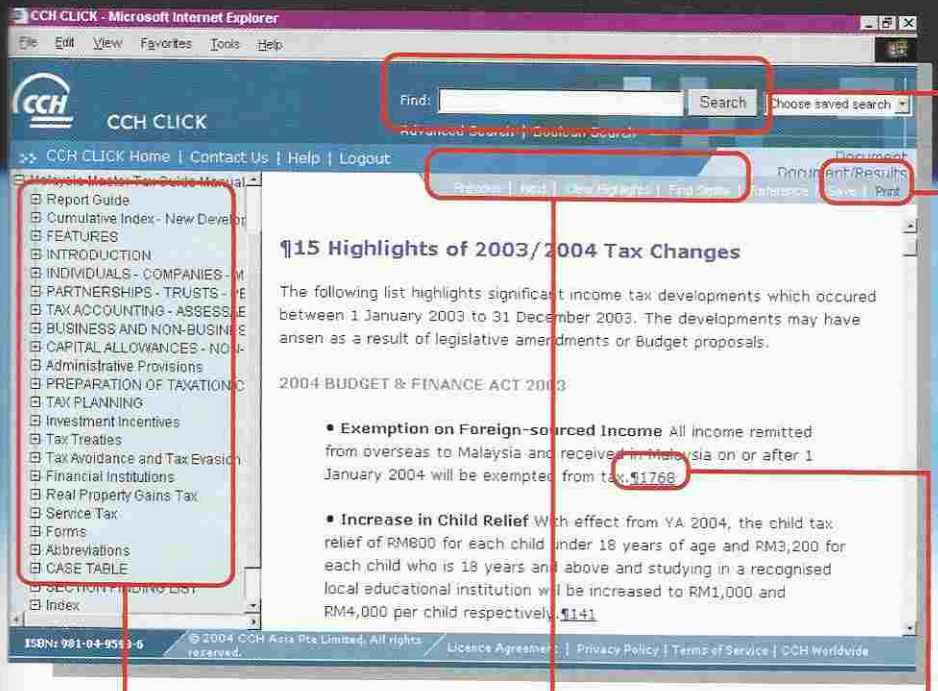

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In Malaysia, with the Federal Court's decision, the strict interpretation of taxing statutes is no longer the law. The purposive approach is allowed but what are the limits of the purposive approach?

4. His Lordship, Haidar, CJ on the question of purposive approach to taxing statutes held:

   "It is clear beyond doubt that in view of section 17A of the Interpretation Acts 1948 and 1967 there is now a statutory recognition for the courts to take purposive approach in the interpretation of statutes including taxing statutes."

5. His Lordship, Gopal Sri Ram, CAJ took the following approach:

   (a) Section 17A of the Interpretation Acts 1948 and 1967 fits well and is complementary with the third principle in the judgment of Lord Donovan, viz:

   "Thirdly, the object of the construction of a statute being to ascertain the will of the legislature, it may be presumed that neither injustice nor absurdity was intended. If therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted." (In **Mangin v. IR Commissioners [1971] AC 739**).

   (b) Words must be given their ordinary meaning.

   (c) *"...one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."* Per Rowlatt, J.

   (d) The history of an enactment and the reasons which led to its being passed may used as an aid to its construction.

6. His Lordship (Gopal Sri Ram, CAJ) concluded:

   "Hence, the governing principle is this. When construing a taxing or other statute, the sole function of the Court is to discover the true intention of Parliament. In that process, the Court is under a duty to adopt an approach that produces neither injustice nor absurdity: in other words, an approach that promotes the purpose or object underlying the particular statute albeit that such purpose or object is not expressly set out therein. Imposing a tax by means of subsidiary legislation on a person not identified in the parent Act produces an absurd and unjust result and therefore does not promote its purpose or object."

7. The net result of those judgements delivered in the Federal Court are:

   (a) A taxing act can no longer be interpreted strictly i.e. a literal interpretation need no longer be given.

   (b) Clear words must be used to impose a tax. "Seed" does not mean "kernel".

   (c) The history of an enactment and the reasons which led to its being passed may be used in construction of the words in a taxing statute (see ***Pepper v. Hart [1993] AC 593***). Reasons and purpose of an Act may thus be used as an aid to 'give effect to the intention of the legislature'. But this is only in cases where a literal interpretation leads to an absurdity (see **Pepper** at page 64 ***[1993] 1 All ER 42***). Again references to Parliamentary material are only permitted where legislation is ambiguous or obscure. (See **Pepper** at page 64 ***[1993] 1 All ER 42***). See ***Sarawak Shell Berhad & Anor v. Menteri Kewangan [2001] 1 AMR 1212, Chor Phaik Har v. Farlin Properties Sdn Bhd [1994] 3 AMR 2103***, where these principles were accepted by Malaysian Courts.

   (d) Where two interpretations can be given, the one more favourable to the taxpayer ought to be adopted. (This principle was not overruled by the Federal Court).

   (e) Orders made pursuant to a parent Act, if ultra vires, are void, notwithstanding the 'purposive' approach to interpretation. The court cannot re-write the statute i.e. put in words which are not in the statute. The Court has no legislative power.

   (f) The position is as in 1899 when Lord Russell held:

   "I see no reason why special canons of construction should be applied to any Act of Parliament and I know of no authority for saying that a taxing Act is to be constructed differently from any other Act. The duty of a court is, in my opinion, in all cases the same; whether the Act to be constructed relates to taxation or any other subject, viz to give effect to the intention of the legislature..." (In **AG Carlton Bank [1899] 2 QB 158**). But extended as in **Pepper v Hart (supra).**

   (g) The purposive approach is neutral in its significance as between the taxpayer and the Revenue. It may be a friend or a foe depending on the words that need interpretation.

The Author

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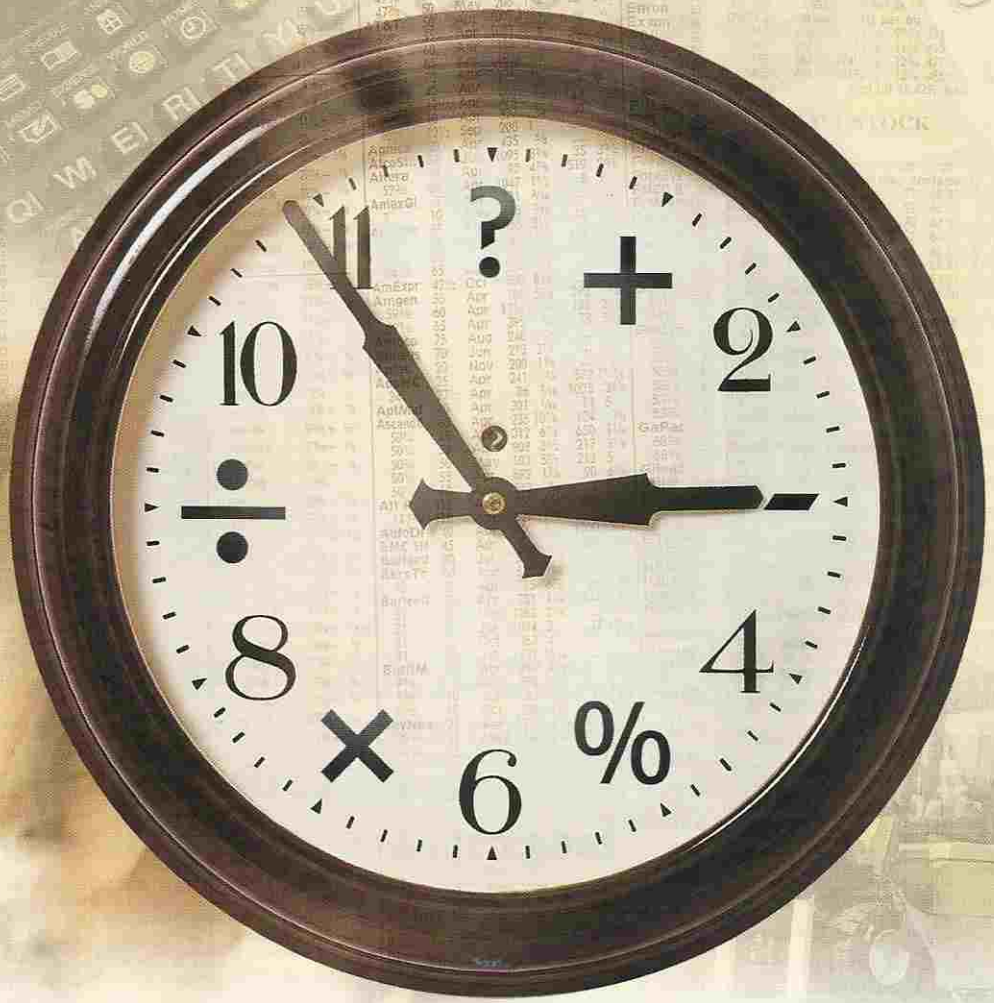
Taxation of interest income under Section 4(a) of the Income Tax Act 1967



Where are we now ?

By VIJEY M. KRISHNAN

On 17 July 2003, the Special Commissioners of Income Tax ("SCIT") decided in the case of ***IMSB v Ketua Pengarah Hasil Dalam Negeri*** (Appeal No. PKCP(R)7/2003) that interest income from fixed deposits placed by the taxpayer ("IMSB"), a company carrying on the business of general contractors is taxable under Section 4(a) of the Income Tax Act, 1967 ("the Act") as "gains or profits from a business" and not under Section 4(c) of the Act as "interest". The decision by the SCIT marks an interesting journey in revenue law and this article intends to highlight in brief the current position *vis-a-vis* the ***IMSB case*** and the significance of the decision of the SCIT in the ***IMSB case***.

The impact on a taxpayer

Needless to say that the taxation of interest income as "gains or profits from a business" under Section 4(a) of the Act can have a tremendous impact on a taxpayer. Where interest from bank deposits are taxed under Section 4(a), the placement of bank deposits will not be seen as investments "otherwise than for the purposes of producing gross income of the taxpayer from its business" and therefore interest restriction under Section 33(2) of the Act will not be applicable.

Furthermore, where interest income is taxable as "gains or profits from a business" under Section 4(a) of the Act, the interest income can be set-off against business losses brought forward. Such set-off is not available where the interest income is not treated as "gains or profits from a business" and is taxed under Section 4(c) of the Act.

The journey – how it starts

As a starting point, it would be important to note that the charging section in Section 4 of the Act lists out 6 categories of income under which income tax is chargeable, namely:

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

(b) gains or profits from an employment;

(c) dividends; interest or discounts;

(d) rents, royalties or premium;

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

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

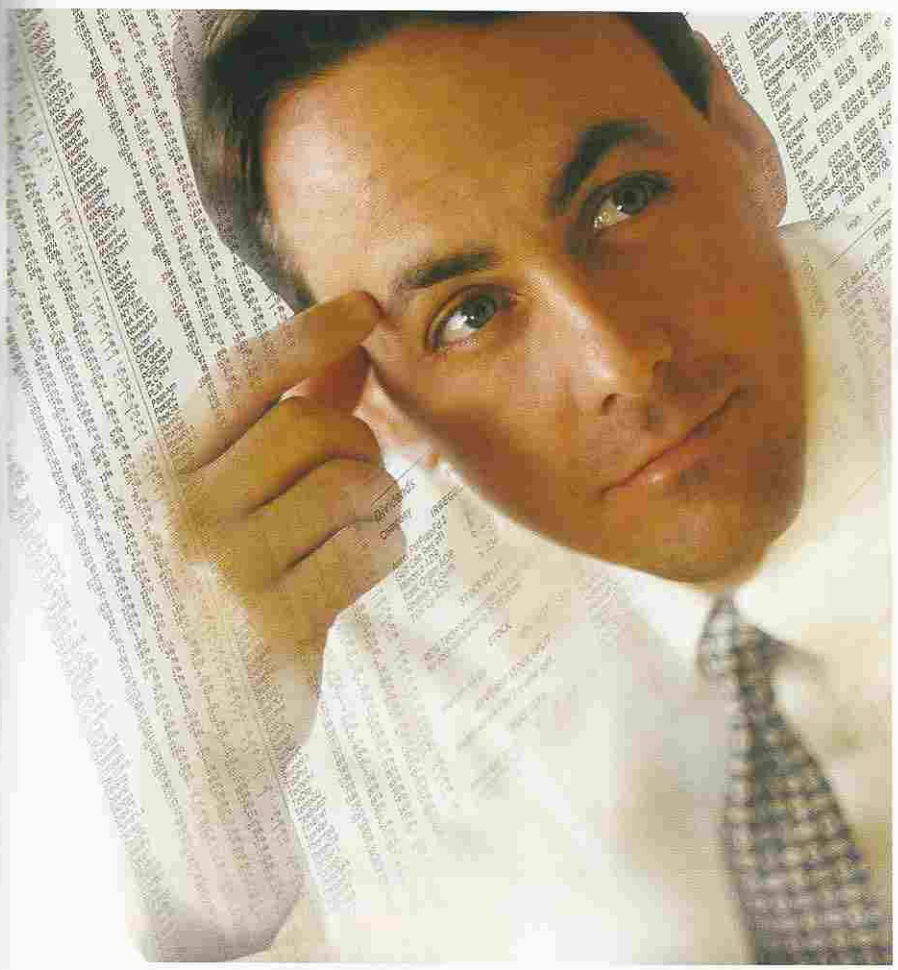
The determination of the category under which an item of income is taxable can have a significant impact on the taxpayer as different provisions of the law may be applicable in each case. As described above, in the case of a receipt in the nature of interest, where the said interest is taxed under Section 4(a), interest restriction will not be applicable under Section 33(2) of the Act and the interest income can be set-off against business losses brought forward.

In its genesis, the journey began essentially when the Privy Council decided in the case of ***American Leaf Blending Co Sdn Bhd v Director General of Inland Revenue*** [1979] 1 MLJ 1 that rents despite being referred to in Section 4(d) of the Act might nevertheless constitute business income taxable under Section 4(a) if the rents are receivable in the course of putting the taxpayer's property to profitable use by letting it out for rent. Their lordships made it clear that there is room for overlapping between paragraphs (a) and paragraphs (c) and (d) of Section 4 of the Act.

Lord Diplock in the ***American Leaf Blending case*** illustrated this by saying :

"*A company may carry on business as an investment or holding company deriving its gains or profits from dividends and interest from the securities it owns. The gains or profit from the business of a bank or moneylender are largely derived from interest received on money lent...*"

Whilst the ***American Leaf Blending case*** was considered to be a pivotal point in clear judicial acceptance that there is room for overlap between paragraphs (a) and paragraphs (c) and (d) of Section 4 of the Act and that the question as to whether an item of income constitutes gains or profits from a business is a question of fact, the issue as to the circumstances in which interest will fall to be taxed under Section 4(a) and not 4(c) of the Act was not addressed as it was not a relevant point for determination in that case. The *dicta* by *Lord Diplock* that interest income derived by a bank or moneylender should be taxed under Section 4(a) was not particularly helpful as this was an obvious position at law. However, with the ***American Leaf Blending case***, the door was unlocked to leave open the argument that in certain circumstances, a taxpayer not being in the business of banking or money lending could also earn interest income which is taxable under Section 4(a) of the Act. The question then was, in what circumstances could taxpayers who are not



What happens where the taxpayer does not have excess cash but places internally generated funds in a fixed deposit as security for bank facilities and then goes on to use the bank facilities obtained for its working capital?

in the business of banking or money lending treat interest income earned as taxable under Section 4 (a) of the Act.

An attempt to address this issue was made in ***Pan Century Edible Oil Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri*** [Civil Appeal No:W-01-200-1997] whereby the taxpayer who was in the business of refining and processing palm oil claimed that interest on excess cash placed on short term and long term deposits and on negotiable certificates of deposits was taxable as business income under Section 4(a). The taxpayer by virtue of its business needed to set aside readily available funds for the purchase of palm oil, the price of which fluctuates from time to time. In this case, the counsel for the taxpayer argued that:

(a) The interest income from the fixed deposits and short term deposits was business income within the meaning of Section 4(a) of the Act.

(b) The short term and long term deposits were ancillary to the main trade because the funds for the deposits were from the main business and thus the deposits were tied up with the main business.

(c) The repeated placing of deposits on a daily, weekly, monthly basis brought the transactions within the ambit of business from an adventure in the nature of trade within the meaning of "business" in Section 2 of the Act.

The SCIT in the ***Pan Century case*** rejected the contention that the interest income could have arisen from the carrying on of an activity ancillary to the trade of processing and refining palm oil. Notwithstanding this, the SCIT in the ***Pan Century case*** held that the interest income falls to be taxed under Section 4(a) of the Act, clearly having been swayed by the high volume and frequency of transactions coupled with the organisation and system adopted by the taxpayer in earning the interest income. The SCIT in the ***Pan Century case*** were willing to go as far as to say that the taxpayer's activities in relation to earning the interest income was such that it was indicative of a business or an adventure or concern in the nature of trade. The High Court and the Court of Appeal upheld the decision of the SCIT in the ***Pan Century Case*** based on the ground that interest constitutes income from a source consisting of a business if it was receivable in the course of carrying on a business of putting the taxpayer's excess cash to profitable use by placing it on short term and long term deposits.

As bold as the decision in the ***American Leaf Blending and the Pan Century case*** may seem, all that was being done was to simply answer a question of fact. Not all taxpayers however are so fortunate as to have a case directly on point supporting their stand. What about a situation where there is no regular and repetitive act of placing fixed deposits? What happens where the taxpayer does not have excess cash but places internally generated funds in a fixed deposit as security for bank

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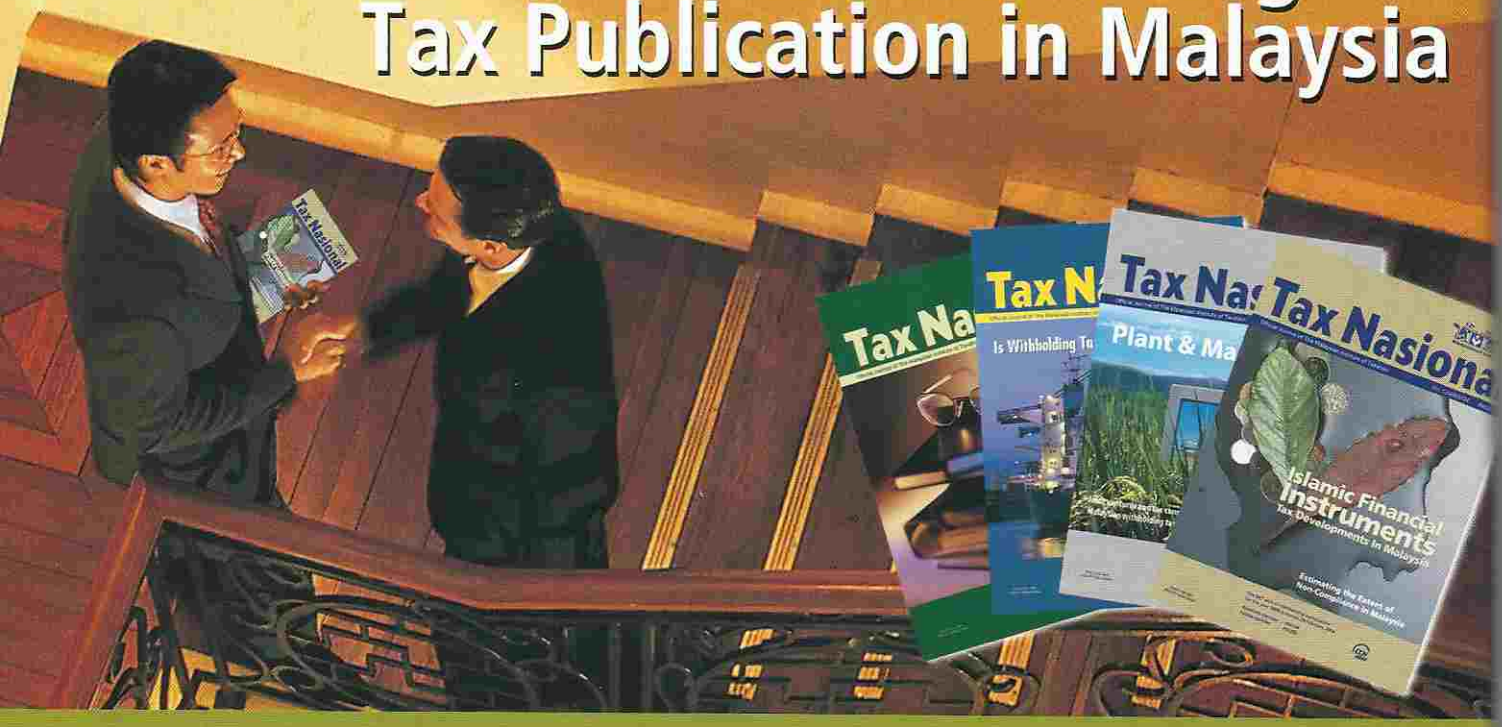

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facilities and then goes on to use the bank facilities obtained for its working capital? When exactly can interest income be considered to have arisen from the carrying on of an activity ancillary to the business of a taxpayer? The exact grounds for the decision of the SCIT in the ***IMSB case*** will only be available once the case stated in accordance with paragraph 34, Schedule 5 of the Act has been prepared by the SCIT. An appeal lodged by the Inland Revenue Board against the decision of the SCIT in the ***IMSB case*** is pending before the High Court. Nevertheless, a study of the relevant facts and submissions made by the counsel in the ***IMSB case*** will present a useful response to some of these questions.

The IMSB Case – The facts

(a) The business of the taxpayer is that of general contractors. It is principally involved in performing construction work for the government including but not limited to construction of roads, bridges and buildings.

(b) As a general contractor, the income stream of the taxpayer consists primarily of progress billings on construction works.

(c) By virtue of the nature of its business, the taxpayer is heavily dependant on bank facilities which would include bank guarantees issued in favour of its clients in relation to the works to be performed and project financing.

(d) Providing bank guarantees and performance bonds to its clients are a necessary and inextricable part of its business. Without providing a bank guarantee, the taxpayer would not be able to take possession of the construction site with the result that the contract will be awarded to some other party.

(e) In order to obtain a bank guarantee and credit facilities, a certain amount of money would need to be placed as a fixed deposit with the bank as security for the bank facilities.

(f) The banks would not grant project financing and issue bank guarantees without prescribed fixed deposits being placed with the banks.

(g) The monies placed in fixed deposits are from progress billings. Fixed deposits are placed in accordance with the banks' requirements. Once the bank facilities are obtained, the taxpayer would pay the sub-contractors and trade creditors from the bank facilities. In some instances, banks require a percentage of the progress billings received by the taxpayer to be placed directly in fixed deposits.

(h) The funds obtained pursuant to bank facilities secured by fixed deposits are utilised purely for business purposes i.e. working capital.

The IMSB Case – The taxpayer's contention

(a) Based on the relevant facts, interest from fixed deposits should be assessed under Section 4(a) of the Act as "gains or profits from a business" and not under Section 4 (c) of the Act as "interest".

(b) The fixed deposits placed by the taxpayer should be disregarded for the purposes of calculating interest restriction under Section 33(2) of the Act as the fixed deposits are not investments made by taxpayer otherwise than for the purpose of producing gross income from the business of the taxpayer.

The IMSB Case – Submission by Counsel

The salient points of the submission made by counsel in the ***IMSB case*** in support of the taxpayer's contention are as follows:

(a) The fixed deposits were placed out of business compulsion and purely for the purposes of complying with the terms and conditions stipulated by the relevant banks. The interest income is part and parcel of the taxpayer's business income or ancillary to its business. In fact, the placement of the fixed deposits are a necessary and inextricable business action.

(b) One must take the business of the taxpayer as a whole to understand and appreciate what role fixed deposits play.

(c) It is clear from the facts that the taxpayer did not and could not have intended to invest in its monies via the placement of fixed deposits as:

(i) the taxpayer did not have the cash-flow to do so;

(ii) the placement of fixed deposits arose out of business compulsion; and

(iii) no reasonable businessman would invest in his monies via placement of fixed deposits for a lower rate of interest and at the same time incur interest expenditure on borrowings at a far higher rate of interest.

The only reason why the fixed deposits were placed was because it was a necessary and inextricable business action.

(d) Banks will not give the relevant bank facilities to the taxpayer if the prescribed fixed deposit are not placed as security for the facilities. The failure to obtain the said facilities would be fatal to the business of the taxpayer. This is not a matter of business expansion or growth but is inextricably linked to the very carrying on of the principal activity of the taxpayer.

(e) There was no other option to the placement of fixed deposits and so the

fixed deposits are not placed voluntarily but instead out of severe and inescapable business compulsion.

(f) The facilities obtained pursuant to the fixed deposits placed are used wholly and exclusively for business purposes.

(g) The taxpayer did not intend to place monies in fixed deposit as an investment. In fact, if the taxpayer had excess cash, it would have paid off its existing borrowings to reduce its overall interest expenditure.

(h) The business of the taxpayer must be looked at as a whole and the words "gain or profits from a business" in Section 4 (a) of the Act must be given their ordinary meaning. A business consists of a whole set of operations and based on the facts of this case, it is clear that the placement of fixed deposits are an inextricable part of the business operations of the taxpayer. Any extrication of the act of placing fixed deposits from the business of the taxpayer would be artificial and contrary to the true business operations and circumstances of the taxpayer.

(i) It is not necessary for the taxpayer to be a bank or financial institution or for cash to be part of the taxpayer's stock in trade for interest income of the taxpayer to be treated as business income under Section 4(a). There is no such rigid and exhaustive requirement at law and what is important is an evaluation of all of the relevant facts. In fact, in the ***Pan Century case***, the Court of Appeal held that interest income qualifies as business income notwithstanding the fact that the taxpayer in the ***Pan Century case*** was neither a bank nor financial institution nor was cash the stock in trade of Pan Century Edible Oils Berhad. What is important is an evaluation of all the relevant facts of the case.

(j) The taxpayer is not contending that the placement of fixed deposits amounts to an adventure in the nature of trade. It is the taxpayer's contention that the interest income from fixed deposits should be assessed as business income under Section 4(a) as it is part and parcel of the taxpayer's business. Therefore, there is no need to consider whether the fixed deposits are the result of an adventure or concern in the nature of trade. All that needs to be done is to give the word "business" its ordinary meaning as was stated in the ***American Leaf Blending case***. Accordingly, any attempt to require the presence of the facts that gave rise to an "adventure in the nature of trade" in the ***Pan Century case*** would be misconceived.

Conclusion

Via a deciding order dated 17 July 2003, the SCIT decided in the ***IMSB case*** that interest income from fixed deposits placed by IMSB is taxable under Section 4(a) of the Act as "gains or profits from a business". An appeal lodged by the Inland Revenue Board against the decision of the SCIT is pending before the High Court. The grounds for the decision of the SCIT will be contained in a case stated pursuant to paragraph 34, Schedule 5 of the Act.

Pending the issuance of the grounds for the deciding order made by the SCIT and the aforesaid appeal, the facts and submissions in the ***IMSB case*** will provide a valuable insight as to the state of law with regards to the treatment of interest income earned by taxpayers who do not fall squarely within the boundaries of the ***Pan Century case***.

Whilst, the ***IMSB case*** will not serve as being broad authority for the application of Section 4 (a) of the Act in every situation where interest income is earned by a taxpayer, it serves as an important reminder that it is clear at law that there is an overlap between paragraphs (a) and paragraphs (c) and (d) of Section 4 of the Act. It is therefore important that the business of the taxpayer is looked at as a whole and the words "gain or profits from a business" in Section 4 (a) of the Act must be given full effect in accordance with their ordinary meaning.

To conclude, the need to consider the specific circumstances in each case can probably be best summed up by the following statement by *Lord Shaw* in the House of Lords case of ***The Liverpool & London & Globe Insurance Co. v Bennett*** [1913] 6 TC "*An infinite number of illustrations might be given of instances in which part of a trader's income is or is not profit of his trade, and it will be time enough to decide each case when it actually arises. I know of no formula which can discriminate in all circumstances what are and what are not profits of a trade. Probably that is the reason why the Statute does not contain a closer definition*".

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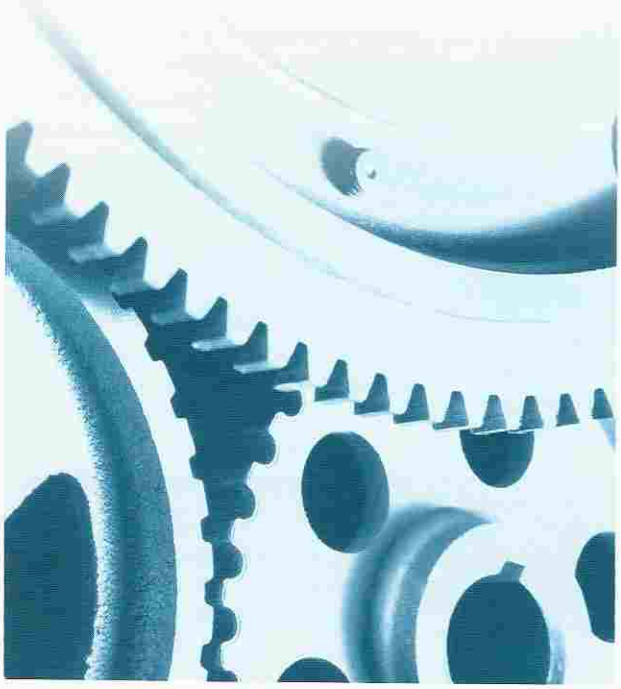
Gearing Up for the Self-Assessment Tax Regime for Individuals

By CHOW CHEE YEN

Malaysian corporate taxpayers are in the fourth year of the self-assessment system ("SAS"). SAS was introduced to companies in Malaysia effective from the year of assessment ("YA") 2001 and is also applicable to individuals commencing from YA 2004. What is the significance of self-assessment? What are the major differences between the new and the old tax regime? What are the implications for taxpayers, tax agents as well as Inland Revenue Board ("IRB") arising from this new regime? Given that self-assessment is already upon us, this article is aimed at addressing the concerns with the objective of enhancing the taxpayers' awareness of their duties come the next individual tax filing in April 2005 in respect of YA 2004.



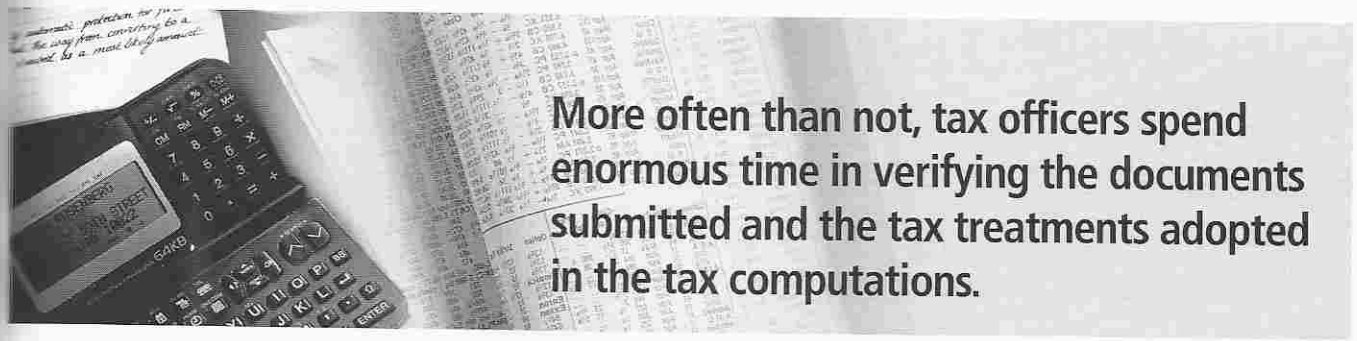
Official Assessment versus Self-Assessment

Official Assessment

It is important to understand as to how the old tax regime, i.e. the Official Assessment (OA) works. Under OA, the IRB would raise the assessment that is the Form J for each YA. In order for the Form J to be issued, first and foremost, the taxpayers must complete and submit their tax returns. The main types of tax return forms are as follows:

Types of Form	
Form B	For resident individuals carrying out business as well as exercising employment.
Form M	For non-resident individuals.

Upon completion of the tax return, a taxpayer who carries out business is also required to submit the tax computation, the Profit & Loss Accounts as well as the Balance Sheet of the business to the IRB, together with the tax return. For an individual who is



More often than not, tax officers spend enormous time in verifying the documents submitted and the tax treatments adopted in the tax computations.

solely under employment, the Form EA (private sector) or Form EC (public sector) issued by the employer indicating the details of remuneration must also be submitted alongside the Form B.

At the same time, to claim certain reliefs, a taxpayer must also submit documentary evidence. Amongst the common claims by an individual are:

Types of relief	Supporting documents to be attached
Medical expense for parents, for taxpayer, spouse and children	Official receipts from hospitals/ clinics etc.
Supporting equipment for disable taxpayer, spouse, children and parents	Official receipts from suppliers Certification from the Social Welfare Department.
Life insurance premium, medical and education insurance	Official receipts from insurers.
Child relief	Copy of Birth Certificate (for new child).
Purchase of books, journals etc	Copies of official receipt from bookstores.

Upon the receipt of the tax return and the abovementioned supporting documents, the IRB would examine the same and raise queries (if any). Normally, the IRB may request the taxpayer to provide further breakdown on certain expenses like listing down the recipients of rental etc. After obtaining the requested information, the IRB may agree to the tax computation or may make some tax adjustments. The common tax adjustment for individuals include disallowing one-third of the traveling expenses incurred by the taxpayer on the basis that only two-third is for business purposes whilst the balance relates to personal traveling. Sometimes, the IRB, at its best judgment, may attribute some residential benefit to the taxpayers as part of the tax adjustment. For example, a taxpayer conducts a grocery business at his shop-house. He and his family reside there too. In his tax computation, he has claimed RM6,000 of utilities as business expenses. In this regard, the IRB may disallow 1/3 of the utilities as deductible expenses. In other words, the taxable income of the taxpayer will increase accordingly.

What is next? The IRB will then issue a notice of assessment i.e. Form J to the taxpayer indicating the amount of income tax payable. For non-taxable cases, in the past, the IRB would issue a letter enclosing its tax adjustments and also to confirm the balance of unutilised tax losses and capital allowances. Once the taxpayer has received the Form J, he must settle the balance tax payable (i.e. the difference between the tax payable indicated in the Form J and tax instalments paid or Schedular Tax Deductions made) within 30 days, failing to do so, a penalty would be imposed accordingly. If the taxpayer does not agree to the tax adjustment, he is entitled to lodge an appeal within 30 days from the issuance of the Form J. Nevertheless, the golden rule of "Pay first, appeal later" would prevail.

The mechanism of the old regime described above has placed greater burden and responsibilities on the tax officials. More often than not, tax officers spend enormous time in verifying the documents submitted and the tax treatments adopted in the tax computations. In short, they were office-based. From the taxpayers' perspective, he would wait for the issuance of the Form J. At times, a taxpayer may also claim some tax relief without documentary evidences and may still be lucky enough to get through the hurdle. It is also true to say that some taxpayers did submit their tax returns without proper assistance from tax agents as they relied on the IRB to confirm the correctness of their tax returns.

Self-Assessment

Things are different under Self-Assessment. The onus of assessing the tax payable has shifted from the tax authorities to the taxpayer. Under the SAS, taxpayers have to ensure that each tax deduction and treatment is well supported by proper documentation, tax laws, case laws precedents etc. Simply put, the implementation of the Self-Assessment is based on the concept of "Pay, Self-Assess and File". Let us examine the new mechanism as explained below.

Basis of Assessment

With effect from YA 2004, the basis period in respect of all income sources (e.g. business, rental, interest, employment etc) of an individual will be the year ended 31 December i.e. calendar year basis, no longer financial year.

A key point to note is that the submission of the tax return by the taxpayer to the IRB is deemed to be a notice of assessment, i.e. the Form J.

Returns and submission of tax returns and payment of balance of tax payable

The taxpayer will continue to submit its Form B indicating the amount of taxable income and tax payable (if any) to the tax office. However, the detailed tax computations, official receipts are no longer required to be submitted to the tax office. This being said, one must bear in mind that the relevant documentations must continue to be retained and properly kept for tax audit at a later stage.

The tax return for an individual must be submitted to the tax office latest by 30 April in the year following the year of assessment for which income is assessed. For example, Farah is carrying on the business of selling handicrafts in the Central Market. Her accounts for the said business are made up for the period 1 January 2005 to 31 December 2005, i.e. the basis period for YA 2005. For this YA, the tax return must be submitted on or before 30 April 2006.

A key point to note is that the submission of the tax return by the taxpayer to the IRB is deemed to be a notice of assessment, i.e. the Form J. In this respect, the IRB will no longer issue the Form J, unlike previously, under the Official Assessment. Based on the earlier illustration, Farah is deemed to receive the Form J from the tax office on the day she submits her Form B, say 30 April 2006. Any balance of tax payable (i.e. the excess of the final tax payable shown in the Form B over the tax instalments paid for a YA) must be paid on or before 30 April of the year following the year of assessment, i.e. 30 April 2006 in the above example, to avoid the imposition of late penalties. Below are the relevant penalties:

- *Failure to submit tax return* – Upon conviction, a taxpayer will be liable to a fine ranging from RM200 to RM2,000 or to imprisonment for a term not exceeding 6 months or both.
- *Failure to remit the balance of tax payable by 30 April* – Penalty of 10% of the sum unpaid and a further penalty of 5% on any balance remaining unpaid after 60 days.

Estimate of tax and variation of instalment

For individuals with business, partnership, royalty and rental income, IRB will determine the estimate of tax payable under an instalment scheme based on the tax assessed in the preceding year. The estimate of tax payable is paid via bi-monthly instalment directed by the IRB beginning from the month of March. Each instalment must be paid to the IRB within 30 days from the due date, failing which a penalty of 10% shall be imposed on the sum unpaid.

Meanwhile employment income will continue to be subject to the monthly salary deduction that is the Schedular Tax Deductions.

- *For taxpayers* – Gradual payments of tax would ensure that the taxpayers will not be burdened with a huge sum of money upon submission of the tax return.
- *For IRB/Government* – Improved tax collection.

Individuals under an instalment payment scheme may apply to the tax office to revise/vary the instalment payment not later than 30 June. Where the revised estimate exceeds the amount of instalment paid to date, the difference shall be payable in the remaining months of the instalment. On the other hand, when the instalments paid to date exceed the revise estimate, the taxpayer may discontinue with the original instalment scheme after obtaining prior approval from the IRB.

The IRB has introduced new forms and procedures for instalment payment under the SAS for individuals. The said forms are described below:

Form	Description
CP 500	Notice of instalment payment which replaces Form CP200 used under the OA.
CP 501	Remittance slip which replaces CP203 used under the OA.
CP 502	Application form for variation of instalment payment.
CP 503	Variation of instalment payment scheme.
CP 504	Rejection of application for variation of instalment payment.

Under the SAS, the IRB will send Forms CP500 and CP501 to individuals. To those who do not receive the forms, they should apply for these forms (where applicable) from the respective IRB collection branch.

Reasonable care, facilities and assistance & record-keeping

Under the self-assessment, tax agents must exercise reasonable care in assisting the taxpayers. In other words, tax agents must strongly hold to their ethics. Huge fees should not be the key factor in undertaking an assignment. Tax agents must be ready to give up an assignment if the client insists on some tax treatments that obviously violates the law.

Having mentioned the above, one would notice that the practical problem in this context is the meaning of reasonable care, which is being subject to different interpretations. A fine of up to RM20,000 or jail term, or both is awaiting a person who assists in, or advises on the preparation of tax return without reasonable care and as a result of that advise or assistance; there is an understatement of the tax liability.

In the meantime, a taxpayer is required to provide reasonable facilities as well as assistance to the tax officer during tax audits at the premises of taxpayers. Above all, taxpayers must retain all records to substantiate and support any tax treatment adopted in the tax returns. The onus is now on the taxpayers.

Appeals

Similar to the OA system, the taxpayer is entitled to appeal against the deemed assessment. Based on Farah's case in the earlier example, this must be done within 30 days of the deemed assessment, i.e. on or before 30 May 2006. It is rather strange when a taxpayer appeals against his own assessment, but that is the reality under self-assessment. This happens when a taxpayer prepares the tax return based on certain guidelines or rules that he or she may not agree.

Conclusion

As time passes by, we have learnt from the SAS for companies and surely there is room for further improvement. Self-assessment for individuals is already upon us. Perhaps the experience that we had gained from SAS will serve as a useful guidance in facing the challenges ahead. Whilst the necessary action has been taken to enhance awareness amongst the general public regarding SAS, the IRB as well as the tax agents should continue to play their role in ensuring the smooth implementation of the SAS.

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

GST

Is Malaysia ready to introduce this "trendy broad-based consumption tax"?

By KAREN TAN

Malaysia is amongst a small handful of countries, which has yet to introduce a broad-based consumption tax such as goods and services tax (GST) or value added tax (VAT). This article outlines some of the core issues relating to GST and highlights the key reasons which spurred the growth of GST or VAT regimes in the world. It also briefly discusses the existing service tax regime in Malaysia before proceeding to consider Malaysia's readiness in adopting a new GST/VAT regime.

A Goods and Services Tax (GST) is an indirect broad-based consumption tax which applies generally to all transactions with limited exceptions.

'The history of taxation reveals no other tax that has swept the world in some thirty years, from theory to practice, and has carried along with it academics who were once dismissive and countries that once rejected it. Every continent now uses the VAT, and each year sees new countries introducing it'.[1]

To-date, there are approximately 120 countries in the world that have adopted GST/VAT. France is often acknowledged as the first country to introduce a GST regime in 1968 although the early growth and development of the GST/VAT regime was prompted by the European Union(EU). Amongst others, it was a pre-condition for entry into the common market environment of continental Europe that each member country was required to have a form of GST. This requirement was imposed to enable each member country to contribute revenue raised from GST or VAT to the EU to fund various common activities and schemes.

Subsequently, many African countries had proceeded to introduce VATs in the 1960s and 1970s. This was followed by many Asian countries including China, Indonesia and Japan. Singapore introduced GST in 1994 and Australia finally replaced its archaic wholesale sales tax regime with GST in 2000. India is also finally introducing its much-delayed value-added tax on 1 April 2005.

What is a GST?

A Goods and Services Tax (GST) is an indirect broad-based consumption tax which applies generally to all transactions with limited exceptions. It is imposed on the value added at every stage of production based on the increase in price and hence, is usually termed as a multiple stage tax. The tax is passed on and borne by the end consumer. Table A provides a general overview of the GST/VAT rates in Asia-Pacific.

The source of rules and regulations for a GST regime is the country-specific legislation, case law and rulings issued by the relevant revenue authorities. However, in the European Union, there are specific EU directives issued (6th VAT Directive) for compliance by member countries.

Generally, GST is imposed when a taxable supply is made. Central to any GST/VAT regime is the concept of input-tax credits. Briefly, input tax credits are credits for the GST component of the supplies purchased by a supplier. As the GST system is designed to ensure that the tax liability rests with the end consumer, the supplier is, therefore, entitled to claim the input tax credits for the GST paid in the course of his business. The supplier must register and lodge his returns with the tax authority to claim the credits once he has fulfilled specific conditions pertaining to the credits' refund.

It is also noteworthy that the terminology and concepts used in the context of GST are unique and different from the traditional income tax. If a specific good is zero-rated or "GST-free", this means that no GST is payable on it and that the supplier is entitled to claim input tax credits for the GST paid on his business inputs. Export supplies are generally zero-rated.

If a specific good is treated as an "exempt supply", it means that no GST is payable but the supplier is generally not entitled to claim input tax credits for the GST paid on his business inputs. An example of an exempt supply is financial services.

Key advantages of GST

Although the specific reasons for adopting VAT differ from one country to another, the main argument has been that a properly designed VAT raises more revenue with lower administrative and economic costs than other broadly based consumption taxes.[2]

In fact, one of the main reasons for the widespread growth of GST/VAT around the world is its ability to generate revenue. Cnossen noted that a VAT, with few exemptions, can generate revenues of on average some 0.4% of gross domestic product for every 1 percentage point of the rate and further stated that VAT is a "revenue workhorse".[3]

1 Tait AA, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988)
2 Cnossen, S, *Global Trends and Issues in Value Added Taxation* (1998) 5 International Tax and Public Finance 399.
3 Ibid.

Generally, the tax base for GST would include a wide range of goods and services and is likely to be broader than that of a typical retail sales tax. With a broader tax base, a lower tax rate can be applied (as compared to applying multiple rates to a narrow base to achieve the same target revenue). In keeping a broad tax base, there are also less economic distortions and less risk of the tax becoming irrelevant in the future.

With the input tax credits being a key feature of this indirect tax system, many suppliers who purchase goods and services for use in its business would want to register with the tax authority to be entitled to the input tax credits. As such, self-enforcement is embedded in the GST structure through this feature. Administrative and compliance costs are likely to be significantly reduced, with voluntary registration achieved through this mechanism.

In addition, having input tax credits within the GST regime also removes the cascading effect of tax. From an economic perspective, the absence of tax credits is likely to result in the tax to be built into the price of the product manufactured or services rendered. As a result thereof, the pricing of the product is adversely affected and this may affect the product's competitiveness in the export market (since the tax is built into the price) as well as in the local market vis-à-vis imported products. With the input tax credit mechanism in the GST regime, this undesirable feature can be eliminated.

Service tax in Malaysia

Whilst there is no GST in Malaysia, there is a service tax regime under the Service Tax Act 1975 (STA). It operates as a single-stage tax in respect of certain stipulated services. Although it bears some similarities with GST, there are significant differences in its design and structure.

Service tax is imposed on any taxable service provided by any taxable person. Since its introduction, its scope was extended on numerous occasions and various services including professional services rendered by accountants, lawyers, engineers as well as management and consultancy services, are now within the scope of the STA. Registration with the Malaysian Royal Customs and Excise Department is necessary once the annual sales turnover is reached. The taxable services are chargeable to 5% service tax. Similar to GST, taxable services which are exported are excluded from service tax.

One of the key differences between the service tax regime and GST is the absence of a tax credit system. As a result thereof, the service tax element is usually borne by the service recipient and could subsequently become embedded in its pricing, resulting in a cascading effect. As highlighted above, this is not efficient, from an economic perspective.

When will it be Malaysia's turn?

It is interesting to note that the service tax legislation has been amended on numerous occasions to broaden its scope and increase the number of taxable services chargeable to tax within Schedule 2 of Group G in the Service Tax Regulations 1975.

Apart from increasing the number of taxable services, the annual sales turnover threshold has also been reduced to widen the service tax net. Notably, the annual sales turnover threshold for the provision of consultancy services has been reduced from RM500,000.00 to RM150,000.00. Aside from amendments to the legislation, there have also been increased enforcement efforts to track down errant companies who had failed or omitted to register and charge service tax.

Based on the foregoing, it may be argued that the need for a broader tax base to improve revenue generation appears to be increasingly apparent. Whilst other measures may be undertaken to increase revenue through service tax e.g. increase the service tax rate or attempt to further widen the number of services, such measures are, to an extent, confined by the existing legislation.

However, if strong continued growth in the services sector is maintained (particularly with the projected development of the Multimedia Super Corridor (MSC) and bio-valley projects) in the forthcoming years, the need to re-examine its existing indirect tax regime and explore the viability of introducing GST may arise sooner than anticipated.

In its effort to attract more foreign direct investment (FDI) into the country, Malaysia may also lower its corporate tax rate (gradually or otherwise) to e.g. 25% to remain an attractive option for FDI. With a 3% decrease, it is likely that the Government may need to seek and explore new avenues to generate additional revenue to fund government expenditure and GST may, arguably, be a noteworthy consideration.

With the implementation of the self-assessment system in 2001 and the much-awaited introduction of the Transfer Pricing Guidelines in July 2003, Malaysia has, in the recent

The main argument has been that a properly designed VAT raises more revenue with lower administrative and economic costs than other broadly based consumption taxes.

years, taken active steps to improve its administration and enforcement mechanisms. Given the series of positive developments in its tax system, it would not come as a total surprise if GST may be the next item on the Government's agenda.

It is clear that the process in implementing a GST regime is no easy task. There are, in fact, a multitude of issues (tax or otherwise) which must be carefully considered when designing and structuring a GST regime in Malaysia. Some of the key tax considerations include the size and scope of its tax base, the applicable tax rate, the need to create public awareness and education and transitional issues in migrating from one regime to another. Apart from the tax issues, there are also various economic, political and commercial consequences which must be examined in implementing the GST regime.

Malaysia will, however, be able to enjoy the benefit and luxury of cherry-picking the most feasible procedure and desirable features from each country when it eventually considers implementing its GST regime. Many aspects of the GST structure would have been tried, tested and used in many countries around the world and Malaysia can have the opportunity of introducing a tried-and-tested system to facilitate its implementation in the future.

Table A

Country	Year of Introduction	GST/VAT Rate
Korea	1977	10%
Indonesia	1985	10%
New Zealand	1986	12.5%
Taiwan	1986	5%
Philippines	1988	10%
Japan	1989	5%
Thailand	1992	7%
China	1994	17%
Singapore	1994	5%
Sri Lanka	1998	20%
Australia	2000	10%
India	2005	12.5%

Malaysia will, however, be able to enjoy the benefit and luxury of cherry-picking the most feasible procedure and desirable features from each country when it eventually considers implementing its GST regime.

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Taxation of Shipping In Malaysia – Towards A Maritime Nation

By STEVE CHIA

The history of the maritime industry dates back centuries when ocean going "perahus" ruled the waves of the seas from the Indian Ocean to the Pacific. The Straits of Malacca is the gateway to the Indian Ocean and Western Europe whilst the passage to Asia through South China Sea lies to the East. Economic activities have blossomed based on the maritime sector and it is estimated that currently, the maritime transportation services sector carries approximately 90% of the global trade.

With aggressive acquisition plans by major Malaysian shipping companies during the recent months, it is believed that Malaysia's ranking for 2004 will move up within the top 20 most important maritime countries and be regarded as one of the fastest growing national flag registries in the world.

The Malaysian trade, like most other developing countries, has always relied heavily on foreign vessels, which resulted in huge currency outflow from the country. At one point in time, this outflow was the 2nd largest contributor to the deficit of the services account of the country's balance of payments. During the period from 1979 to 1985 alone, the country lost an average of RM1.92 billion annually on freight and insurance payments to foreign countries.

Despite our strategic location and tradition of being a seafaring nation, the shipbuilding and naval industry did not take root until after independence. A national shipping company was established in the 1960s whilst large-scale shipbuilding only started about 2 decades later. Notwithstanding this, the development of the Malaysian shipping and maritime sector has leapfrogged over the recent years to put Malaysia as one of the respectable maritime nation in the world. Based on the "Review of Maritime Transport 2003" published by the United Nations Conference for Trade & Development (UNCTAD), Malaysia ranked 22nd in position among the 35 most important maritime countries in the world. With aggressive acquisition plans by major Malaysian shipping companies during the recent months, it is believed that Malaysia's ranking for 2004 will move up within the top 20 most important maritime countries and be regarded as one of the fastest growing national flag registries in the world.

The Government should be applauded for this success by adopting a liberal fiscal policy towards the promotion of the Malaysian shipping industry. Following the introduction of attractive tax incentives coupled with other relentless efforts by the Government in the form of funds, legislations, infrastructure, etc., the Malaysian shipping industry has grown and expanded from a modest fleet of 433 vessels (733,225 GRT) in 1982 to 3,001 vessels (5.9 million GRT) as at 1998.

The Malaysian ship registry is currently a closed registry as only Malaysian incorporated companies with majority Malaysian ownership are allowed to register their vessels. To protect the development of local ship owners, Malaysia has adopted the sabotage policy whereby foreign ships are not allowed to undertake domestic transportation except in certain very special circumstances.

Even though the Government has introduced an international ship registry i.e. the Malaysian International Ship Registry (MISR) in the merchant shipping legislation before the turn of the 21st century, however, until to-date, the MISR is still not enforced yet.

Taxation of shipping operations in Malaysia

The specialised and borderless nature of the industry would no doubt add complexities to the tax implications on such activities, which likely involves several jurisdictions. It is therefore critical that the tax implications of shipping activities are properly considered to ensure maximum tax efficiency for Malaysian ship operators.

Scope of charge

The taxation of shipping income is mainly contained in Sections 54 and 54A of the Income Tax Act, 1967 ("the Act").

Income of a resident arising from the business of transporting passengers or cargo by sea is subject to Malaysian income tax on a worldwide-scope i.e. income wherever accruing or derived except for income earned from the operations of Malaysian ships which is exempted from income tax. Where the foreign shipping income of the resident has been taxed twice i.e. in the foreign country as well as Malaysia, the operator can claim either bilateral or unilateral relief (depending on whether Malaysia has concluded any tax treaty with the foreign country) in respect of the foreign tax suffered.

On the other hand, non-residents would only be subject to Malaysian income tax in respect of income derived from freight lifted from Malaysia arising from the business of transporting passengers or cargo by sea (i.e. territorial basis).

Let us now dissect the tax rules for resident and non-resident shipping operators in greater detail as follows:

Resident operators

As mentioned, the income from the business of transporting passenger or cargo of a resident person is subject to Malaysian income tax on a worldwide scope and is deemed to be a separate and distinct business source of that person.

Where a resident shipping company has other business and investment income, the income is subject to Malaysian income tax based on the general provisions of the Act i.e. income accruing in or derived from Malaysia and foreign income received in Malaysia. It should be noted that a company in the business of

transporting passenger or cargo would not be eligible for the tax exemption granted in respect of income derived from sources outside Malaysia and received in Malaysia under Paragraph 28 of Schedule 6 to the Act.

In order to promote the local shipping industry and develop the national fleet, the Malaysian Government has granted tax exemption for Malaysian ship owners when certain criterias are met. Under Section 54A of the Act, a resident operator would be exempted from income tax in respect of its statutory income arising from the business of -

(a) transporting passengers or cargo by sea on a Malaysian ship; or

(b) letting out on charter a Malaysian ship owned by him on a voyage or time charter basis.

A Malaysian ship is defined as a sea-going ship registered as such under the *Merchant Shipping Ordinance 1952*, other than a ferry, barge, tug-boat, supply vessel, crew boat, lighter, dredger, fishing boat or other similar vessel. While it is not necessary for a ship to be owned by the resident if it is used for transport, a ship let out on charter must be owned by him.

Section 54A provides for specific rules in determining the shipping income to be exempted:

- The operator is required to maintain a separate account for the income for each Malaysian ship i.e. on a ship-by-ship basis.

- Capital allowances can only be set off against the income exempted under Section 54A. The balance, if any, of such allowances cannot be set off against any other income.

- Similarly, any adjusted loss incurred in respect of the operation of a Malaysian ship can be deducted only against the exempt income. The balance, if any, of such loss cannot be set off against any other income.

- The income exempted can be credited to a tax-exempt income account whereby 2-tier tax-exempt dividends can be distributed. This means that the dividends would be tax exempt in the hands of the shareholders. Where the dividends are received by a corporate shareholder, the tax-exempt dividends can be further credited to a tax-exempt income account for distribution of tax exempt dividends to its shareholders. In the event that the recipient of the dividends is also a company, as 2nd tier corporate shareholder, though still tax exempt, the 2nd tier corporate shareholder cannot credit the tax-exempt dividend income into a tax-exempt income account for further tax exempt dividend distribution. The 2nd tier corporate shareholder would be faced with a dividend trap problem if it wishes to further distribute the income to its shareholders unless it has sufficient tax franking credits.

In view of the unique characteristics of the shipping tax exemption, it is important that the following issues are considered in structuring a tax efficient Malaysian shipping operations:

- As there is no mandatory requirement to claim capital allowance and the election to claim capital allowance for shipping business is at the discretion of the taxpayer, it would be more tax advantageous for the operator not to claim capital allowance to maximise the tax-exempt income. Where the operator elects not to claim capital allowance, a notional allowance would be imputed on the qualifying capital expenditure.

- Review the corporate structure to ensure that the shipping tax-exempt income can be distributed to the ultimate owners without incurring any additional tax costs.

- As resident shipping companies are given income tax exemption in respect of its operations of Malaysian ships, equity financing may be a tax efficient instrument utilising the company's tax-exempt income account.

In order to promote the local shipping industry and develop the national fleet, the Malaysian Government has granted tax exemption for Malaysian ship owners when certain criterias are met.

Non-resident operators

Non-resident carrying on a business of transporting passengers or cargo by sea would be subject to Malaysian income tax on the gross income derived from Malaysia. Income derived from sources outside Malaysia is not subject to income tax.

"Gross income derived from Malaysia" refers to the total of all sums first receivable by the operator in respect of transporting by sea passengers or cargo embarked or loaded in Malaysia into ships owned or chartered by the operator. This means that inbound freight of the non-resident shipping operator would not be subject to Malaysian income tax.

However, the following items would be excluded from the "gross income derived from Malaysia":

- Passengers or cargo brought to Malaysia solely for transfer from one ship or aircraft to another, from a ship to an aircraft or vice versa (transit/ transhipment).

- Passengers or cargo embarked or loaded into a ship on a 'casual call'. Generally, a call is regarded as casual call if apart from that particular Malaysian call the operator did not make any Malaysian call in the preceding two years and the operator is not expected to make another Malaysian call in the following two years.

There are two options in computing the chargeable income of the non-resident shipping operator for Malaysian tax purposes:

(i) "5 percent method"

The taxable income of the non-resident operator arising from the business of transporting passenger or cargo in Malaysia is deemed to be 5 percent of the gross income derived from Malaysia. The taxable income is subject to Malaysian income tax at the prevailing corporate tax rate of 28% i.e. a non-resident operator is effectively taxed at 1.4% of freight lifted from Malaysia.

ii) Ratio certificate method

Alternatively, the operator can elect to be taxed on the ratio certificate basis. Briefly, under this method, the non-resident shipping company will be taxed in Malaysia based on the proportion of its world statutory income attributable to the gross income derived from Malaysia. Where the ratio certificate method gives rise to lower tax liability compared to the "5 percent method", the non-resident shipping company may within three years from the year in question, submit the certificate obtained from the tax authorities of its country of residence. In practice, the Inland Revenue Board only accept certificate issued by certain tax authorities.

Where the non-resident shipping operator is from a country, which has concluded tax treaty with Malaysia, the treaty may provide for full or partial exemption of the freight earnings of the non-resident operator. In order to qualify for the exemption (if applicable), in practice, the non-resident shipping operator is required to apply to the Malaysian tax authorities for confirmation of exemption by submitting the Certificate of Tax Residence and a confirmation letter stating that the company does not undertake domestic transportation between Malaysian ports. This is because generally, the relief under the tax treaty would only be applicable for shipping operations in international traffic.

In order to avoid any potential loss of revenue by the Government in respect of income derived by non-resident shipping operators in Malaysia, the Malaysian tax authorities have in practice appointed shipping agents to be the income tax agents for all their non-resident shipping principals for whom they act as shipping agent either on a regular or ad hoc basis pursuant to Section 68 of the Act.

Under the appointment, the shipping agent of a non-resident shipping company is required to notify certain particulars of the shipping operator to the Malaysian tax authorities. In addition, as and when freight is collected on behalf of the non-resident shipping operator, the shipping agent is required to deduct freight tax, currently at 1.4% before making any

outward remittance. The Malaysian agent is also required to report the total freight earnings for each non-resident shipping principal annually to the Malaysian tax authorities.

However, if the non-resident shipping operator is dealing directly with the Malaysian tax authorities and is paying Malaysian taxes via the tax instalment scheme, then strictly, the agent is not obliged to deduct the freight tax. However, the non-resident shipping operator must obtain a confirmation letter from the Malaysian tax authorities that it is on a tax instalment scheme. In this situation, the agent would only be required to furnish the tax authorities with the income tax reference number of the operator.

Withholding tax on shipping related payments

The Malaysian tax authorities are currently taking the view that charter hire payments (whether time, voyage or bareboat charter hire), rental of containers, etc. made to non-resident shipping companies would fall within the ambit of Section 4A(iii) of the Act and therefore, subject to withholding tax at the rate of 10%. Section 4A(iii) charges to tax "rent or other payments made under any agreement or arrangement for the use of any moveable property".

Nevertheless, recognising the need to promote the growth of the local shipping industry in Malaysia, the Government has accorded the following income tax exemption for shipping related payments to non-residents:

- Payments for the use of moveable properties made in respect of participation in a pool by a company resident in Malaysia engaged in the business of transporting passenger or cargo by sea under the *Income Tax (Exemption) (No. 25) Order 1995*; and
- Income from the rental of ISO containers under the *Income Tax (Exemption) (No. 17) Order 2002*.

Conclusion

As you would appreciate from the above, the shipping tax incentives granted by the Government are targeted at local shipping players with the view to increase the national fleet. The Government should be commended for its efforts to promote the growth of the local fleet but it is important that these fiscal measures should be flexible to respond to challenges of the industry. In addition, the legislators should also continuously review and benchmark our incentive packages with that introduced by other countries so that the country's tax competitiveness in the industry can be maintained if not improved in the global front.

Our neighbour country, Singapore for example, has over the recent years upgraded its incentive packages for shipping industry whereby most shipping income are now exempted from Singapore income tax. In addition, countries such as United Kingdom, Ireland, etc. has introduced innovative tax schemes e.g. tonnage tax to woo shipping companies to their shores.

As the Malaysian Government sees the development of a leading maritime nation as high priority, it is imperative that the overall tax strategy for the shipping industry should support these aspirations. In this respect, some of the areas which need to be addressed include:

- Extending the shipping income tax exemption to companies involved in offshore supplies industry e.g. offshore supply vessels, dredgers, barge, etc. In respect of floating production storage offloadings (FPSOs) and floating storage offloadings (FSOs), even though it can be argued that in certain circumstances, FPSOs and FSOs would fall within the Section 54A exemption, the legislation should provide clarity on the taxation of FPSOs / FSOs by including such vessels as Malaysian ships for tax purposes.
- Extending the withholding tax exemption to include time / voyage charter hire fees payable in respect of the chartering of foreign vessels in complementing the national fleet. Even though the withholding tax is effectively the tax of the non-resident ship owner, it is likely that the ship owner would require the charter hire fees to be paid on net basis resulting in the Malaysian shipping company bearing the withholding tax. This additional cost would no doubt reduce the competitiveness of Malaysian shipping company vis-à-vis other players.

The Government should undertake a holistic study of the maritime sector with the view to devise fiscal and non-fiscal measures to meet the challenges in the global environment. It should be recognised that in order to build a maritime nation, the focus is not just on creating an efficient shipping industry but also to address issues in the entire system as a chain which encompasses areas such as maritime infrastructure, technology, support services, equipment supplies, education, etc. The commissioning of a logistics study by the Government last year is of course a step in the right direction.

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Green Tax
Its Potential in Malaysia

By ASSOC PROF DR SITI NORMALA SHEIKH OBID

The issues of 'Environmental Wealth' and 'Environmental Prosperity' are gaining importance worldwide and has been recognized as a cornerstone policy in the pursuit of economic growth by most governments, especially developed countries such as the European countries and the USA. The United Nation Stockholm Conference in 1972 first identified the need for ecologically sustainable development and has acknowledged that without a proper environmental support system, there will be no long-term economic growth.

Many believed that economic development such as industrialisation, which is an integral part of development, is the major cause for pollution whereby it simultaneously brings negative impacts on the environment along with the positive benefits (Beckerman, 1992). However, there are several approaches in minimising pollution. These include:

(a) Legislation and enforcement that helps to monitor and administer suitable punishment for polluters;

(b) Economic mechanism to encourage the private sectors to adopt and to develop environmentally sound technologies; and

(c) Economic instrument (EI) such as charges, incentives and taxation (direct and indirect taxes) to further facilitate the control of pollution and act as means to finance environmental clean up. Examples of direct taxes are emission standards, emission fees and emission permits. The indirect taxes are green tax on financial products associated with pollution (such as onto motor vehicles), taxes on goods used as inputs into the polluting activities (for example coal), and taxes on polluting substances contained in inputs, such as sulfur contained in coal. EI is claimed by many as an effective means to minimise pollution and has been widely used by most of the European countries such as UK and also USA, in addition to the existing environmental legislature.

Klarer et al., (2000) in their study supported the idea that green tax if properly implemented and managed becomes an effective and efficient means to finance environmental clean ups. The key motivation for implementing green tax are:

(1) to increase revenue;
(2) to enforce compliance;
(3) to preserve or conserve the agricultural lands we depend upon for sustenance;
(4) to reduce carbon dioxide emission;
(5) to stimulate investment in waste management, and
(6) to cover the costs to clean up wastes.

Green tax and its effect

Green taxation seems to have a direct effect on the economy and society (often relates to human health, compliance, attitude and awareness as well as on the surrounding environment). The effect of green taxation which takes the form of short-term or long-term effect on economy can be seen on government revenue and the double dividend (such as GDP, public expenditure and per capita income). Some economists claimed that green tax schemes are not design to reduce pollution in the most efficient way; indeed most of them are introduced to raise revenue for other environmental measures (Svendsen *et al.*, 2000). The American experience suggest that there may be something in the permit market system that could be beneficial to both the US and the EU in future efforts to comply with stringent target levels, such as those imposed by the Kyoto Agreement on carbon dioxide (CO2) reduction (Svendsen, 1998a; Baumol and Oates, 1988).

According to E. Law (1997), there are a wide array of taxes that are imposed in the pursuit of environmental protection. However, the two most popular green taxes that are used to raise revenue for pollution control purposes are:

(1) emission charges, which is widely used in European countries and imposed on firms for permission to release industrial wastes into the air, water and landfill; and

(2) input taxes, i.e. tax on the inputs used in environmentally damaging processes.

Some of the advantages of green tax are the impacts on fiscal policy (i.e. they raise revenue) and the environment (i.e. maintaining a clean and healthy environment).

(i) **The effect of green tax on pollution from the social perspective**

The effect of green tax on pollution from the social perspective is examined from the experience of the European and OECD countries. Most of these countries had adopted green tax in the late 1980s as a method to reduce the level of pollution, in particular air pollution in the late 1980s. After imposing green tax, these countries experienced substantial reduction in the level of pollution, as evidenced by Tables A and B, using the examples of carbon dioxide and fresh ground and surface water extraction. This is particularly important because the releasing of excess carbon dioxide by industries and vehicles into the atmosphere will upset the equilibrium of atmospheric gases. Other implications from air pollution include global warming and acid rain.

Table A shows the comparison of the carbon dioxide emission levels produced before and after the implementation of green tax. It can be seen from Table A that the degree of carbon dioxide reduced in each country during the 15 years period. Poland had the highest recorded level of carbon dioxide emission (410 mln.t) in the year 1980 and is able to reduce the emission level by 22% in 1995, i.e. after green tax was being implemented in the country. On the other hand, Slovakia who had the lowest recorded carbon dioxide emission of 50 mln.t in 1980 enjoyed a better reduction, i.e. by 26% in the year 1995 as compared to other countries including Poland. From these examples, it is clear that green tax have a direct and positive impact in reducing the level of pollution.

Table A Pre and Post Green tax – Carbon Dioxide emission

	Pre-Implementation	Post-Implementation	
	Total mln.t		
Place / Year	1980	1995	% of Reduction
Eastern Europe	978	693	29
Bulgaria	82	53	35
Czech Republic	172	111	36
Hungary	79	57	28
Poland	410	322	22
Romania	178	111	38
Slovakia	50	37	26

The above results are influenced by factors such as attitude and behaviour of both public and private sector, enforcement level, timing factor and the degree of seriousness of each country in implementing green tax. In respect of the timing factor, some countries may have introduce the tax much earlier as compared to the others, hence it could capture a better exposure and compliance. As for law enforcement, it is believe that the relaxation of law enforcement and corruption are the contributing factors to non-conformance of the law, hence pollution remains. The degree of tolerance on the type of pollution may vary from one country to another. One country may regard it as a serious threat, compared to another country.

From Table B, we can see a reduction in the extraction of fresh ground and surface water when charges are imposed for the extraction and usage of fresh ground and surface water in the European countries between 1993 and 1997. The revenue collected from water extraction is used for financing activities related to water use and the corresponding part of expert and administrative work, as reported by Klarer *et al.*, (1999b). From the said table, we could see that countries such as Latvia manage to reduce its water extraction by 27% in the year 1997 as compared to 1993, i.e. after the implementation of water charges. On the other hand, Poland was by far the highest in terms of water extraction in 1993 and was only able to reduce its extraction by 4% in the year 1997.

Table B Fresh ground and surface water extracted: 1993 and 1997

Country	1993 (gal)	1997 (gal)	% of Reduction
Bulgaria	3,764	3,089	18
Estonia	2,006	1,628	19
Hungary	6,638	6,011	9
Latvia	726	530	27
Poland	12,277	11,799	4
Romania	10,180	9,260	9

From the table above, it can be inferred that although the degree of reduction of pollution differs from one country to another, green tax proven to be successful through the concept of 'Polluters Pay Principle' (PPP). Hence, imposing green tax on polluting activities is an effective alternative measure to curb pollution, apart from environmental laws.

This reduction of pollution is not only true for the countries mentioned in the section above, but there are also other countries whose pollution levels have been reduced because of the implementation of green tax. For instance, due to the green tax imposed on leaded petrol, leaded petrol disappeared from the market in Austria and Norway. In Sweden, the sulphur dioxide tax caused a fall in the sulphur content in fuels by 50% below legal standards and also caused a reduction of emission by 80% from 1989 to 1995. A tax differentiation was first introduced in 1991 on diesel fuels in order to stimulate the use of less polluting

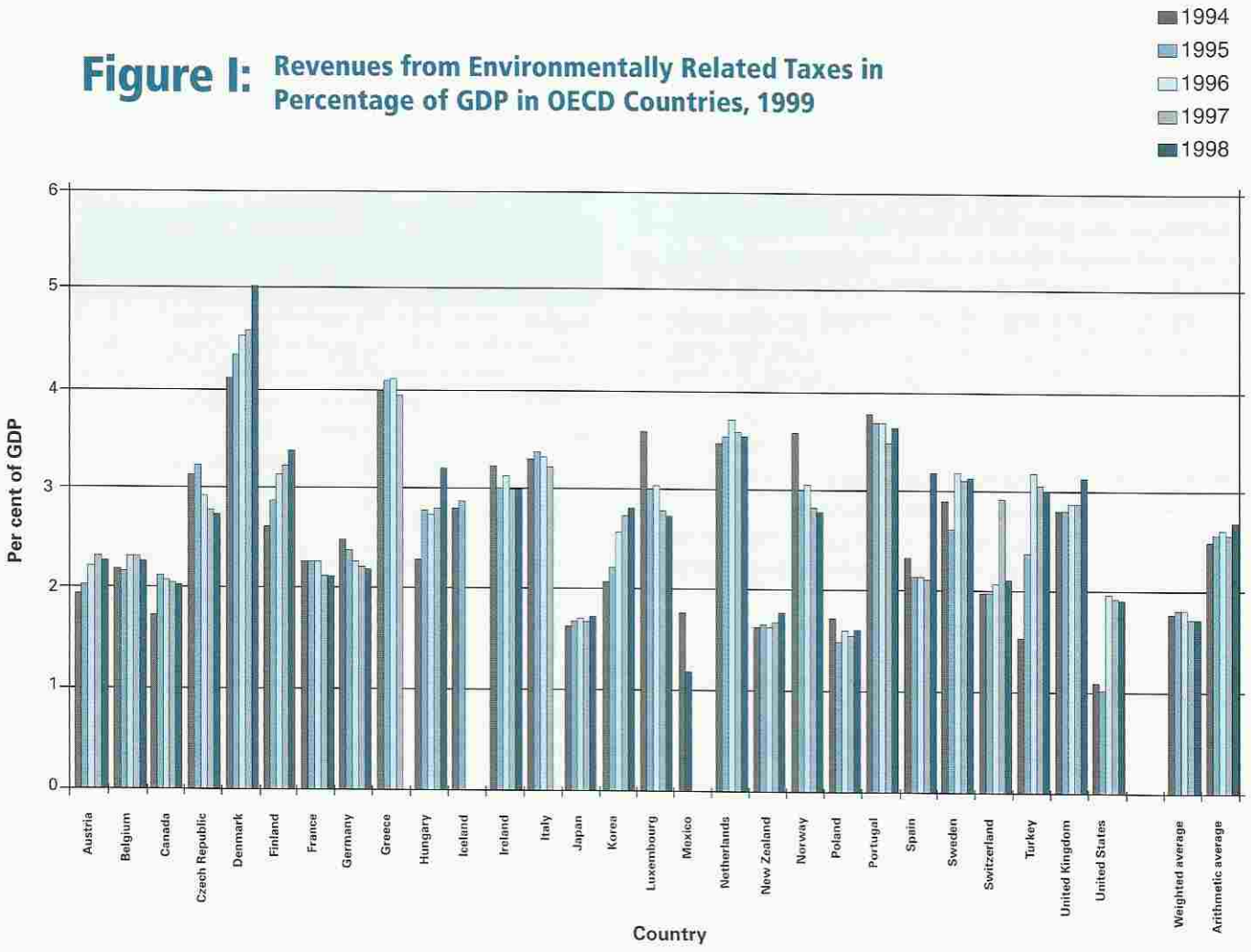
fuel oils in Sweden. It was reported that from 1992 to 1996, the proportion of clean diesel sold in Sweden rose from 1% to 85% which led to a reduction of more than 75% on the average of sulphur emission from diesel-driven vehicles.

(ii) The effect of green tax on government's revenue (economic perspective)

E. Law (1997) in his study of economic cost and benefit analysis points out that environmental inputs and outputs and the wider social consequences of polluting the environment are often not included. This is because business disregard these issues as there are no penalties while the market mechanism has "an inherent tendency to shift elements of social costs onto others, or into the future". As such, these social costs are termed "external" because they fall outside the consideration of the party generating the pollution. The problem therefore, is to devise a way of making these parties carry the costs of pollution. E. Law (1997) in his study further indicates that imposing green tax is indeed a means of raising revenue and do little to alter taxpayer's behavior.

E. Law studies has been supported by Figure I, where the figure shows the green tax revenue as a percentage of GDP collected over five years from 1994 until 1998. From Figure I, it can be observed that green tax revenue as a percentage of GDP has increased over the period of 1994 to 1998 in Denmark, Finland, Greece, Hungary, Iceland, Japan, Korea, New Zealand, Portugal, Spain, Sweden, Switzerland, and the United Kingdom (Mountford, 2001). However, the green tax collection from the rest of the OECD countries recorded a slight decreased in 1998 compared to the previous years.

Figure I: Revenues from Environmentally Related Taxes in Percentage of GDP in OECD Countries, 1999



Environmental Policy in Malaysia

The environmental policy in Malaysia started in 1991, under the New Development Policy (NDP). The objective of the policy at that time is to achieve a balanced development between economic activities and environmental protection. The concept of long-term sustainability of the environment has been spelt out in the Sixth Malaysian Plan (1991-1996). The plan has identified major environmental issues and concerns that require an effective management alongside with the rapid urbanisation and industrialisation.

The initial step taken by the Malaysian government in working towards long-term sustainability of the environment is through the Langkawi Declaration in 1989 and was further endorsed in the Rio Conference that emphasizes the seriousness of the government's commitment in the preservation and conservation of the environment. For example, environmental pollution from industries, domestic households and the municipal wastes will be minimise to ensure that the quality of air and water will not suffer further degradation, thereby worsening the quality of life and human welfare.

Malaysian Environmental Laws and Its Administration

The environmental law first introduced in 1974 is known as the Environmental Quality Act 1974. The Act is the main legislation that governs environmental control. As the economy evolved, the environmental law had increases its scope which includes prevention, abatement, controls of pollution and enhancement of environment. The existing law had been strengthen by additional regulations. These includes:

(1) Environmental Quality Regulation for Prescribe Premises and Crude Palm Oil 1977;

(2) Environmental Quality Regulations for Clean Air 1978; and

(3) Environmental Quality Regulations for Sewage and Industrial Effluent 1979.

Other related laws are Local Government Act 1976, the Town and Country Planning Act 1976 and Housing Developers (Control and Licensing) Act 1966.

The Department of Environment (DOE) administers the Environmental Quality Act, 1974 and is empowered to impose fine, imprisonment or both to polluters. Simultaneously, the DOE helps to promote environmental awareness and information dissemination, which act as a preventive strategy in environmental management. Air and water pollution is their main concern. This is shown by the existence of the water pollution unit and air pollution unit within the department.

Environmental Control

A serious commitment of the Malaysian government in maintaining the friendly environment can be seen from its Seventh Malaysia Plan (1996-2000). Towards this end, environmental and conservation consideration has been increasingly integrated with economic development planning. Innovative economic mechanisms such as Environmental Impact Assessment (EIAs) 1985, including development on environmental sound technologies are instituted to supplement the existing legislation and enforcement. The EIAs requires continuous assessment in identifying, predicting, evaluating, and communicating the impact on the environment of a proposed project and to detail out mitigating measures prior to project approval and implementation. In which case the investor are required to submit detailed EIA to the DOE office for an approval on the suitability of the site and the environmental control measures that need to be taken. The participation in protecting the environment is not done by the government alone instead the non-governmental organisations (NGOs) also play a positive and constructive role to educate the public on environmental awareness.

Potential of Introducing Green Tax in Malaysia

Malaysia spent less than 1% of the country's GDP on the cleaning of environment. This figure is small if compared with other countries such as Japan with 1.8-2% of GDP, South Korea with 1.3 - 1.6%, Singapore with 1.2 - 1.5% and Taiwan with 1 - 1.2% of GDP. Meanwhile Vietnam spends only about 0.1 - 0.3% of GDP, and China, Indonesia and the Philippines spend 0.5 - 0.7% each of their GDP(Boyd, A., 2002). Therefore, there is potential for more spending on environmental protection measures in Malaysia. From the substantial increase in *E. coli*[1] counts in Malaysian marine waters from 1996 to 2000 and the high Total Suspended Solids[2], there is a need for more critical environmental monitoring, better wastewater treatment facilities and other types of environmental facilities. Hence, economic instruments such as green tax could be introduced to complement enforcement measures.

According to Klarer *et al.*, 1999, environmental and economic variables are mutually exclusive and dependent. This is because the environment is a key input to many economic activities and economic decisions are also important for the quality of the physical environment, therefore, it is not a question of "either the environment or the economy", but of "*both*" the environment and the economy (OECD, 1996).

Green taxes are new to most countries in Southeast Asia, including Malaysia. In many of these countries, environmental laws are the only direct means to prevent environmental degradation. In Malaysia, in addition to environmental legislation, tax incentives and grants/ subsidies are available, but they do not play a major role in environmental protection.

Generally, tax incentives for environmental protection, are provided for in the tax legislations. However, these tax incentives grant only partial relief for a limited time (MICPA, 2003). There are no

specifically designed incentives for environmental protection in Malaysia. In the Promotion of Investment Act (PIA) 1986, environmental protection are targeted to encourage companies to offer environmental protection services and to carry out such activities, namely facilities for the storage, treatment and disposal of toxic and hazardous wastes, waste recycling facilities, energy conservation and utilization of biomass, while there are also incentive for energy conservation and forest plantation projects (MICPA, 2003).

With regard to grants/subsidies, the UNDP-GEF Small Grants Program (SGP) is among the most prominent in Malaysia. SGP channels financial and technical support directly to NGOs and Community-Based Organisations for activities that conserve and restore the environment, while enhancing the well-being and livelihoods of communities; and has an overall project portfolio that comprises of 65% biodiversity, 16% climate change, 6% international waters, and 13% multi-focal issues (GEF Small Grants Program, 2003).

Even with the existence of environmental legislation, coupled with tax incentives and grants/subsidies, pollution problems have not decreased to a satisfactory level and it has had a negative impact on society. Government expenditure to clean up the polluted environment is also increasing. This shows that the existing environmental laws are not generating sufficient revenue to cover the clean up costs or to curb the pollution problems. This is the reason why green tax is needed as an additional measure to the existing environmental laws in order to curb pollution.

Since Malaysia is still at the developing stage, the approach taken to develop and implement green tax should differ from those of the developed countries, as their industrial sectors had been fully set up by the time they introduced green tax. Perhaps a good approach would be to plan and design green tax according to specific industrial sectors, instead of tax-bases. An example would be the ISO 14001[3] categorization of industrial sectors as found in Table E. In this way, a stage-by-stage implementation of green tax would be possible, starting with the industrial sectors that currently produce the most adverse environmental effects.

Table C List of 39 Industrial Sectors Categorised for ISO 14001 Certification

EAC Code Nos.	Industrial Sector	EAC Code Nos.	Industrial Sector
1	Agriculture, fishing	21	Aerospace
2	Mining and quarrying	22	Other transport equipment
3	Food products, beverages and tobacco	23	Manufacturing not elsewhere classified
4	Textiles and textiles products	24	Recycling
5	Leather and leather products	25	Electrical supply
6	Wood and wood products	26	Gas supply
7	Pulp, paper and paper products	27	Water supply
8	Publishing companies	28	Construction
9	Printing companies	29	Wholesale and retail trade; repairs of motor vehicles, motorcycles and personal and household goods
10	Manufacturing of coke and refined petroleum	30	Hotels and products restaurants
11	Nuclear fuel	31	Transport, storage and communication
12	Chemicals, chemical products and fibre	32	Financial real intermediation, estate, rental
13	Pharmaceuticals	33	Information technology
14	Rubber and plastic products	34	Engineering services
15	Non-metallic mineral products	35	Other services
16	Concrete, cement, lime, plaster, etc.	36	Public administration
17	Basic metal and fabricated metal products	37	Education
18	Machinery and equipment	38	Health and social work
19	Electrical and optical equipment	39	Other social services
20	Shipbuilding		

Source: ISO (2001)

1 *Escherichia coli* (*E. coli*) is a type of bacteria normally present in the intestinal tract of humans and other animals; sometimes pathogenic; can be a threat to food safety. It's presence in seawater is an indication of pollution from untreated wastewater from residential areas, animal husbandry, etc.

2 Total Suspended Solids (TSS) is the measurement of suspended particles in the seawater. The particles may come from a variety of natural and anthropogenic causes, such as fine sand suspended as a result of dredging activities, runoff containing eroded soil from rivers flowing into the sea, etc. High TSS may interfere with the respiration of fish, shellfish and other aquatic organisms, and smother coral reefs and sea grass beds.

3 The ISO 14001 standard, the first to be published among the ISO 14000 family of standards, is a specification with guidelines for the implementation of Environmental Management Systems (EMSs). ISO 14001 specifies requirements for EMS implementation in an organisation.

Conclusion and Recommendation

The introduction of green tax in Malaysia is possible if it is properly designed and executed, as can be seen from the experiences of European countries. However, the introduction of these taxes should produce a synergistic result; not only generating funding for environmental protection and management, but aid in economic development and reforms as well. Moreover, green tax could be more effective if introduced along with a package of inter-related and inter-supporting economic instruments.

The following is a checklist for the successful implementation of economic instruments, of which green tax is a major part (EEA, 1996):

(1) Pre-implementation studies investigating the potential effects of the policy package, in particular the calculation of the abatement costs in each sector, equity implications and the benefits and costs of improving eco-efficiency.
(2) Early and greater involvement of fiscal authorities.
(3) Extensive consultations with stakeholders and the public.
(4) Early announcement of the economic instrument.
(5) Introduction of economic instruments within a policy package of complementary measures.
(6) Gradual imposition of the instrument (e.g. phase-in tax/ charge rate).
(7) Recycling of revenues to:
    - Charge/ tax (e.g. for environmental measures, via rebates or investment incentives);
    - Provision for education and training;
    - Related environmental sectors (e.g. some revenues of waste tax going to the waste sector); and
    - Reduce other taxes such as taxes on labour.
(8) Increasing incentive effect, via:
    - Gradually increasing the real price signal over longer periods; and
    - Gradually reducing exemptions.
(9) Evaluation measures designed into the administration of the economic instrument.

Lastly, green tax can be an effective tool provided certain pre-conditions must exist for them to be a viable policy options (Klarer *et al.*, 1999a). This includes:

(1) The economy in which economic instruments are set must feature (or make real progress towards) important characteristics of a free-market, such as well-defined property rights, private enterprises as the pervasive norm (rather than exception) and price liberalisation.
(2) A basic level of institutional capacity must exist, e.g. within the relevant environmental policy and enforcement agencies, to support the design and implementation of the instruments.

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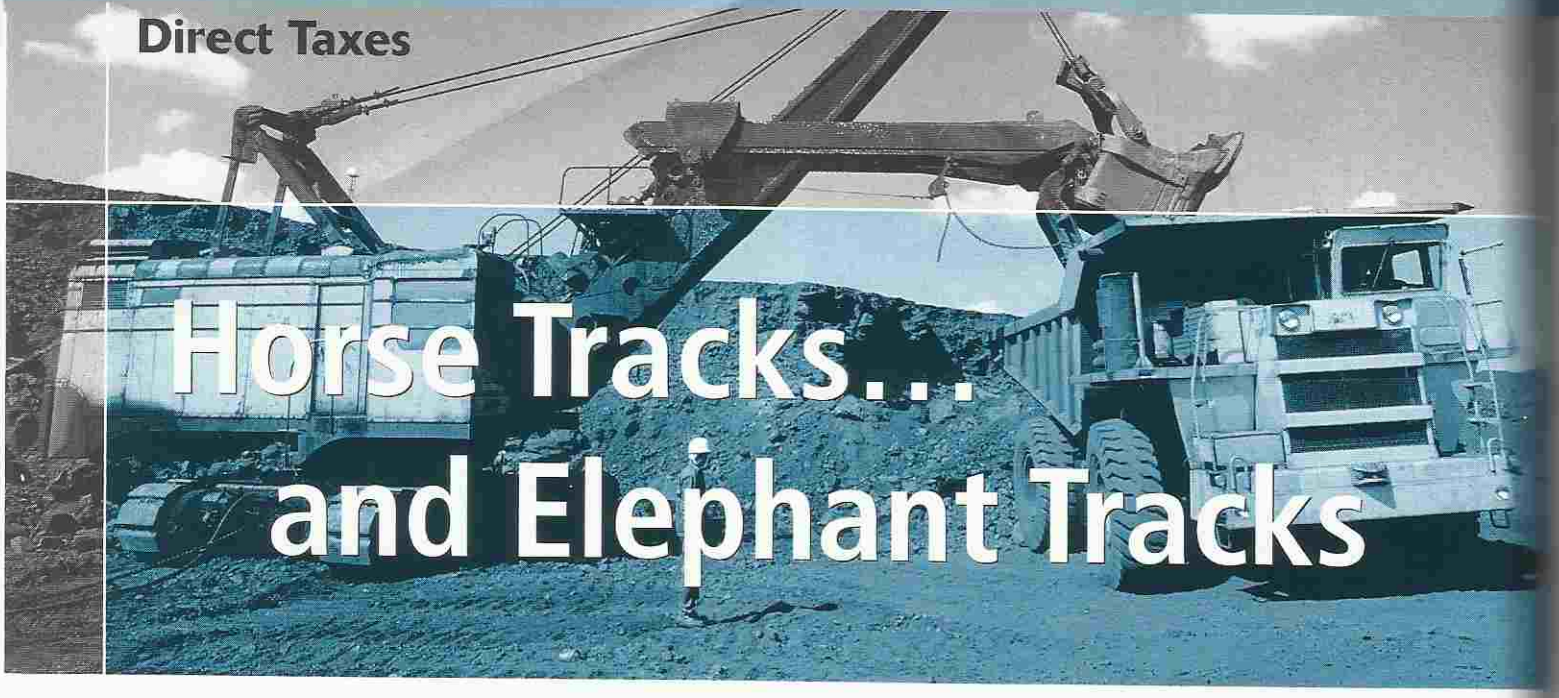


Horse Tracks... and Elephant Tracks

By NAKHA RATNAM SOMASUNDARAM

Among primitive tribal people, a good hunter is one who can look at a track and tell whether an animal made those tracks. They must also tell whether it is made by a horse or by an elephant. Nothing more is demanded of them – except to hunt that horse or elephant – for dinner!

Good Revenue officers and tax accountants, on the other hand are required to look at a track and tell whether it is a horse track or an elephant track. They must also identify whether it is machinery or plant. Nothing more is demanded of them – except to make some calculations – for capital allowance!

This tracking issue of what is plant and what is not plant is made excruciatingly and insufferably difficult with the courts doing legal somersaults on what is plant and what is not plant.

This article will look at some current plant issues following the development of recent overseas and local cases.

Plant: The income tax legislation – UK and Malaysia

Plant is not defined (a smart move, no doubt!). It is so in the United Kingdom's (UK) *Capital Allowance Act 1990 (CAA 1990)*[1] and in the *Malaysian Income Tax Act 1967 (ITA)*. Under the CAA 1990, Section 24 provides that:

> '(1) Subject to the provisions of this Part, where –
>
> (a) a person carrying on a trade has incurred capital expenditure on the provision of machinery or plant wholly or exclusively for the purpose of the trade, and
>
> (b) in consequence of his incurring that expenditure, the machinery or plant belonged to him, allowances and charges shall be made to and on him in accordance with the following provisions of this section.'

The ITA 'defines' plant in a similar way. Para 2 of Schedule 3 provides as follows:

> 2. (1) Subject to sub-paragraph (2) and paragraph 67, qualifying plant expenditure is capital expenditure incurred on the provision of machinery or plant and other expenditure incurred incidentally to the installation thereof;...

The question of whether an item is plant or machinery depends very much on the facts of the case. Different definitions have been suggested for specific instances. For example, in *Yarmouth v France*[2] a claim was brought by a workmen, 116 years ago, under the Employers' Liability Act 1880 for injuries sustained on account of a faulty plant - in this case a vicious horse – and it was held that the horse was indeed 'plant' – albeit a faulty one.

The decision in that case was successfully applied with some ingenuity[3] for several years to cover fixtures and fittings of a durable nature like locomotives,[4] knives and lasts[5] etc. It was even extended to intellectual storehouse and property like a lawyer's legal books.[6]

Invariably over the years, legal plants started growing, just like real plants do, and in due course, it became unmanageable. Legal fencing to statutorily separate the plants from the settings was put up. These 'fencing' were introduced in the UK legislation in 1994. It was later repealed, rewritten and replaced by the *Capital Allowance Act of 2001 (CAA 2001)*. It provided for three lists: Section 21 provides List A that are assets, which must be treated as building and not as plant. List B under Section 22 provides

1 The Capital Allowance Act, 2001, now replaces this Act.
2 [(1887) 19 QBD 647]
3 See the reflections of Lord Wilberforce in CIR v. Scottish & Newcastle Breweries Ltd (1982) 55 TC 251
4 Caledonian Rly Co. v Banks (1880) 1 TC 487
5 Hinton v Maden and Ireland Ltd [1959] 3 All ER 356, 38 TC 391
6 Munby v Furlong [1977] STC 232, [1997] 2 All ER 953

another list of structures that must be treated as such. Under Section 23, List C is a long list of exceptions to List A and List B. In addition, there are a number of special provisions that treat specified expenditure as plant or machinery. Thus, a dry dock is not a structure but plant. And glasshouses that are so constructed as to provide the required environment for growing plants by means of automatic devices that form an integral part of the building or structure is deemed under this legislation as plant and machinery.[7]

The purported intention of the legislative changes is to consolidate the court's decision over the years as to what constitute plants and what is not. It also confirms the notion that building and structures cannot qualify as plants. Nevertheless, the distinction between what is plant and what is not plant is at best, indistinct.

So, what constitute plant, building and structure under the amended legislation?

Plant

Section 21 of UK's CAA 2001 excludes plant and machinery from any expenditure on the provision of building. This means that walls, floors, ceilings, gates, shutters, and moving walkways are part of a building and not plant or machinery. On the other hand, electrical appliances, cold water, gas and sewerage systems provided mainly to meet particular requirements of trade such as hotel business, would be considered as plant (with the exception mentioned in list C).[8]

Structures

Structure is defined as a fixed structure of any kind, other than a building. The legislation in section 22 begins with a prohibition – expenditure on the provision of plant and machinery does not include any expenditure on the provision of structures or other specified assets or any works involving the alteration of land. For example, in List B, items that will not qualify as machinery or plant include tunnels, bridges, railways and airstrips.

In Malaysia for example, airport and motor racing circuit do not qualify as plant and machinery but instead will qualify as industrial building.[9] Capital expenditure on the construction, reconstruction, extension or improvement of any public road and ancillary structures, too, will be treated as industrial building.[10]

However, List C which is a list of exception to List A and List B includes as plant expenditure on the provision of towers used for supporting floodlights, reservoirs incorporated into a water treatment works, silos used for temporary storage of grains, swimming pools and even fish tanks and fish ponds.

Land

The CAA 2001 also provides for the expenditure on the acquisition of any interest in land as not qualifying expenditure on plant. This also extends to any assets that are installed or affixed in or to any description of land as to become in law part of that land[11].

These provisions have tremendous impact on the modern leisure industries that spend vast amounts of money on all-weather-all-year-round sporting and entertainment facilities for participants and spectators.

This aspect will be discussed in detail in relation to the case of Anchor International[12] and Lingfield Park[13], in the later part of this article.

Plant and setting

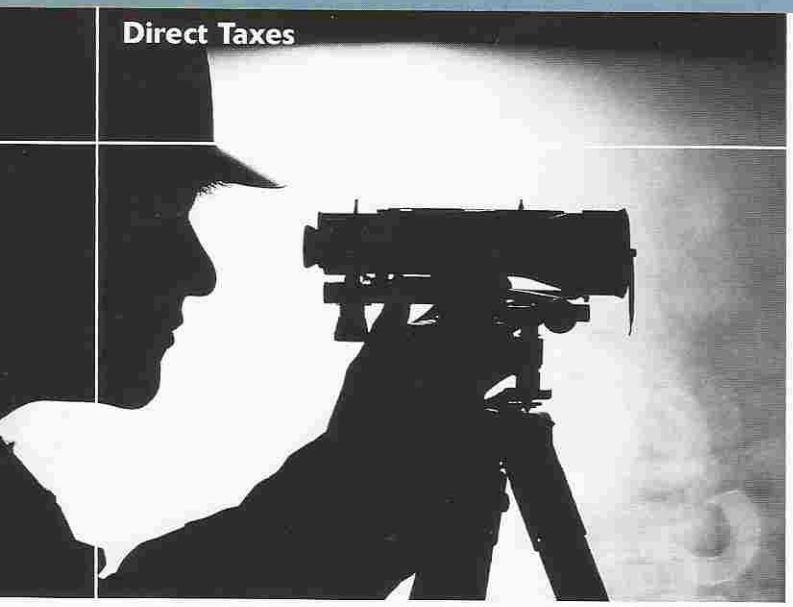
Plant is one with which a trade is carried on. On the other hand, setting or premises is one in which the trade is carried on.[14] One would therefore imagine that equipment or apparatus either fixed or movable is plant. Obviously, the meaning is not wide enough to cover buildings. There is certainly a clear distinction between a shell of a building and any machinery that will be set up within it. In a rubber glove factory for example, one can easily see the distinction between the building and the equipment and machineries inside it that is used to produce the gloves.

However, equipment does not cease to be plant just because it discharges an additional function like providing the place in which the business is carried on. A landmark case is that of the dry dock in *Barclay, Curle & Co.*[15]

The categories are not mutually exclusive and for tax purposes, it is important the appropriate test and the correct classification be made to obtain the legally correct allowance for capital expenditure incurred.[16]

In some instances, the items of the various installations can be treated as one and therefore qualifying as plant or it can be taken individually and treated as forming part of the building. In *Cole Brothers v Phillips*[17], the taxpayer claimed an expenditure of £945,600 (approx. RM 6.6 m) on electrical installation for a new retail store as qualifying capital expenditure on plant. The company argued that the installation as a whole was a single

7 CAA 2001, ss 27-33
8 CAA 2001 s 23, List C, paras 23 and 17
9 Schedule 3, Para 37G and 37H Income Tax Act 1967 effective from the year of assessment 2001
10 Schedule 3, Para 67A, Income Tax Act 1967
11 CAA 2001, s 24 and 24(2)
12 Anchor International v IRC [(2003) STC (SCD) 115]
13 Lingfield Park (1991) Limited v Shove [(2004) EWCA Civ. 391]
14 Jarrold v John Good & Sons 40 TC 681
15 [1969] 1 All ER 732 45, TC 221
16 See Nakha Ratnam Somasundaram, 'Plant: Horse or Elephant?' *Tax Nasional* Vol 13/2002/Q3 pp. 15-23
17 [1982] STC 307 HL



Building is defined to include any asset in the building, which is incorporated into the building. It also includes movable items that are not so incorporated but is of a kind normally incorporated into buildings.

item of plant. This argument was rejected by the Special Commissioners. The appellate court treated this as one of the facts for the Commissioners to determine. But the decision did not sit well as reflected in the speeches of the House of Lords[18].

The changes in the CAA was brought about with the stated purpose of defining the boundary between structures and plant and machinery although provision was made so that expenditure on building and structure which already qualify as plant should continue to do so[19]. The list also reflects the effect of the changes in the concept of what is plant as determined by the courts over the years.

Buildings

Section 21 of the CAA 2001 begins with buildings and excludes from the category of plant and machinery any expenditure on the provision of a building. Building is defined to include any asset in the building, which is incorporated into the building. It also includes movable items that are not so incorporated but is of a kind normally incorporated into buildings.[20] However, things that can qualify as plant and included in List C are items such as caravans provided for holiday lettings,[21] and movable building that can be moved in the course of the trade. The taxpayer will have to establish that what is provided is indeed plant within the meaning of the existing legislation, case law principle or alternatively is not included as an excluded expenditure in List C.

So much for clarity in the law!

Golf Courses: Ediboro Company

Are golf courses plants with which a trade is carried on or is it the premise in which the trade is carried on?

Golf courses are of two types – the 'push-up' or natural greens and modern greens. The 'push-up' or natural greens are basically landscaping that involves some reshaping or re-grading of the land to form the green. Such greens have limited drainage system.

Modern greens use sophisticated technology in green design and construction. It contains sophisticated and integrated drainage system. This is done after the general earthmoving, grading and the initial shaping of the area surrounding and underneath the green. It is constructed with a network of subsurface drainage tiles and interconnected pipes with several layers of gravel and sand particles that will include root zone layer and a variety of turf grass. The drainage system become ineffective over time and may require a complete replacement after about 20 years. It is a comprehensive job involving the excavation and replacement of the gravel layer, root zone layer and the turf grass above the tiles and pipes.

These expenditures are held to be capital but not qualifying as plant for purposes of tax allowance.

In *Ediboro Company v United States*[22] the court held that golf course improvement such as greens, tees, fairways and traps were not depreciable under section 167(a) because they are not distinguishable from the land. The golf course is primarily a landscaping proposition. The expenditure on the land improvement forms essentially a cost attributable to the land and therefore forms part of the land cost and not plant.

Artificial Pitch: Anchor International[23]

In this 2003 case, the appellant company was involved in the provision of leisure facilities. The leisure facilities included pitches specifically designed for a five-a-side football matches and a clubhouse building providing a combination of indoor facilities, including shower and changing rooms, snooker and pool tables etc. About 70% of the gross income of the appellant is derived from the pitch.

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.

18 See [1982] STC 307, 312-13 *per* Lord Hailsham, 314f, *per* Lord Wilberforce, and 316 *per* Edmund Davies.
19 Inland Revenue Press Release, 30 November 1993, (1993) *Simon's Tax Intelligence* 1539.
20 Section 21(3) of the CAA 2001
21 Cooke v Beach Station Caravans Ltd [(1974) 49 TC 514]
22 224 F. Supp. 301 (W.D. Pa. 1963)
23 [2003] STC (SCD) 115

Expenditure on the construction of the artificial pitch involves a ground investigation and topographical study to identify suitable grounds. The ground is then prepared by excavating and stripping the topsoil, installing underground drainage system, with a cut and fill operations where necessary. The prepared ground is trimmed, proof rolled, and terram geotextile is laid to prevent ground contamination and to facilitate clean drainage. A stone base is laid, on which another layer of terram geotextile is placed. Finally a synthetic grass carpet is laid onto the terram layer in strips. About 22 tons of sand in-fill helps to anchor the artificial grass carpet and keeps the pile upright, giving the carpet its durability and playing characteristics. Worn out and damaged strips can be repaired or replaced. The pitch has a life expectancy of between five to ten years.

The company claimed a sum of £297,863 (approx. RM2m) that included a sum of £195,456 (approx. RM 1.3m) on excavation, infilling, drainage and terram geotextile (i.e. basically land modification cost).

The question was whether the artificial pitch qualifies as plant.

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 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.[24]

The taxpayer argued that the carpet retained its separate identity and is separate from the land works. 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, is 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. This argument has its roots in the *Barclay* case.

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...*'

The Crown has appealed against the decision of the Special Commissioners and the case is now in Court of Session.

Artificial Horse Track: Lingfield Park (1991) Limited

In this March 2004 case, the taxpayer carries on the business of organizing and promoting horse racing. It had in 1991 taken over the business of another company carrying on a similar trade. That company had installed alongside existing grass track, an all-weather artificial track (AWT). Both the grass track and the AWT were part of a large leisure complex site consisting of access roads, squash courts, gymnasium, golf course, grandstand, restaurant, bars, car parks, horse walks, stabling, betting shops and waiting areas.

A dispute arose as to a claim for the capital expenditure incurred on the installation of the AWT – whether the item is 'plant' within the meaning of sec 24 of the CAA 1990.

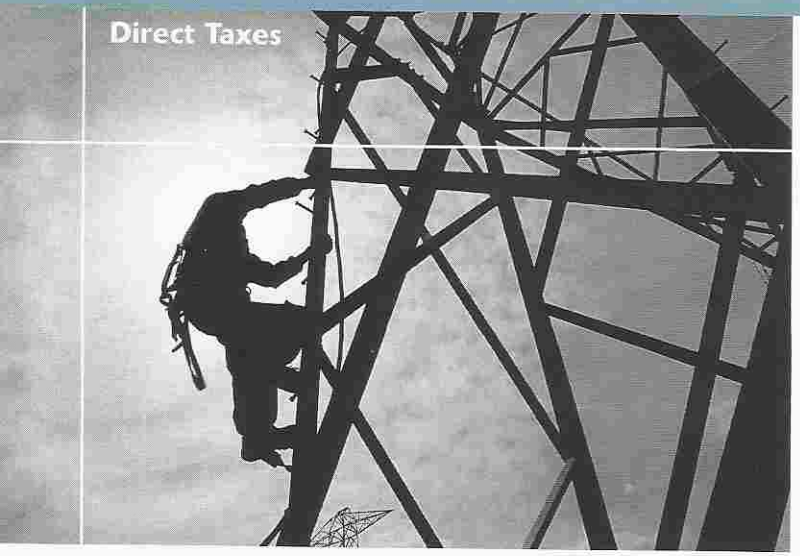
Lingfield: Facts of the case

The General Commissioners found as a fact that AWT consists of installation of a foundation, equitrack surfacing, drainage and fencing. The foundation consists of a trench 1 foot deep, filled with limestone chips up to 10", capped with a 2" layer of compacted limestone screening. Drainage consists of a series of drains running under the foundation of the track. Equitrack material consisting of graded silica and particles bonded by synthetic oil are applied over it. The materials are then compressed to 4". A top-layer material is placed in a semi-loose state. This is harrowed and cambered to provide a consistent and correct surface for horse racing. A safety fence is erected on the outside of the track. The equitrack material is recyclable. The AWT needs daily maintenance and has a life expectancy of about 10 years.

The most attractive feature of the AWT is that it is capable of being use in all weather conditions, an important feature to the leisure industry operating in a land with unpredictable weather. The taxpayer claimed that capital expenditure of £2,962,650 (approx. RM20m) incurred on the installation of the AWT, which included the drainage, equitrack surfacing and the safety fence, as qualifying capital expenditure on plant for the purposes of sec 24 of the CAA 1990.

The General Commissioners concluded on the facts of the case that the AWT was not land in its natural state but '*...retained its separate identity from the grass track, and building at Lingfield Park, that it functions as plant and not as part of the premises...*' It was

24 The applicable law was para 2 of Schedule AA1 of the Finance Act 1994.



A dispute arose as to a claim for the capital expenditure incurred on the installation of the AWT – whether the item is 'plant' within the meaning of sec 24 of the CAA 1990.

part of the plant with which the business was carried on. The AWT consisting of the foundation, and their ancillaries were to be regarded as one unit, and accordingly qualified as plant for the purpose of the 1990 Act. In arriving at their decision the business function test and the premises test was applied.

However, on appeal Lord Justice *Mummery* gave judgment for the Crown. According to his Lordship:

> *'The purpose, use, construction and nature of the AWT are such that the AWT functions as premises for horse racing, as does the grass racecourse running parallel with it. It is common ground that the grass track is not plant; nor is the construction of a replacement or additional grass track; nor is the construction of a building to cover the grass track so that it can be used for racing in all weathers. None of these items is plant. It would be an inaccurate use of language to describe any of them as the means, apparatus, equipment or tools by which or with which Lingfield's trade is carried on.'*

In giving an opposing view for the use of the premise test, his Lordship went on to say that:

> *'It is more accurate to describe them as a place or premises …on or in which the trade of organizing and promoting horse racing is carried on…it was no doubt separately identifiable from the other parts of the premises … having regard to the way in which it had been constructed and maintained. I cannot however see that this made it lose its character as part of the premises for the purpose of the premise test.'*

Driving school training ground: MSDC case

In the local case of *MSDC Sdn. Bhd*[25] a limited company carried on the business of driving school for motorcars, motorcycles, lorries, tractors and other motor vehicles.

In complying with the conditions of the permit issued for its driving school, it incurred capital expenditure on the construction of the following:

a) A training ground; and
b) A building, housing an administrative office and various classrooms.

The training ground is specially constructed to comply with the Road Transport Department's specification. It incorporated a 5-meter broad tarred road circuit, road slopes of various gradients, artificial hills, parking lots, dangerous curves, roundabouts, various type of junctions and so on. Special grounds are constructed for motorcycle training including skid stretch, emergency braking stretch, digit "8" maneuver spots etc. The building consisted of classrooms for the teaching of theoretical lessons in driving.

The taxpayer claimed capital allowances in respect of the building and the training ground as qualifying building expenditure and qualifying plant expenditure respectively, under Schedule 3 of the ITA (as amended). The claims were made 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 or premises and therefore did not qualify for capital allowances.

The taxpayer appealed.

The Special Commissioners considered the two items i.e. the buildings and the training ground separately. They decided that the buildings were part of the setting in which the business was carried on. It had no function to perform other than to shelter the trainees and therefore did not qualify as a plant. And neither does it qualify as industrial building.

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 Schedule 3 of the ITA (as amended).

The Director-General of Inland Revenue was not satisfied and appealed to the High Court. The appeal was dismissed.

25 KPHDN v MSDC Sdn. Bhd. [(2003) MSTC 3,973]

The High Court's decision by Faiza Thamby Chik, J. explained the decision thus:

> *'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', the business test and the function test were clearly dominant in the determination of this case. However, in view of the decision in the case of Lingfield Park, it is now doubtful whether the expenditure on the training ground in the MSDC case is one on qualifying plant expenditure.

Wavering on a decision is quite acceptable I think and even accomplished legal minds do – for example in the Lingfield case, Lord Justice Scott Baker, in his Lordship's judgment, admitted as follows:

> *'Although my mind wavered somewhat during the course of argument, in the end I have concluded that the appeal should be dismissed...'*

Some case law reviews

The decision on whether a particular expenditure is plant or not, together with the premises test, has not been a consistent one, whether it is a statutory distinction or one made by the courts.

In *IRC v. Barclay Curle & Co Ltd*[26] a leading case in its category, the excavation of land and construction of a dry dock for ship repairs was held to be plant. In the same vein, in *Cooke v Beach Stations Caravan Ltd*[27] the excavation of land and construction of two swimming pools in a caravan park were held to be provision of plant and not premises or setting. In both these cases, the main feature was the extensive modification to land to install the item of plant.

As regards land modification to install a plant, a parallel legislation in the Malaysian situation is Para 2(b) and Para 67 of Schedule 3 of the ITA where the expenditure can fall to be included as either plant or industrial building depending on the installation cost.[28]

On the opposite end, in *Benson v Yard Arm Club Ltd*[29] the purchase and conversion of a vessel to be used as a permanently moored floating restaurant was held not to be plant but premises. In *Gray v Seymour's Garden Centre (horticulture)*[30] the expenditure on the construction of specialist green house at garden center i.e. '*planteria*' was held to be premises rather than plant.

26 (1969) 45 TC 221
27 (1974) 49 TC 514
28 Under Para 2(b) of the ITA (as amended) if the expenditure on the land modification to install a machine is more than 10% of the aggregate cost of the plant and the installation, the installation expenditure will be excluded as qualifying plant expenditure. On the other hand if installation cost exceeds 75% the aggregate cost of the plant and the installation, then the aggregate cost qualifies as an industrial building under Para 67 of ITA.
29 (1979) 53 TC 67
30 (1995) 67 TC 401
31 See Nakha Ratnam Somasundaram, 'Plant: Horse or Elephant?' *Tax Nasional* Vol 13/2002/Q3 pp. 15-23
32 (1982) 55 TC 251
33 (1988) 61 TC 51

Conclusion

A review of all the authorities since the days of *Yarmouth* confirms that there is no universal formula or solution for the puzzle as to what is and what is not plant[31]. In *CIR v Scottish & Newcastle Breweries Ltd*[32] Lord Wilberforce, in reflecting on the meaning of 'plant', said:

'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"...'

A white hunter was once asked by a Maharajah to describe a white elephant. The white hunter replied, 'Your Majesty, I do not know how to describe a white elephant, but I do know one when I see it'.

If the Maharajah were to ask a similar question today about plant, chances are the reply would be, 'Your Majesty, I do not know how to describe a plant, but I do know one when I see it.'

In fact, Lloyd LJ in *Wimpy International Ltd v Warland*[33], in the course of his Lordship's judgement said:

'... plant, though difficult to define, is like an elephant, easy enough to recognize when one sees it...'

Now, if only the *Lingfield Park* people had laid an elephant track instead...

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Commencement of Business

By Siva Nair

We concluded the last article with a good understanding of the badges of trade to determine whether there is an element of trading in a particular transaction or at least whether it can be taken to be an adventure in the nature of trade. Now we shall move on to find out how to determine when a business has commenced and the significance of it.

Determination of Commencement

The Income Tax Act 1967 ("the Act")(as amended) does not have a definition for commencement of business nor does it provide any guidance on what constitute commencement of business. However the Inland Revenue Board (IRB), through its public rulings, has shed some light on what constitutes commencement of business for a particular industry.

There are several tax cases as well that have addressed this delicate issue and the deliberations and arguments discussed in, together with the conclusions arrived at, in these cases would be useful to us in determining the commencement of business for persons involved in industries not mentioned in the public ruling.

Generally, a business commences on the date on which the taxpayer actually indulges in the specific activity that is going to produce business income. Therefore, all initial activities relating to getting the business ready for the production of income would not constitute commencement of business. For example if I wanted to start a college to conduct MIT courses, I would need to:

- Apply for the relevant authorisation to conduct the courses
- Find a suitable premise
- Engage administrative staff and lecturers
- Purchase the necessary fixed assets
- Obtain the necessary study materials and teaching aids

All these activities are just to ensure that I am ready to commence the business of providing educational courses and are not in themselves indicators of commencement.

Therefore, commencement is when one finally embarks upon the activities directly related to the production of the business income as distinct from activities, which are merely preparatory or preliminary. However, it may sometimes be difficult to know when preparatory acts stops and the business itself begins. This was illustrated in ***Cannop Coal Co. Ltd. v I.R.C. [(1918) 12 TC 31]*** where the taxpayers had been formed to mine coal, but had not made much money from their mining activities. Some distance from their main pit, they had exploited a subsidiary pit to provide coal for their machines. The subsidiary pit was so successful that it made more money than the main colliery. The question that arose was when did the trade of selling coal from the subsidiary pit commence? The commissioners and Sankey, J. held that the trading had started as soon as coal was recovered from the subsidiary pit.

In the case of ***Southern Estates Pty Ltd v FC of T [(1966) 117 CLR 481],*** arguments by a partnership rearing sheep on a property that the purchase and clearing of the land and the sowing of pasture grass indicated commencement was set aside by the court by holding that these activities did not constitute a business of primary production, being no more than preparations designed to enable the taxpayer to commence business.

The date of incorporation and minutes of board meetings are not relevant in the ascertainment of commencement of business. In ***Birmingham & District Cattle By-products Co. Ltd. v I.R.C. [(1919) 12 TC 92],*** a company was incorporated to carry on the business of making use of the by-products of a butcher's trade on 20th June 1913. The directors went about and looked at places of business of a similar character in various parts of the country.

> *[The judge commented "if you go and look at other businesses to see how you will conduct your business when you set it up, you are preparing to commence business, but you are not commencing business].*

The business of the company was the manufacturing of cement. However, the raw material used to manufacture cement, limestone, was not purchased by the company but rather extracted by them by quarrying a leased area of land. The limestone was then processed into cement by using plant and machinery set up for that purpose and the manufactured cement was subsequently sold. All three stages constituted the business of the taxpayer. However, all the three stages could not be started simultaneously; the extraction had to be started earlier so that by the time the plant and machinery was installed, the limestone would have arrived for processing into cement.

So what is the commencement date?

The learned judge in this case opined that each one of these activities was as much essential for the purpose of carrying on of the business of the taxpayer as the others. Each one of these activities constituted an integral part of the business of the taxpayer. Where a business is a continuous process comprising of various activities, which need not be started simultaneously, it is said to commence at the start of an integral stage of an activity which triggers off an active process. Once the activity, which is first in point of time and must necessarily precede the other activities is started then the business has commenced.

Commencement is when one finally embarks upon the activities directly related to the production of the business income as distinct from activities, which are merely preparatory or preliminary.

In July 1913, the company engaged in erection works, purchased and installed of plant and machinery and engaged a foreman. All these were held to merely constitute the process of getting the business ready for commencement & not incurred in the actual running of the business. Subsequently, they entered into agreements for the purchase of products but no materials arrived nor were any sausage skins made before 20th October.

In October, having got their machinery and plant and also employed their foreman, and generally got everything ready, they began to take the raw materials to turn out their product. They have commenced!!!

This is fine where, the business comprises of a simple activity of processing purchased raw materials into finished goods for sale at a profit. However, some manufacturing activities involve numerous activities which may not start all at the same time as illustrated in ***CIT v Saurashtra Cement & Chemical Industries Ltd [91 ITR 170].***

Therefore, in this case it was established that the business had commenced when the company started the activity of extracting limestone.

In ***Softwood Pulp & Paper Ltd. v F.C of T. [76 ATC 4439],*** it was established that preliminary investigations undertaken to determine the viability of a venture project including the subsequent incorporation of a company to conduct feasibility studies did not place the company at a stage remotely near to the carrying on of a business.

For example if I wanted to set up a *roti chanai* stall in Iceland, I would probably have to go and check out how the Eskimos react to roti chanai and perhaps *polar bear rendang*. Assuming the reception is warm and they find it a very palatable dish, I would probably proceed with my plans to invest there, but a reverse reaction of vomiting and painful convulsions would see

me making a beeline to Malaysia, roti chanai flour and all! Therefore, the feasibility study is merely a decision-making tool to decide whether to commence business or not and not an indicator of commencement.

In ***Western Gold Mines N.L. v C. of T. (W.A.) [(1938) 59 C.L.R. 729]*** the courts spelt out the principle that just as every business must begin with a single transaction, every undertaking or scheme must commence with some overt act by its undertakers. Examples of overt acts include assent or direction given to persons engaged in it to proceed with some physical act or entering into some contract or arrangement by which the scheme is put into operation.

Another interesting case was ***Ferguson v F.C. of T [79 ATC 4261].*** Here the taxpayer was a navy officer who decided that upon his retirement from the navy in two or three years' time he would raise cattle in a farm. Before his retirement, he undertook the following activities so that everything will be ready when he retires. He entered into an agreement with a cattle-leasing company for the sub-lease of cattle. He also signed an agreement with a management company to assist, manage and arrange for the insemination of the cattle. Further, he spent considerable time gathering information about the facets of cattle raising and kept comprehensive records about all matters relating to his scheme.

The Court of Appeal found for the taxpayer and held that although his activities preceded his ultimate goal of raising cattle on his own property, they were conducted in such a systematic & business like manner as to amount to the carrying on of a business. Furthermore the whole undertaking had a commercial flavour.

The Public Ruling 2/2002 issued by IRB relating to allowable pre-operational & pre-commencement of business expenses for companies provides clarification on what would constitute commencement dates for the different industries as follows:

The determination of the date of commencement of a business requires a consideration of all the circumstances and facts of each case. Generally, commencement of business means the commencement of activities undertaken in the course of business or activities that are part of the income-producing process as distinguished from activities that are preparatory to the carrying on of a business. Subject to the specific circumstances and facts of the case, the following examples may be indicative of the commencement of business if the act or activity constitutes part of a series of acts or activities that are actively carried out or undertaken in the course of the business:

- Acquisition of a business - the date the existing business is acquired
- Hotel - the date the hotel is opened to the public
- Retailing - the date the goods for resale are purchased

...preliminary investigations undertaken to determine the viability of a venture project including the subsequent incorporation of a company to conduct feasibility studies did not place the company at a stage remotely near to the carrying on of a business.

- Manufacturer - the date raw materials are purchased
- Plantation - the date the seeds are sown or seedlings planted
- Property developer - the date the land is purchased
- Construction - the date the land is levelled

MIT Tax II Dec 2000 Q2 (Part Question)

DotBomb Sdn Bhd was incorporated in January 2000 to offer holographic wargames through the internet. With the aid of special headsets, the user is able to enter a digitised world and interact with other users as part of the game.

The three directors of the company were the sole employees during the business development and start-up phase. In order to finance this stage, the directors each loaned to the company their earnings from share profits earned on the NASDAQ. The funds were expended on developing and patenting the software and prototype of the headsets. By early March 2000, a vice president of marketing and three other employees were engaged. Venture capital of RM 10 million was obtained by mid April 2000 and the excess funds were placed on a monthly fixed deposit.

As at 1 August 2000, the website was officially launched by the company with total development costs amounting to RM 3 million. By the end of November 2000, the DotBomb website had gained instant popularity with approximately 15,000 regular users in Malaysia. Each user is charged RM 2.50 for each hour of game time. It is not unusual for some users to be continuously playing for 8 hours.

Candidates were required to determine "When does DotBomb's business source commence for tax purposes?"

Since it is a service industry, business arguably commences when the service is first offered to the public. For DotBomb this would be the date of the official launch of the website which is 1 August 2000.

SIGNIFICANCE OF DETERMINING THE DATE OF COMMENCEMENT

Determination of Basis Period for Companies, Trust Bodies and Cooperative Societies

As we have seen in an earlier article, Section 21A (4) of the Act provides that where a company, trust body or cooperative society commences operations on a day in a basis year and makes up the accounts of his business for a period of twelve moths ending on a day other than 31st December, there shall be no basis period in relation to the business for the first year. We also noticed that the definition of operations includes an activity which consists of the carrying on of a business. Therefore, if a company, trust body or cooperative society closes accounts for a 12-month period they are able to defer their payment of income tax. To achieve this they have to be sure of their date of commencement of business.

Deduction of Pre-Commencement Expenses

Generally deduction for expenses is only after commencement of business because it must be *wholly and exclusively incurred in the production of income*. Therefore, the earlier the date of commencement, the more expenses can be deducted. Even if there is no income, it will result in an adjusted loss, which can be used to offset any income both business and non-business.

Alternatively, the incurrence of deductible expenses should be delayed so that they are incurred after the commencement of business.

However, Public Ruling 2/2002 provides certain pre-operational and pre-commencement business expenses for companies which qualify for deduction. These qualifying expenses are indicated below:

- Income Tax (Deduction of Incorporation Expenses) Rules, 1974 [P.U. (A) 134 / 1974];
- Schedule 4B, Income Tax Act 1967 - Qualifying Pre-Operational Business Expenditure;

Deduction for expenses is only after commencement of business because it must be *wholly and exclusively incurred in the production of income.* Therefore, the earlier the date of commencement, the more expenses can be deducted.

- Income Tax (Deductions for Approved Training) Rules 1992 [P.U.(A) 61 / 1992] - as amended by Income Tax (Deductions for Approved Training) (Amendment) Rules 1995 [P.U.(A) 111 / 1995]; and
- Income Tax (Deduction of Pre-commencement of Business Training Expenses) Rules 1996 [P.U.(A) 160/1996].

The Public Ruling considers the pre-operational and pre-commencement of business expen1ses that are allowable, under the specific provisions in the Act or the specific Rules mentioned above, to a company when it commences its operations or its business.

We will not discuss each of these in details, as they will be elaborated in a later article.

Capital Expenditure Incurred Prior to Commencement is Deemed to be Incurred on the Date of Commencement of Business

The proviso to Paragraph 55 of Schedule 3 of the Act (as amended) states that where a person incurs qualifying capital expenditure for the purposes of a business of his which he is about to carry on, that expenditure shall be deemed to be incurred when he commences to carry on the business. Although the whole amount does not lose its eligibility to rank for allowances, the claim for allowances is delayed thus giving the taxpayer a financial disadvantage. Therefore, it is better to have an early commencement date so that the claim for allowances can be made earlier.

Further Reading

Alan Yeo Miow Cheng – Malaysian Taxation (latest edition) *PAAC Sdn Bhd*

Awther Singh – Malaysian Income Tax (4th Edition) *Quins Pte. Ltd*

Dr. Arjunan Subramanian – Malaysian Taxation System 2004, *Sweet & Maxwell*

Dr. Chin Yoong Kheong – Malaysian Taxation (latest edition) Butterworths

Dr. Choong Kwai Fatt Malaysian Taxation – Principles and Practice (2004) *Infoworld*

Dr. Veerinderjeet Singh – Malaysian Taxation: Administrative and Technical Aspects (6th edition) *Longman*

Malaysian Master Tax Guide 2004 – *CCH Asia Pte. Ltd*

Richard Thornton – MLJ Tax Handbook (2003) *Malayan Law Journal Sdn Bhd*

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Siva Nair

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Service Tax In Hotels

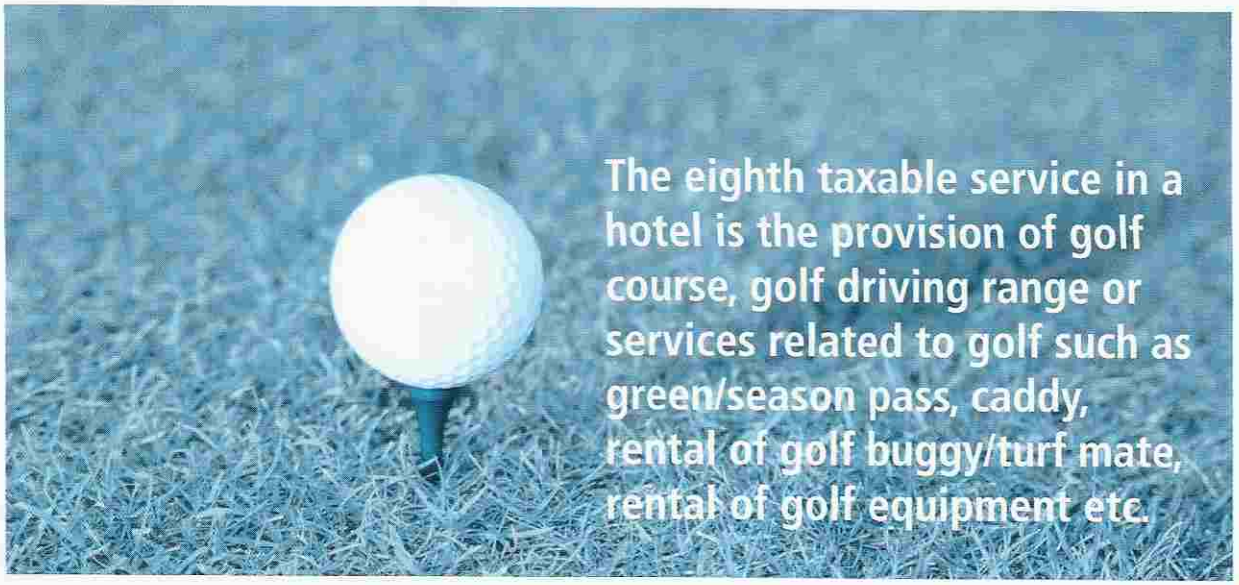
By THOMAS SELVA DOSS

Anyone checking into a hotel will notice that the tariffs are subject to a 5% service tax usually stated as government tax. Most people accept this as a common feature and pay the tax without questioning. But what are the services in a hotel that are subject to service tax? We need to look at the Second Schedule of the Service Tax Regulations 1975 which lists out the taxable persons providing taxable services.

One of the taxable persons listed in the schedule is a hotel. Any person operating one or more hotels having more than twenty-five rooms and providing taxable services is required to apply for a service tax licence and charge service tax. A 'hotel' means any premises, whether furnished or unfurnished, where lodging or sleeping accommodation is provided for reward. Therefore the first taxable service is the provision of rooms for lodging or sleeping accommodation. It does not matter whether the rooms are furnished or unfurnished. The length of time for which the rooms are rented out is immaterial. Some hotels rent out rooms to the public on an hourly basis and they are still subject to service tax. In short, all the twenty-six rooms (or more) must have lodging and sleeping facilities which are rented out to the public. Hotels having twenty-five rooms or less are automatically exempted from service tax. The *Service Tax Act* 1975 ("the Act") specifically exempts hostels for students of educational institutions and hostels established and maintained by religious institutions or bodies from service tax even though the number of rooms may exceed twenty-five and they provide lodging and sleeping facilities. The Act recognises the need to levy service tax only on hotels which have a profit motive.

The second taxable service in a hotel is the provision or sale of food, drinks or tobacco products. The mere provision or sale of food and/or drinks in any part of the hotel premise is subject to service tax and not restricted to only sale of food and /or drinks in a restaurant. Sometimes pushcarts are placed in certain areas of the hotel providing or selling food and drinks. They are also subject to service tax. The provision or sale of tobacco products in any part of the hotel premise is also subject to service tax. Tobacco products refer to products such as cigarettes, cigars, cigarillos and ceruts.

The third taxable service is the provision of services in the forms of 'corkage', 'towel charge' or 'cover charge' in any part of the hotel. 'Corkage' is defined in the Oxford dictionary as 'a charge



made by a restaurant for opening wine a customer has bought elsewhere.' The corkage referred to here is the charge levied by the hotel for chilling and serving wine or liquor which the customer has bought elsewhere. 'Towel charge' is the charge levied for the provision of a small often perfumed hand towel for the cleaning of hands before or after a meal. 'Cover charge' here refers to any cover charge levied for services provided in any part of the hotel. Going by the definitions, it would be alright to assume that the corkage and towel charge would normally be levied for services provided in a restaurant located in a hotel.

The fourth taxable service is the provision of premises for meetings or for promotion of cultural or fashion shows. Meetings here would refer to seminars, conferences, briefings, annual general meetings, weddings, concerts and gatherings for any particular purpose. Taking the word 'premises' in the broadest sense it would cover the lobby, lounge, swimming pool, restaurant and even the surrounding areas which constitute the premises of the hotel. It is known that in beach hotel, meeting or cultural shows have been held close to the beach but within the premises of the hotel.

The fifth taxable service in a hotel is the provision of health services. Health services here refer to steam bath, herbal bath, sauna, spa and jacuzzi which are normally provided in a health centre or a particular area. If a hotel room has a built-in jacuzzi then the charge for the jacuzzi would be added to the cost of the room. Sometimes, occupants of the hotel are entitled to use these facilities free of charge. As such there will be no service tax levied on the use of these facilities.

The sixth taxable service is the provision of massage services. Normally this service would be provided in a massage parlour, but nowadays it is not uncommon for massages to be provided near swimming pools, rest areas or even near a beach in a beach hotel. It must be noted that the provision of massages in a hotel room by a masseur is also subject to service tax. Massages provided by barbershops, hairdressing saloons, or beauty saloons such as facial massage are not subject to service tax.

The seventh taxable service is the provision of parking spaces for motor vehicles where parking charges are imposed. This refers to parking spaces which are owned by the hotel and where a parking charge is imposed. The service tax is levied on the parking charge. In cases where no parking charge is imposed, no service tax is levied.

The eighth taxable service in a hotel is the provision of golf course, golf driving range or services related to golf such as green/season pass, caddy, rental of golf buggy/turf mate, rental of golf equipment etc. Obviously, this refers to hotels which have a golf course or golf driving range and where a separate charge apart from the room rate is levied for the use of these facilities.

From the discussion above, it must be borne in mind that not all types of services provided in a hotel are taxable. Take laundry and dry cleaning services, currency exchange or banking facilities for example, although they constitute a service they would not be subject to service tax. Also one must not confuse service tax with service charge. The service tax is levied by the government but a service charge is normally levied by the management for a particular purpose. Hotels usually do not state 'service tax' on their bills but prefer to use the term 'government tax'. As such, when one sees the sign '++' in a hotel, it means that the rate is subject to a service tax and a service charge. The service charge is normally at the rate of 10%. A service charge is not subject to service tax. Service tax is only levied on the value of the taxable service. The Customs Department recently allowed hotels to use the term 'nett' in their advertisements. That is why we see many hotels using the term 'nett' which means that this rate is inclusive of the service tax. In the economic stimulus package announced by the Minister of Finance on 21 May 2003, all hotels and restaurants were exempted from paying service tax from 1 Jun 2003 until 31 December 2003. But from 1 January 2004

onwards, the service tax has been re-imposed on hotels and restaurants.

The service tax is fixed at a rate of 5% and is levied at the time the taxable service or goods are provided. It is to be shown separately from the charge levied on the bill. There have been cases where hotel rooms or other premises are given free of charge to certain persons. In cases like these, where no charge is levied, the service tax is still levied based on the charge which would have been levied for the provision of the service in the ordinary course of business. If a discount is given, it must be freely available to anyone using that service. If the discount is restricted to a certain group of people, then it is not allowed by Customs Department.

A hotel operator or the management of a hotel has to clearly understand the guidelines set by the Customs Department. The guidelines are also subject to change from time to time. The management is responsible to keep copies of all bills, guest cheques, books of accounts and other records for six years from the latest date. They must be printed and serially numbered and kept in the hotel premise. A service tax audit will be carried out from time to time by the Customs Department according to its guidelines. The management of a hotel is advised to seek clarification from the nearest Service Tax Branch on any 'grey areas' or problems that may arise from time to time.

There are many types of services available in a hotel such as restaurants, lounge, massage parlours, health centres, bars, discothethes and so on. The management must be able to differentiate the taxable services from the non-taxable ones.

Budget hotels, which provide 'bed and breakfast' usually, do not have individual rooms rented out to the public. They have dormitories which consist of many beds. As such, one dormitory can be considered as one room and the total number of rooms in a small budget hotel would not normally exceed twenty-six.

Any person operating one or more hotels having more than twenty-five rooms and providing taxable services is required to apply for a service tax licence and charge service tax.

Hotels having twenty-six or twenty-seven rooms have tried to avoid paying service tax by converting the additional rooms to store rooms. Care must be taken to ensure that there are no lodging or sleeping facilities in those rooms or they might constitute a problem.

Another problem faced by hoteliers is when the hotel is located in a shopping complex. Any taxable service provided in a hotel would be taxable. But what would constitute the premises of the hotel? The Customs Department after considering several cases has arrived at the decision that the hotel management has to clearly delineate the boundaries of the hotel and notify the Customs as such. Again, it is up to the Customs to accept or extend the boundaries drawn up by the hotel in a shopping complex. Any taxable service provided outside the boundaries would not be subject to service tax.

Hotels became 'taxable persons' in the year 1975 when they were referred to as 'prescribed establishments.' Since then many hotels have approached the Customs seeking clarification on a number of issues and the Customs has solved those problems by issuing guidelines. Hoteliers who still face problems are advised to consult a Senior Officer of Customs at the nearest Customs office or write to the Internal Tax Division of the Customs Department.

The Author

Thomas Selva Doss

is a customs consultant with Dossnett Consulting Sdn. Bhd. providing customs advisory services to clients in Malaysia and Singapore. He was a Senior Officer of Customs in the Royal Malaysian Customs Department for 13 years and is trained in Customs Audit, Custom Investigation and Anti-smuggling procedures. He holds a Bachelor's degree in Economics and Certificate in Customs Procedures from the Malaysian Customs Academy. He can be contacted at 012-230 9417 or e-mail:customs@tm.net.my

Refund of Stamp Duty Rejected

THE TAXPAYER WAS A CO-OPERATIVE SOCIETY INCORPORATED UNDER THE *CO-OPERATIVE SOCIETY ACT, 1993* AND HAD ENTERED INTO AN AGREEMENT ON 24 MAY 1995 TO PURCHASE A PROPERTY. THE TAXPAYER'S SOLICITORS SUBMITTED THE APPROPRIATE FORMS TO THE STAMP OFFICE FOR THE TRANSFER UNDER SEC. 35 OF THE *STAMP DUTY ACT 1949* ("THE ACT") AND WAS ASSESSED A STAMP DUTY PAYABLE OF RM30,000 WHICH THE TAXPAYER SUBSEQUENTLY PAID.

Two years later, the taxpayer discovered that being a co-operative society, the taxpayer was exempted from paying any stamp duty under sec. 35 (General Exemption) First Sch., para. 5 of the Act. Thus, the taxpayer sought for a refund of the stamp duty paid. The claim for refund was rejected by the Stamp Office based on sec 57 of the Act. The taxpayer appealed to the court against the rejection of their claim for a refund.

The taxpayer's appeal was dismissed by the court:

1. The Stamp Office could not rely on sec. 57 to reject the taxpayer's claim for a refund as sec 57 concerned stamp on any paper and not to a transfer from which duty has been paid.

2. Paragraph 5 of the General Exemptions of the First Sch. did not confer automatic exemption on all instruments executed by a co-operative society. The taxpayer has a duty to seek and apply for the exemption by showing:

   (a) the instruments relating solely to the business of any society;

   (b) the society was registered under any written law relating to co-operative societies; and

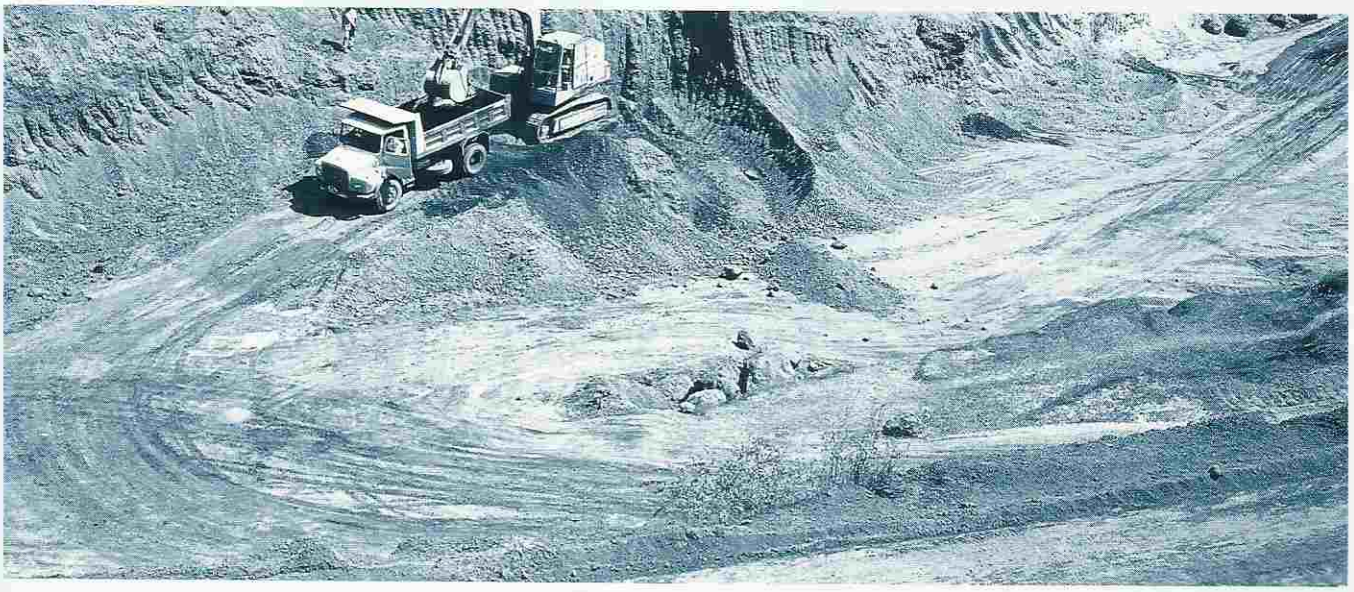
   (c) the instruments were executed by the officer or member of such society.

   The taxpayer in this case failed to provide proof that it came within the said para. 5. The Stamp Office therefore could not be faulted for imposing the stamp duty.

3. Sec. 58 of the Act provides that the time limit for a repayment of the stamp duty paid was within 12 months after the date of the instrument. The taxpayer was not entitled to the refund due to the lapse of time.

Koperasi Serbaguna Kebangsaan Berhad v. Pemungut Duti Setem.
High Court of Malaya, Kuala Lumpur.
Originating Summons No. R1–24–33 of 1988.
Judgment delivered on 11 December 2003.

D Kalaimany (of Messrs Kalai & Partners) for the plaintiff.
Juliana Ismail for the Collector of Stamp Duty.
Before: Raus Sharif J.



Date of land transfer is the date of acquisition of shares

THE TAXPAYER WAS ONE OF THE DIRECTORS IN A REAL PROPERTY COMPANY (THE COMPANY). ON 16 DECEMBER 1975, THE TAXPAYER TRANSFERRED TWO PROPERTIES TO THE COMPANY IN CONSIDERATION FOR THE SHARES IN THE COMPANY. THE TAXPAYER SUBSEQUENTLY DISPOSED OFF HIS SHARES ON 18 DECEMBER 1989. A NOTICE OF ASSESSMENT WAS RAISED AND THE TAXPAYER WAS REQUIRED TO PAY REAL PROPERTY GAINS TAX FOR THE GAINS MADE FROM THE DISPOSAL OF THE SHARES. THE TAXPAYER THEN APPEALED AGAINST THE ASSESSMENT.

The taxpayer contended that the date of the acquisition of the shares was the date of registration of the transfer of the properties by the taxpayer to the Company on 16 December 1975 as provided under section 215(2) of the National Land Code 1965, which was to be read with paragraph 34A(2) Schedule 2 of the Real Property Gains Tax Act 1976 ("the Act"). As the disposal of the shares was 14 years after the acquisition date, the gains derived was subject to the rate of NIL under Schedule 5 of the Act. The Director-General, on the other hand, contended the date of disposal to be 21 October 1988, by virtue of the deeming provision of paragraph 34A(6)(a) Schedule 2 of the Act.

The appeal was allowed by the Special Commissioners.

1. In accordance with the cases of *Linder* v *Wright* 14 ALR 105, *Syed Mubarak Bin Syed Ahmad* v *Majlis Peguam Negara* (2000) 3 AMR 2048 and *Binastra Holdings Sdn Bhd* v *Ketua Pengarah Hasil Dalam Negeri* (2001) 5 MLJ p. 481, the correct approach in interpreting paragraph 34A Schedule 2 of the Act was to give it a purposive construction to gauge the legislative purpose in incorporating the provision into the Act.

2. Paragraph 34A Schedule 2 was introduced to impose real property gains tax on the gains arising from the disposal of shares in real property company and to prevent the avoidance of real property gains tax by selling shares in a real property company. Applying the law to the facts of the case therefore, the taxpayer did not use the Company in order to purchase land and then disposed of shares in such company as it was evident from the facts that the taxpayer had transferred his two properties to the Company on 16 December 1975 and in consideration thereof was allotted the said shares. Thus, paragraph 34A Schedule 2 of the Act was not applicable to the taxpayer.

3. As to what was the date of the acquisition of the shares, in view of section 215(2) of the National Land Code 1965 and *DGIR* v *Ooi Guan Hoe* (1986) 2 MLJ 385, ownership was vested upon registration. The shares in the present case were acquired when the taxpayer transferred his land to the Company on 16 December 1975 as shown in the title deed. The acquisition date of the shares was therefore the date of transfer of the land by the taxpayer to the Company, which was 16 December 1975 as provided under paragraph 34A(2)(b) of the Act. Since this was more than 6 years from the date of disposal on 18 December 1989, the rate of tax was nil as provided under Schedule 5 of the Act.

MD v. Ketua Pengarah Hasil Dalam Negeri
Special Commissioners of Income Tax. Rayuan No. PKCP (R) 14/2001
Judgment delivered on 6 November 2003.

Abdul Jalil Bin Mohamed (Advocate and Solicitor) for the taxpayer.

Zaleha Binti Adam and Noor Kamaliah Binti Mohamed Japeri (Legal Officers, Inland Revenue Board) for the Revenue.

Before: Dato' Ahmad Zaki Bin Husin, Kamarudin Bin Mohd. Noor and Hariraman Palaya.

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

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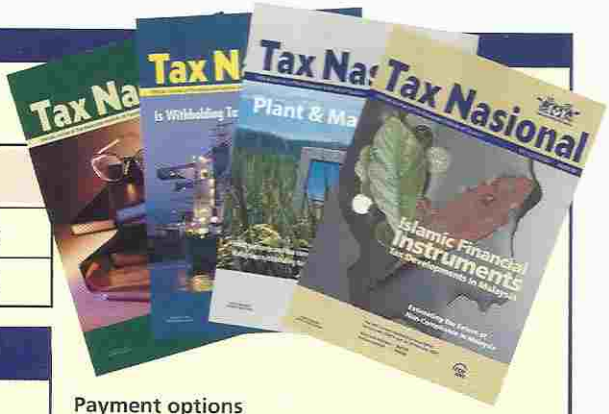

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